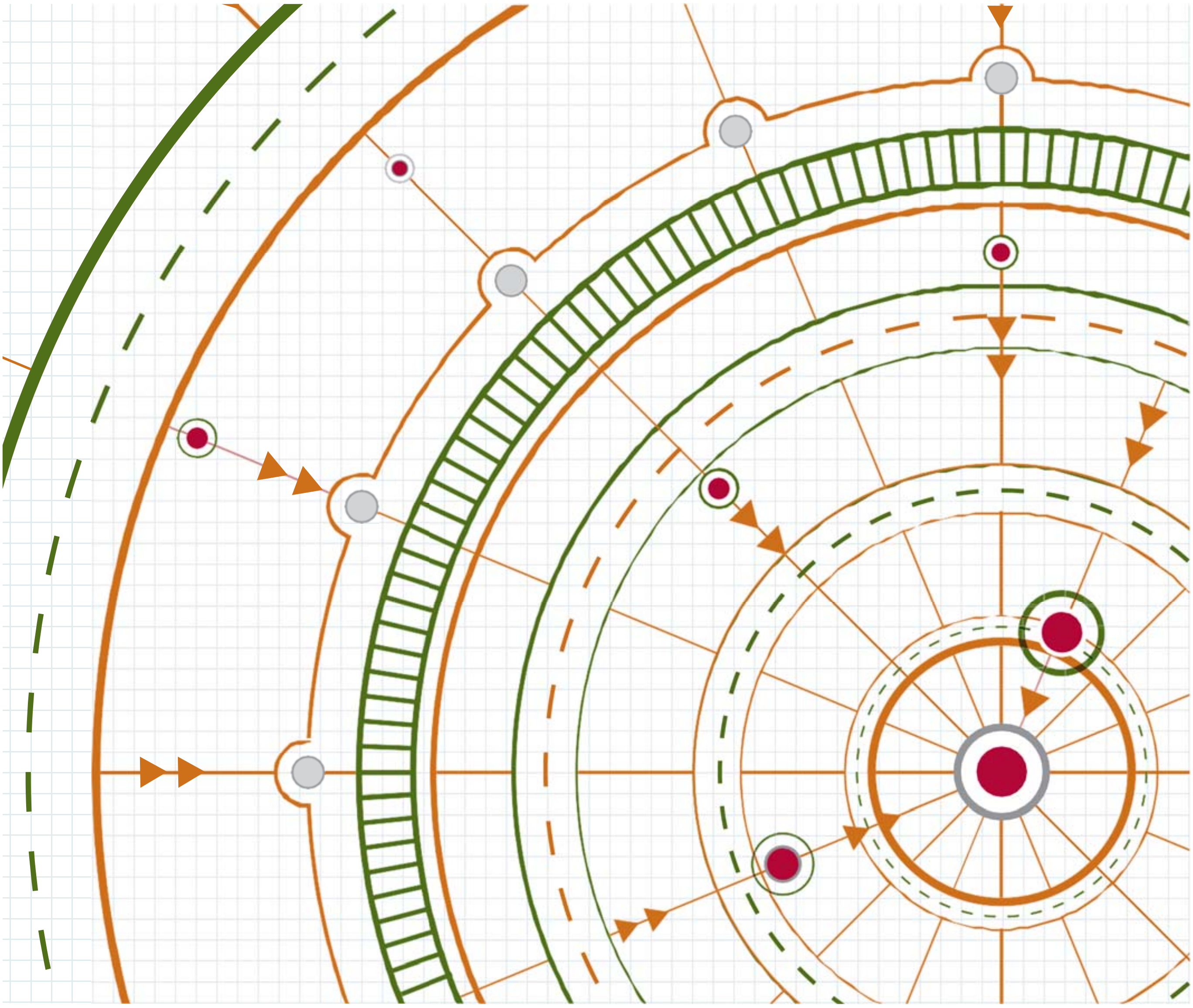
IFRS for SMEs® Standard (2015) + Q&As

IFRS® Foundation—Supporting Material for the *IFRS for SMEs* Standard

Module 29—Income Tax



IFRS®

IFRS® Foundation
Supporting Material
for the *IFRS for SMEs*® Standard

including the full text of
Section 29 *Income Tax*
of the *IFRS for SMEs* Standard
issued by the International Accounting Standards Board in October 2015

with extensive explanations, self-assessment questions and case studies

IFRS® Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Telephone: +44 (0)20 7246 6410
Email: info@ifrs.org
Web: www.ifrs.org

Publications Department
Telephone: +44 (0)20 7332 2730
Email: publications@ifrs.org

Contents

Module 29 – Income Tax

The accounting requirements applicable to small and medium-sized entities (SMEs) discussed in this module are set out in the *IFRS for SMEs* Standard, issued by the International Accounting Standards Board (Board) in October 2015.

This module has been prepared by IFRS Foundation education staff.

The contents of Section 29 *Income Tax* of the *IFRS for SMEs* Standard are set out in this module and shaded grey. The Glossary of terms of the *IFRS for SMEs* Standard (Glossary) is also part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 29. The notes and examples inserted by the education staff are not shaded. These notes and examples do not form part of the *IFRS for SMEs* Standard and have not been approved by the Board.

INTRODUCTION

Which version of the *IFRS for SMEs*® Standard?

When the *IFRS for SMEs* Standard was first issued in July 2009, the Board said it would undertake an initial comprehensive review of the Standard to assess entities' experience of the first two years of its application and to consider the need for any amendments. To this end, in June 2012, the Board issued a Request for Information: *Comprehensive Review of the IFRS for SMEs*. An Exposure Draft proposing amendments to the *IFRS for SMEs* Standard was subsequently published in 2013, and in May 2015 the Board issued *2015 Amendments to the IFRS for SMEs* Standard.

The document published in May 2015 only included amended text, but in October 2015, the Board issued a fully revised edition of the Standard, which incorporated additional minor editorial amendments as well as the substantive May 2015 revisions. This module is based on that version.

The *IFRS for SMEs* Standard issued in October 2015 is effective for annual periods beginning on or after 1 January 2017. Earlier application was permitted, but an entity that did so was required to disclose the fact.

Any reference in this module to the *IFRS for SMEs* Standard refers to the version issued in October 2015.

This module

This module focuses on the accounting and reporting of income tax applying Section 29 *Income Tax* of the *IFRS for SMEs* Standard. It introduces the subject and reproduces the official text along with explanatory notes and examples designed to enhance understanding of the requirements. The module identifies the significant judgements required in accounting for income tax. In addition, the module includes questions designed to test your understanding of the requirements and case studies that provides a practical opportunity to apply the requirements to account for income tax applying the *IFRS for SMEs* Standard.

Module 29 – Income Tax

Upon successful completion of this module, you should, within the context of the *IFRS for SMEs* Standard, be able to:

- understand which taxes are income taxes;
- ascertain which tax rates and tax laws should be used in the measurement of current and deferred tax assets and liabilities;
- recognise and measure current tax assets and liabilities;
- determine the tax base of assets, liabilities and other items that, although not recognised as assets or liabilities, have a tax base;
- calculate temporary differences;
- identify unused tax losses and unused tax credits;
- determine which temporary differences, unused tax losses and unused tax credits should be recognised as deferred tax assets and liabilities;
- recognise and measure deferred tax assets and liabilities;
- allocate current and deferred tax to the related components of total comprehensive income (that is, continuing operations, discontinued operations or other comprehensive income) and equity;
- identify when current tax assets and current tax liabilities, and deferred tax assets and deferred tax liabilities, can be offset;
- present and disclose income tax in financial statements; and
- demonstrate an understanding of significant estimates and other judgements required for accounting for income tax.

IFRS for SMEs Standard

The *IFRS for SMEs* Standard is intended to apply to the general purpose financial statements of entities that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The *IFRS for SMEs* Standard is comprised of mandatory requirements and other non-mandatory material.

The non-mandatory material includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* Standard and explains its purpose, structure and authority;
- implementation guidance, which includes illustrative financial statements and a table of presentation and disclosure requirements;
- the Basis for Conclusions, which summarises the Board's main considerations in reaching its conclusions in the *IFRS for SMEs* Standard issued in 2009 and, separately, in the 2015 Amendments; and
- the dissenting opinion of a Board member who did not agree with the issue of the *IFRS for SMEs* Standard in 2009 and the dissenting opinion of a Board member who did not agree with the 2015 Amendments.

In the *IFRS for SMEs* Standard, Appendix A: Effective date and transition, and Appendix B: Glossary of terms, are part of the mandatory requirements.

Module 29 – Income Tax

In the *IFRS for SMEs* Standard, there are appendices to Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue.* These appendices provide non-mandatory guidance.

The *IFRS for SMEs* Standard has been issued in two parts: Part A contains the preface, all the mandatory material and the appendices to Section 21, Section 22 and Section 23; and Part B contains the remainder of the material mentioned above.

Further, the SME Implementation Group (SMEIG), which assists the Board with supporting implementation of the *IFRS for SMEs* Standard, publishes implementation guidance as 'questions and answers' (Q&As). These Q&As provide non-mandatory, timely guidance on specific accounting questions raised with the SMEIG by entities implementing the *IFRS for SMEs* Standard and other interested parties. At the time of issue of this module (January 2019) the SMEIG has not issued any Q&As relevant to this module.

Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity's financial position, performance and cash flows that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Such users include, for example, owners who are not involved in managing the business, existing and potential creditors and credit rating agencies.

The objective of Section 29 is to prescribe the accounting requirements for income tax. Income tax includes all domestic and foreign taxes that are based on taxable profit. It also includes taxes, such as withholding taxes, payable by a subsidiary, associate or joint venture on distributions to the reporting entity.

Current tax

Current tax is the amount of income tax payable or recoverable in respect of the taxable profit or loss for the current period or past reporting periods. An entity shall recognise a current tax liability for current tax payable. If the amount paid exceeds the amount due, the entity recognises a current tax asset.

An entity measures current tax using the tax laws and rates that have been enacted or substantively enacted at the reporting date.

Deferred tax

Deferred tax assets and liabilities are recognised for income tax that is expected to be recoverable or payable in respect of the taxable profit for future reporting periods because of past transactions or events. Deferred tax arises from the difference between the amounts recognised for the entity's assets and liabilities in the statement of financial position and the amounts recognised for those assets and liabilities by the tax authorities, as well as from the carryforward of currently unused tax losses and tax credits.

Deferred tax assets and liabilities are measured using the tax rates and laws that are expected to apply when the deferred tax asset is realised or the deferred tax liability is settled, and that have been enacted or substantively enacted at the end of the reporting period. Deferred tax assets are only recognised to the extent it is probable that taxable profit will be available against which the deductible temporary differences, unused tax losses and unused tax credits can be used.

Presentation and disclosure of current and deferred tax

Current and deferred tax expense is recognised in the same component of total comprehensive income (that is, continuing operations, discontinued operations or other comprehensive income) or equity as the transaction or other event that resulted in the tax expense.

Current and deferred tax assets and liabilities are not discounted.

Section 29 requires an entity to provide specified disclosures about current and deferred tax.

What has changed since the 2009 IFRS for SMEs Standard

When the 2009 version of the *IFRS for SMEs* Standard was issued, Section 29 was based on the IASB's Exposure Draft *Income Tax*, published in March 2009, which proposed amendments to IAS 12 *Income Tax*. However, the changes proposed in the Exposure Draft were never finalised by the Board. Consequently, in the *2015 Amendments to the IFRS for SMEs*, the Board aligned the main requirements in Section 29 for recognising and measuring deferred tax with the approach in IAS 12, modified to be consistent with the other requirements in the *IFRS for SMEs* Standard.

The Board also introduced an undue cost or effort exemption to the requirement to offset income tax assets and liabilities (see paragraphs 29.37 and 29.41).

Appendix A to the *IFRS for SMEs* Standard states that an entity may elect to apply the revised Section 29 prospectively from the beginning of the first period in which it applies the 2015 amendments. Where an entity applies the requirements prospectively it is required to state in the financial statements which amounts have not been restated.

Module 29 – Income Tax

REQUIREMENTS AND EXAMPLES

Scope of this section

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

Notes

Paragraph 29.1 defines income tax for the purposes of Section 29—income taxes are taxes that are based on taxable profit. Taxable profit or tax loss is the profit or loss for a reporting period for which income taxes are payable or recoverable, determined in accordance with rules established by the government taxation authority(ies). Taxable profit equals taxable income less amounts deductible from taxable income. The tax rate, the percentage applied to the taxable profit to calculate the tax payable for the year, is also governed by those rules.

Section 29 applies only to income taxes. Taxable profit generally differs from accounting profit. Judging whether a tax is an 'income tax' sometimes requires judgement, based on the facts and circumstances.

Taxes that are not based on taxable profits, and therefore do not constitute income tax for the purposes of Section 29, include:

- sales taxes, because they are based on sales value (a gross amount) rather than on taxable profits, for example, a tax based on the total value of sales of alcohol or cigarettes.
- consumption taxes levied on any value added to a product, such as value added tax (VAT), or goods and services tax (GST).
- production taxes that do not meet the definition of income tax because of the specific terms, for example, a tax imposed on mining companies for each unit mined (tax based on an individual item).
- taxes payable on employee benefits paid, for example, social security taxes payable based on a percentage of employees' wages. Such taxes would be accounted for under Section 28 *Employee Benefits*.
- stamp duty, a form of tax that is levied on documents based on the price paid.

Example—scope of Section 29

Ex 1 **Entity A pays tax to the authorities as follows:**

- **Corporate tax at the rate of 25% on profit before tax in the Statement of Comprehensive Income adjusted:**
  - **to deduct tax depreciation calculated in accordance with local legislation, in place of accounting depreciation;**
  - **to exclude provisions for doubtful debts that are less than eight months old; and**
  - **to exclude all entertaining expenditures.**
- **Pollution tax paid to the tax authorities that varies with the quantity of emissions in a year.**

The corporate tax is an income tax and Section 29 applies. The pollution tax is not a tax based on taxable profit and so is not an income tax and—it is therefore outside the scope of Section 29.

29.2 This section covers accounting for income tax. It requires an entity to recognise the current and 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 income tax payable (recoverable) in respect of the taxable profit (tax loss) for the current period or past periods. Deferred tax is income 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**, and the tax effect of the carryforward of currently unused tax losses and tax credits.

Notes

Section 29 requires two calculations for income tax at the end of the reporting period:

- the calculation of the current tax expense (or income)—the amount of income tax payable (or recoverable) in respect of the taxable profit (or tax loss) for the current period and adjustments relating to current tax for prior periods.
- the calculation of the deferred tax expense (income)—the amount of income tax payable (or recoverable) in respect of the taxable profit (or tax loss) for future periods as a result of past transactions or events.

Accounting for income tax would be straightforward if accounting profit (that is, profit in the income statement or statement of comprehensive income) was always equal to taxable profit (that is, profit upon which income tax is payable) and both types of profit were always determined using the same rules. In such a case, accounting for income tax would involve calculating the amount payable by applying the tax rate to accounting profit, recognising a liability and an expense for the amount payable and recording the eventual payment on settlement of the liability.

However, the taxable profit for a period often differs, sometimes significantly, from the accounting profit. This is because a jurisdiction's tax laws may differ from the

IFRS for SMEs Standard in terms of the recognition and measurement of income, expenses, assets and liabilities. For example, tax laws are sometimes influenced by political objectives such as when tax deductions for certain capital expenditure are permitted to encourage entities to invest in capital infrastructure. Consequently, the tax expense cannot be determined simply by multiplying accounting profit by the tax rate. Instead, accounting for income taxes involves calculating the tax payable for the year (current tax) and also identifying and accounting for the tax payable or recoverable in a future period as a result of past transactions (deferred tax).

The two simple examples that follow illustrate the calculation of current tax and deferred tax. In the two examples, the effect of accounting for deferred tax, in addition to current tax, is that the tax effect of a transaction is reflected in the same accounting period (and same statement or part of statement, for example, profit or loss or other comprehensive income) as the transaction.

The approach for deferred tax taken by Section 29 is to require an entity to compare the carrying amount of its assets and liabilities recognised in the financial statements with the effect that those assets and liabilities will have on the entity's future tax payments. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger or smaller than they would be if such recovery or settlement were to have no tax consequences, then an entity recognises a deferred tax liability or a deferred tax asset.

Assets and liabilities recognised in the statement of financial position must result from a past transaction. By using assets and liabilities as the starting point for calculating deferred tax, Section 29 ensures that deferred tax results only from past transactions.

Example—deferred tax arising from interest income

Ex 2 **The only difference between an entity's accounting profit and its taxable profit arises from the laws requiring interest income to be taxed when received in cash. Interest income is included in accounting profit when it is earned. The entity's accounting profit was CU21,000[1] in 20X1 and CU20,000 in 20X2. The entity earned interest income of CU1,000 in 20X1, all of which was received, and so taxed, in 20X2. No interest income was received in 20X1 and no interest income was earned in 20X2. The entity incurs income tax at the rate of 30% of its taxable profit.**

The entity calculates current tax as follows:

	20X2	*20X1*	*Cumulative 20X1&20X2*
	CU	*CU*	*CU*
Accounting profit	20,000	21,000	41,000
Deduct interest income not received in cash	–	(1,000)	(1,000)
Add interest income received in cash	1,000	–	1,000
Taxable profit	21,000	20,000	41,000

[1] In this example, and in all other examples in this module, non-foreign currency monetary amounts are denominated in currency units (CU).

Current tax expense	30% × taxable profit	6,300	6,000	12,300

The entity calculates deferred tax as follows:

	Calculation	20X2 CU	20X1 CU
Carrying amount: interest receivable		–	1,000
Tax base (ie future tax deductions)		–	–
Temporary difference		–	1,000
Deferred tax liability	30% × temporary difference	–	300
Deferred tax expense/(income)	change in the deferred tax liability for the period	(300)	300

The entity's income tax expense would be presented in its statement of comprehensive income or income statement or statement of income and retained earnings as follows:

	Explanation	20X2 CU	20X1 CU
…			
Profit before tax	accounting profit	20,000	21,000
Income tax expense	current tax + deferred tax	(6,000)	(6,300)
Profit for the year		14,000	14,700
Effective rate of tax	Income tax expense ÷ Profit before tax	30%	30%

Notes:

The temporary difference in this example arises from a difference in the timing of income recognition for accounting and tax purposes —the interest income is recognised in profit or loss in one period (CU1,000 in 20X1) but, under the tax laws, is included in taxable income (profit) in a different period (CU1,000 in 20X2). The total amount included in accounting profit (CU1,000) and taxable profit is the same over the two-year period.

By recognising a deferred tax liability in respect of the temporary difference in 20X1 and the reversal of that liability in 20X2, the entity's total tax expense (current tax expense + deferred tax expense) equals 30% × accounting profit in each of the two years.

Example—deferred tax arising because of accelerated tax depreciation

Ex 3 The only difference between an entity's accounting profit and its taxable profit arises from the laws permitting the cost of a particular type of machine with a useful life of three years to be fully deductible for tax purposes in the year of purchase. For financial reporting purposes, the entity depreciates the machine on a straight-line basis over three years to a nil residual value. The entity acquired the machine for CU600 on 1 January 20X1. Its accounting profit is CU1,000 for each of the years 20X1–20X3. The entity incurs income tax at the rate of 30% of its taxable profit.

The entity calculates current tax as follows:

	Calculation	*20X3* *CU*	*20X2* *CU*	*20X1* *CU*	*Cumulative 20X1–20X3* *CU*
Accounting profit		1,000	1,000	1,000	3,000
Add back accounting depreciation	CU600 ÷ 3 years	200	200	200	600
Deduct tax depreciation		–	–	(600)	(600)
Taxable profit		1,200	1,200	600	3,000
Current tax expense	30% × taxable profit	360	360	180	900

The entity calculates deferred tax on the machine as follows:

	Calculation	*20X3* *CU*	*20X2* *CU*	*20X1* *CU*
Carrying amount	CU600 less CU200 depreciation per year	–	200	400
Tax base (ie future tax deductions)	nil as CU600 all deducted in 20X1	–	–	–
Temporary difference		–	200	400
Deferred tax liability	30% × temporary difference	–	60	120
Deferred tax expense/(income)	change in the deferred tax liability for the period	(60)	(60)	120

The entity's income tax expense, for inclusion in its statement of comprehensive income or income statement or statement of income and retained earnings, is calculated as follows:

	20X3	*20X2*	*20X1*
	CU	*CU*	*CU*
Current income tax	360	360	180
Deferred income tax	(60)	(60)	120
Current tax + deferred tax	300	300	300

The entity's income tax expense would be presented as follows:

		20X3	*20X2*	*20X1*
	Calculation	*CU*	*CU*	*CU*
…				
Profit before tax	accounting profit	1,000	1,000	1,000
Income tax expense	current tax + deferred tax	(300)	(300)	(300)
Profit for the year		700	700	700

Notes:

The temporary difference (accelerated tax allowance) in this example arises from a difference in the timing of the expense recognition for accounting and tax purposes. The expenses recognised in profit or loss in one period (CU200 per year in 20X1–20X3) are, under the tax laws, included in taxable income (profit) in a different period (CU600 in 20X1). The total amount included in accounting profit (CU600) and taxable profit is the same over the three-year period.

By recognising a deferred tax liability in respect of the temporary difference, the entity's tax expense reflects the temporary nature of the accelerated tax allowance. Accordingly, in this simple example total tax expense (current tax expense + deferred tax expense) equals 30 % × CU1,000 accounting profit in each year from 20X1 to 20X3.

Summary of overall approach for income tax

A summary of the overall approach for accounting for income tax is as follows:

(i) determine which taxes are income taxes for the purposes of the *IFRS for SMEs* Standard (paragraphs 29.1–29.3 and 29.34);

(ii) recognise, in the statement of financial position, current tax measured using the tax rates and laws that have been enacted or substantively enacted by the reporting date (paragraphs 29.4–29.6, 29.32–29.33 and 29.36–29.37);

(iii) recognise, in the statement of financial position, deferred tax assets and deferred tax liabilities arising from taxable and deductible temporary differences, unused tax losses and unused tax credits, measured using the tax rates and laws that have been enacted or substantively enacted by the reporting date that are expected to apply when the deferred tax assets are realised or the deferred tax liabilities are settled (paragraphs 29.7–29.33 and 29.36–29.37);

(iv) recognise current and deferred tax in the same component of total comprehensive income (continuing operations, discontinued operations or other comprehensive income) or equity as the transaction or other event that resulted in the tax expense (paragraph 29.35); and

(v) disclose relevant information about current and deferred income taxes (paragraphs 29.38–29.41).

29.3 This section does not deal with the methods of accounting for **government grants** (see Section 24 *Government Grants*). However, this section does deal with the accounting for **temporary differences** that may arise from such grants.

Notes

Section 24 *Government Grants* specifies the accounting for all government grants. Consequently, government grants are not accounted for under Section 29. However, when a government grant is taxable, Section 29 sets out how to account for the current and deferred tax consequences of the government grant. For example, if a government grant is taxable in the period in which it is received, say 20X1, but it is accounted for over three accounting periods, say 20X1-20X3, Section 29 sets out how to account for the current and deferred tax consequences.

In addition, some government assistance may take the form of income tax allowances. Paragraph 24.3 notes that Section 24:

'does not cover government assistance that is provided for an entity in the form of benefits that are available in determining ***taxable profit*** *or tax loss, or are determined or limited on the basis of* ***income tax*** *liability. Examples of such benefits are income tax holidays, investment tax credits, accelerated* ***depreciation*** *allowances and reduced income tax rates. Section 29* Income Tax *covers accounting for taxes based on* ***income****'.*

Accelerated depreciation allowances accelerate the rate at which the cost of a new item of property, plant and equipment is written off against taxable income (ie the allowances mean the asset is depreciated at a faster rate for tax purposes than the rate of depreciation charged in the financial statements for financial reporting purposes). The effect is to reduce taxable income (and thereby reduce income tax) in earlier periods (as illustrated in Example 3). Section 29 covers the accounting for such income tax effects.

Module 29 – Income Tax

Recognition and measurement of current tax

29.4 An entity shall recognise a current tax liability for tax payable on taxable profit for the current and past periods. If the amount paid for the current and past periods exceeds the amount payable for those periods, the entity shall recognise the excess as a current tax asset.

Notes

Current tax is the amount of income tax payable (recoverable) in respect of the taxable profit (or tax loss) for the current period and past reporting periods. The current tax expense for the year is based on the taxable and deductible amounts reported on the tax return for the current year.

Occasionally, there is uncertainty over whether the tax authority will accept the amounts the entity reports as income or deductions. Hence, the actual amount that is eventually paid may be different from the initial estimate determined under Section 29. In this case the entity will have made either an over-provision or under-provision for current tax.

If an over-provision or under-provision for current tax is identified before the financial statements are authorised for issue, the current tax expense/liability will be adjusted. Identifying the over-provision or under-provision is an example of an adjusting event under Section 32 *Events after the End of the Reporting Period*.

If an over-provision or under-provision for current tax is identified after the financial statements are authorised for issue, it would, in accordance with Section 10 *Accounting Policies, Estimates and Errors* be accounted for in the following year as a change in an accounting estimate (see paragraphs 10.15-10.17) or as a prior period error (see paragraphs 10.19-10.22).

The facts and circumstances that resulted in the prior period over-provision or under-provision determine which accounting treatment is appropriate—preparers cannot 'freely' choose which treatment to apply. The amounts should only be adjusted retrospectively if an error was made and the error led to a material misstatement. An error may arise if the entity's management has made a mistake, for example, by applying the tax rules from the wrong year or by using tax rules that apply to a completely different item. Module 10 *Accounting Policies, Estimates and Errors* provides guidance on accounting for changes in accounting estimates and prior period errors. If no material error was made, the revised estimate is, in accordance with paragraphs 10.15−10.17, usually accounted for in profit or loss for the period in which the estimate is revised as an adjustment of the current tax liability or asset.

Example—calculating current tax

Ex 4 An entity has a year-end of 31 March. The tax year in the jurisdiction runs from 1 April to 31 March. The entity has an accounting profit of CU150,000 for the year ended 31 March 20X8 and the relevant income tax rate for 20X7/20X8 is 15%. The rules for determining taxable profit in the jurisdiction for the year ended 31 March 20X8 are identical to the *IFRS for SMEs* Standard, except for the following income and expenses:

- CU20,000 royalty revenue recognised in 20X8 is exempt from income tax.
- No tax deduction is permitted for CU5,000 of entertainment expenses.
- No tax deduction for bad debts is allowed until the debtors are derecognised in the financial statements. On 31 March 20X8, CU2,000 of debts were derecognised in the financial statements because the entity waived payment from a customer in financial difficulty. The bad debt provision, which is offset against trade receivables, was CU4,000 and CU4,500 on 31 March 20X7 and 31 March 20X8 respectively. Consequently, the bad debt expense for the year ended 31 March 20X8 was CU2,500—comprising the debts written off and the increase in the provision.
- The building is depreciated at a faster rate for tax purposes. The amount of tax depreciation deductible in the year ended 20X8 was CU43,000. The amount of accounting depreciation in the financial statements for the same building for the year was CU35,000.

Taxable profit could be estimated as follows:

Accounting profit for the year ended 31 March 20X8	CU150,000
Less royalty revenue not taxable	(CU20,000)
Plus entertainment expenses not deductible	CU5,000
Plus bad debt expense not deductible (CU2,500 – CU2,000)[(a)]	CU500
Less additional depreciation deductible (CU43,000 - CU35,000)	(CU8,000)
Taxable profit	CU127,500
Current tax expense for the year ended 31 March 20X8 (CU127,500 × 15%)	CU19,125

[(a)] The bad debt expense totals CU2,500: CU2,000 for bad debts written off; and CU500 increase in provision (CU4, 500 – CU4,000)

Deferred tax has not been calculated for this example.

Examples—recognising and adjusting current tax expense for the year

Ex 5 **An entity calculates its taxable profit to be CU100,000 for the tax year 20X7/20X8 determined in accordance with the relevant tax rules in its jurisdiction. The tax year in the jurisdiction runs from 1 April to 31 March. The appropriate income tax rate for 20X7/20X8 is 20%. The current tax payable for the tax year 20X7/20X8 is payable by 30 September 20X8 and the entity makes the payment on 15 September 20X8. The entity has a 31 March financial year end (end of the reporting period).**

The entity could recognise the current tax payable for the year ended 31 March 20X8 as follows:

Dr	Profit or loss—income tax (current tax)	CU20,000[(a)]	
	Cr Current tax liability		CU20,000

To recognise current tax liability and expense for 20X7/20X8.

(a) CU100,000 × 20% = CU20,000

This expense arises over the year, but assuming the entity only reports on 31 March 20X8, the expense may be recorded in full on the reporting date

On 15 September 20X8 the entity could recognise the payment of income tax for the year ended 31 March 20X8 as follows:

Dr	Current tax liability	CU20,000	
	Cr Cash		CU20,000

To recognise the settlement of the current tax liability for 20X7/20X8.

Ex 6 **The facts are the same as in Example 5. However, on 1 June 20X8, before the financial statements are authorised for issue, the entity recalculates its taxable profit to be CU95,000 owing to new information arising between 31 March and 1 June 20X8 that provides evidence of conditions that existed at 31 March 20X8 (for example, because the amount of profit-sharing payments to employees for the year ended 31 March 20X8, which had originally been estimated, is now finalised). The entity's accounting profit is also reduced by the CU5,000 adjusting event.**

The entity would recognise current tax expense for year ended 31 March 20X8 at CU19,000[(a)] and, at 31 March 20X8, a liability for current taxes payable at CU19,000 because the adjustment to profit and to tax is an adjusting event after the end of the reporting period in accordance with Section 32 *Events after the End of the Reporting Period*.

The entity would recognise the following journal entries to correct the original estimate of current tax payable for the year ended 31 March 20X8:

Dr	Current tax liability	CU1,000[(b)]	
	Cr Income tax expense (current tax)		CU1,000

To recognise an adjustment to the current tax liability and expense for 20X7/20X8 following the final determination of the employee profit-sharing payments.

On 15 September 20X8 the entity would make the following journal entries to recognise the payment of tax:

Dr	Current tax liability	CU19,000	
	Cr Cash		CU19,000

To recognise the settlement of the current tax liability for 20X7/20X8.

(a) CU95,000 × 20% = CU19,000
(b) CU20,000 original estimate less (CU95,000 × 20% = CU19,000) = CU1,000 adjustment

Ex 7 **The facts are the same as in Example 6. However, the adjustment of CU5,000 to taxable profits for the year ended 31 March 20X8 is not determined until 1 July 20X8, which is after the financial statements were authorised for issue. The accounting profit is also not adjusted by the CU5,000 because it was not determined until 1 July 20X8, which is after the financial statements were authorised for issue.**

The entity would recognise in the financial statements for the year ended 31 March 20X8, current tax expense for the year at CU20,000 and, at 31 March 20X8, a liability for current taxes payable at CU20,000 because the adjustment to profit (accounting and taxable), and to tax, was not determined until after the financial statements for the year ended 31 March 20X8 were authorised for issue.

The adjustment to profit or loss (and the corresponding adjustment to the provision for profit sharing payments to employees) would be recognised in the financial statements for the year to 31 March 20X9.

Similarly, on the assumption that, in determining the taxable profit for the year ended 31 March 20X8, the tax authorities in the jurisdiction will accept an adjustment to accounting profit to reflect the final determination for the employee profit-sharing payments, the adjustment for over-provision for current tax would also be recognised in the financial statements for the year to 31 March 20X9. The entity would recognise the following journal entries on 1 July 20X8 to correct the original estimate of current tax payable for the year ended 31 March 20X8:

Dr	Current tax liability	CU1,000[(a)]	
	Cr Income tax expense (current tax) [(b)]		CU1,000

To recognise an adjustment to the current tax liability and expense for 20X7/20X8 following the final determination of the employee profit-sharing payments.

On 15 September 20X8 the entity would make the following journal entries to recognise the payment of tax (again, assuming that in determining the taxable profit for the year ended 31 March 20X8, the tax authorities in the jurisdiction will accept an adjustment to accounting profit to reflect the final determination for the employee profit-sharing payments):

Dr	Current tax liability	CU19,000[(c)]	
	Cr Cash		CU19,000

To recognise the settlement of the current tax liability for 20X7/20X8.

(a) CU20,000 original estimate less CU19,000[(c)] revised estimate = CU1,000 adjustment
(b) This adjustment would be recognised in profit or loss for the year ended 31 March 20X9
(c) CU95,000 × 20% = CU19,000

Ex 8 **In Entity A's jurisdiction the tax year runs from 1 July to 30 June. All companies are required to pay a provisional amount of tax to the tax authorities three months before the end of the tax year (by 1 April) based on taxable profits for the prior year. The tax rate from 20X1 to the current date is 30%.**

Entity A has a 30 June financial year end (end of reporting period). For the year ended 30 June 20X4, Entity A had taxable profits of CU50,000. Consequently, the current tax payable for 20X3/20X4 was CU15,000. Based on this amount, Entity A made a provisional tax payment of CU15,000 to the tax authority on 1 April 20X5 as the best estimate of tax payable for 20X4/20X5.

Before Entity A's 30 June 20X5 financial statements are authorised for issue, its taxable profit for the year ended 30 June 20X5 is estimated at CU40,000.

The entity would recognise current tax for the year ended 30 June 20X5 at CU12,000[a]. At 30 June 20X5 the entity has an asset for the overpayment of tax (a refund due from the tax authorities) of CU3,000[b].

On 1 April 20X5 the entity could make the following journal entries to recognise the payment of tax:

Dr	Current tax asset	CU15,000	
	Cr Cash		CU15,000

To recognise an advance payment of the estimated current tax liability for 20X4/20X5.

The entity should recognise the following journal entries to recognise its estimated current tax payable for the year ended 30 June 20X5:

Dr	Income tax expense (current tax)	CU12,000[a]	
	Cr Current tax asset		CU12,000[c]

To recognise current tax expense and reduction of current tax asset for 20X4/20X5.

Upon receiving the refund from the tax authorities, the entity would recognise the following journal entries:

Dr	Cash	CU3,000	
	Cr Current tax asset		CU3,000

To recognise the refund of current tax for 20X4/20X5 from the tax authorities.

(a) CU40,000 × 30% = CU12,000

(b) CU15,000 less CU12,000 = CU3,000

(c) After this journal entry the balance on the current tax asset will be CU3,000 (CU15,000 - CU12,000)

29.5 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.

Notes

A tax loss arises in an accounting period in which taxable 'profit' is negative, that is, one in which allowable deductions exceed taxable income. Some tax laws allow entities to use a loss in one year to offset a profit in one or more prior years (called a tax loss carryback). When a tax loss is used to recover current tax for a previous period, an entity recognises the benefit as an asset in the period in which the tax loss occurs, because it is probable that the benefit will flow to the entity and that the benefit can be reliably measured.

If the entity is unable to carry back the tax loss, for example, if doing so is not permitted by the jurisdiction's rules or the entity has insufficient profits in prior years to offset the entire loss, the entity may be able to carry the tax loss (or tax loss in excess of the amount carried back to a prior year) forward with or without a time limit and set the loss against taxable income in a future period. The amount carried forward would be recognised as deferred tax, rather than current tax, because it affects the payment of future tax. See paragraphs 29.21–29.22 regarding the recognition of a deferred tax asset for carryforward of unused tax losses.

If the entity is unable to carry forward or carry back the loss, the loss is not usable and so no asset is recognised.

Examples—tax loss carryback

Ex 9 **In accordance with the tax rules in its jurisdiction, an entity estimates its taxable loss for the tax period 20X7/20X8 at CU9,000. The tax legislation in the jurisdiction permits entities to carry losses back three tax years with no requirement on which of the three years the loss is first set off against. Taxable income was CU7,000 in 20X6/20X7, CU5,000 in 20X5/20X6 and CU3,000 in 20X4/20X5 . The entity has a 30 September financial year-end (end of the reporting period) and this coincides with the entity's tax year.**

The relevant income tax rates are as follows:

- **18% in 20X6/20X7 and 20X7/20X8**
- **20% in 20X5/20X6**
- **17% in 20X4/20X5.**

Assuming the entity wishes to maximise the refund, the entity would first set off the losses against the prior year that has the highest tax rate. Hence, the entity would carry CU5,000 of the loss back to 20X5/20X6 (the maximum possible, because the amount cannot exceed available profits) and would carry CU4,000 back to 20X6/20X7. As a result, the entity will save tax at 20% on the CU5,000 carried back to 20X5/20X6 and at 18% on the CU4,000 carried back to 20X6/20X7.

The tax refund is CU1,720 ((CU5,000 × 20%) + (CU4,000 × 18%)).

For the year ended 30 September 20X8, the entity would recognise a current tax asset/benefit as follows:

Dr	Current tax asset	CU1,720	
	Cr Profit or loss—income tax (current tax)		CU1,720

To recognise current tax asset and income for 20X7/20X8.

Ex 10 **The facts are the same as in Example 9 except that the tax laws require the entity to set the losses against the most recent period possible—that is, 20X6/20X7 first, 20X5/20X6 second and 20X4/20X5 last.**

The entity must first set off the losses against 20X6/20X7. Consequently, the entity would carry back CU7,000 of the loss to 20X6/20X7 and CU2,000 to 20X5/20X6. As a result, the entity will save tax at 18% on the CU7,000 carried back to 20X6/20X7 and at 20% on CU2,000 in 20X5/20X6.

The tax refund is CU1,660 ((CU7,000 × 18%) + (CU2,000 × 20%)).

For the year ended 30 September 20X8, the entity would recognise a current tax asset/benefit as follows

Dr	Current tax asset	CU1,660	
	Cr Profit or loss—income tax (current tax)		CU1,660

To recognise current tax asset and income for 20X7/20X8.

Ex 11 **The facts are the same as in Example 9 except that the entity also incurred tax losses in each of the three previous years and is unable to carry the loss back to an earlier year. Tax laws preclude a tax loss from being carried forward to a later period.**

The entity is unable to benefit from the tax loss incurred during the year ended 30 September 20X8. Consequently, the entity makes no journal entry in respect of current tax for the year ended 30 September 20X8.

29.6 An entity shall measure a current tax liability (asset) at the amount 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 and tax laws as substantively enacted when the remaining steps in the enactment process have not affected the outcome in the past and are unlikely to do so. Paragraphs 29.32–29.33 provide additional **measurement** guidance.

Notes

Current tax assets and liabilities (and deferred tax assets and liabilities, see paragraph 29.27) are often measured by reference to the tax rates and tax laws enacted by the reporting date. It should be easy to ascertain whether a tax rate or other law has been enacted by the end of the reporting period.

In some jurisdictions, government actions relating to tax rates and tax laws have the substantive effect of actual enactment, even though official enactment may be a formality that follows these actions by a period of several months. In this case the substantively-enacted rates or laws should be used, because it would be inappropriate to wait for formal enactment. When enactment is merely a formality, waiting for enactment would give undue weight to the act of enactment. For example, in some jurisdictions a formal government announcement of the changes may constitute substantive enactment. New tax rates or tax laws are substantively enacted when the remaining steps in the enactment process have not affected the outcome in the past and are unlikely to do so. This does not mean that they cannot do so under any circumstances. An entity may need to apply judgement based on the specific facts and circumstances in determining whether government actions mean a change has been substantively enacted. For example: what are the remaining procedures, when are they likely to take place, and are they simply small, routine tasks or larger, unusual tasks? Where government actions such as announcements of tax rates and tax laws, are in substance equivalent to actual enactment, the announced tax rates and tax laws will be used for calculating tax relating to the periods in which they will apply.

In other jurisdictions, it may be necessary for all (or close to all) of the legally-required steps towards enactment to have been completed before the new rates or laws can be regarded as substantively enacted. For example, in the US tax jurisdiction, substantive enactment is generally thought to be achieved only upon legal enactment. This is because the effect of the President's power of veto is that the point when any future steps in the enactment process will not change the outcome is always only at legal enactment.

When paragraphs 29.6 and 29.27 require that current tax assets and liabilities and deferred tax assets and liabilities are measured by reference to the tax rates and tax laws that have been enacted or substantially enacted by the reporting date, that is not limited to the rates that apply to the taxable period ending at the reporting date. Rather, for deferred tax paragraphs 29.6 and 29.27 also require use of the rates enacted or substantively enacted by the end of the reporting period that will be in effect at the time the temporary difference reverses.

Examples—change in tax rates

Ex 12 **An entity operates in a jurisdiction where a change in tax rate from 25% to 26% was announced on 1 November 20X6 and will take effect from 1 April 20X6. The entity has a year end of 31 March. Assume that the announcement on 1 November 20X6 is considered substantive enactment. Actual enactment was on 30 April 20X7.**

An entity shall measure its current tax liability using the tax rates and laws that have been enacted or substantively enacted by the reporting date.

The new tax rate of 26% has been substantively enacted by the reporting date (31 March 20X7) so it should be used for tax relating to the periods in which that rate applies. Although the entity's accounting period had started before the change in rate had been announced and substantively enacted, current tax for the year ended 31 March 20X7 will be determined using the new rate of 26%. The new rate will also apply to the measurement of deferred tax.

Ex 13 **The facts are the same as in Example 12 except that the announcement on 1 November 20X6 is not considered substantive enactment and substantive enactment is only achieved on 10 April 20X7.**

An entity shall measure its current tax liability using the tax rates and laws that have been enacted or substantively enacted by the reporting date.

The new tax rate of 26% has not been substantively enacted by the reporting date (31 March 20X7) so it should not be used for tax relating to the periods in which that rate applies. Consequently, current tax for the year ended 31 March 20X7 will be determined using the rate of 25% because the new rate was not substantively enacted by 31 March 20X7. Similarly, the new rate will not be applied to the measurement of deferred tax. Assuming the entity's 20X6-X7 financial statements are authorised for issue after 10 April 20X7, the change in tax rate would be disclosed in the notes to the financial statements (paragraph 32.11(h)). The adjustment to the tax expense for the year ended 31 March 20X7 would be recognised in profit or loss for the year ended 31 March 20X8.

Ex 14 **The facts are the same as in Example 12 except that the change in tax rate from 25% to 26% takes effect from 1 April 20X7.**

An entity shall measure its current tax liability using the tax rates and laws that have been enacted or substantively enacted by the reporting date.

The new tax rate of 26% has been substantively enacted by the reporting date (31 March 20X7) so it should be used for tax relating to the periods in which that rate applies—periods beginning on or after 1 April 20X7.

Current tax for the year ended 31 March 20X7 will therefore be determined using the rate of 25% because the new rate does not apply until the following period, that is, the period beginning on 1 April 20X7.

The new rate will apply to the measurement of deferred tax in the financial statements for the year ended 31 March 20X7 because deferred tax is payable or recoverable in periods beginning after the reporting date.

Current tax for the year ended 31 March 20X8 will be determined using the new rate of 26% unless by 31 March 20X8 another change has been enacted or substantively enacted that is effective for that period.

Recognition of deferred tax

General recognition principle

29.7 It is inherent in the **recognition** of an asset or a liability that the reporting entity expects to recover or settle the carrying amount of that asset or liability. If it is **probable** that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, this section requires an entity to recognise a **deferred tax liability** (**deferred tax asset**) with certain limited exceptions. If the entity expects to recover the carrying amount of an asset or settle the carrying amount of a liability without affecting taxable profit, no deferred tax arises in respect of the asset or liability.

29.8 An entity shall recognise a deferred tax asset or liability for tax recoverable or payable in future periods as a result of past transactions or events. Such tax arises from the differences between the carrying amounts of the entity's assets and liabilities in the **statement of financial position** and the amounts attributed to those assets and liabilities by the tax authorities (such differences are called 'temporary differences'), and the carryforward of currently unused tax losses and tax credits.

Notes

The notes supporting paragraph 29.2 provide a short introduction to accounting for income tax and the rationale for accounting for deferred tax. The approach in Section 29, like the one in IAS 12, is that an entity should recognise a deferred tax liability or asset if the recovery of the carrying amount of an asset or the settlement of a liability will result in higher or lower tax payments in the future than would be the case if that recovery or settlement were to have no tax consequences. This approach is known as a 'balance sheet liability approach'.

Paragraphs 29.7 to 29.37 set out the requirements for determining and presenting deferred tax. These requirements can be divided into a few key stages (and the steps referred to are explained in the table that follows this diagram):

The requirements for determining and presenting deferred tax can be summarised into the steps listed in the diagram and explained in the table. The notes in this module refer to the step to which they relate.

Steps summarising the requirements for determining and presenting deferred tax liabilities and assets:	
Step 1	Determine the tax base for: (a) all assets and liabilities recognised in the statement of financial position; and (b) other items that have a tax base but are not recognised as assets or liabilities, for example, research costs recognised as an expense in one period but deductible for tax in a later period. The tax base of an asset is the amount of future tax deduction and the tax base of a liability is its carrying amount less the future tax deductible amount.
Step 2	Calculate temporary differences for each item identified in Step 1. Temporary difference equals carrying amount less tax base.
Step 3	Determine which temporary differences are taxable temporary differences not exempt by paragraphs 29.14 and 29.25.
Step 4	Identify which temporary differences are deductible temporary differences not exempt by paragraph 29.16 and, for those arising from investments in subsidiaries, branches, associates and interests in joint ventures, those for which the temporary difference will reverse (paragraph 29.26).
Step 5	Determine the extent to which it is probable that taxable profit will be available against which the deductible temporary differences identified in Step 4 can be utilised.
Step 6	Compute unused tax losses and unused tax credits.
Step 7	Determine the extent to which it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits identified in Step 6 can be utilised.
Step 8	Measure the deferred tax liabilities (from the taxable temporary differences identified in Step 3) and the deferred tax assets (from the deductible temporary differences, unused tax losses and unused tax credits identified in Steps 5 and 7) using tax rates and tax laws that have been enacted or substantively enacted at the end of the reporting period and are expected to apply when the deferred tax asset is realised or the deferred tax liability is settled.
Step 9	Recognise deferred tax liabilities and assets (from Step 8) in the statement of financial position and deferred tax expense and/or income in the same component of total comprehensive income (continuing operations, discontinued operations or other comprehensive income) or equity as the transaction or other event that resulted in the tax expense or income. (Expense and/or income for the year will equal the deferred tax assets and liabilities at the end of the year less the deferred tax assets and liabilities at the start of the year.)

The following additional steps are to identify some of the disclosures:	
Step 10	Reassess any deferred tax assets that were unrecognised at the end of the previous reporting period and determine the extent to which it has become probable that future taxable profit will be available to allow the deferred tax asset to be recovered. (Reassessment will facilitate the disclosure required by paragraph 29.39(e).)
Step 11	Reassess any deferred tax assets that were recognised at the end of the previous reporting period and determine the extent to which it is no longer probable that future taxable profit will be available to allow the deferred tax asset to be recovered. Determine the reduction in the carrying amount. (Reassessing will facilitate the disclosure required by paragraph 29.39(g).)
Step 12	For all deferred tax assets that were recognised at the end of the previous reporting period and continue to be recognised and for all deferred tax liabilities that were recognised at the end of the previous reporting period and continue to be recognised, remeasure to the extent that there has been a change during the reporting period in the enacted or substantively enacted tax rates and laws. (Remeasuring will facilitate the disclosure required by paragraph 29.39(d).)

Tax bases and temporary differences

29.9 The **tax base** of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

Notes—Step 1 tax base of assets

The approach to accounting for deferred tax in Section 29 is based on the principle that an asset recorded in the financial statements will be realised, for its carrying amount, in the form of economic benefits that will flow to the entity in future periods, for example, a receivable of CU100 for interest income will result in cash of CU100 being received. When such benefits flow to the entity, they give rise to amounts that may be used to determine taxable profits. For example, the CU100 interest income may be taxable when received in cash.

The tax base of an asset is equal to the amount that will be deductible for tax purposes against any taxable benefits that will flow to the entity when it recovers the carrying amount of the asset. For example, the tax base of the CU100 interest income will be nil if the interest income is taxable when received in cash.

When the economic benefits that flow to the entity are not taxable, the tax base of the asset equals the carrying amount of the asset. For example, if the interest income is not subject to tax at all or is taxed when accrued in the financial statements, the tax base of the CU100 interest income receivable will be CU100.

An entity may generate economic benefits in excess of the carrying amount of an asset, by using the asset to generate operating profits or by selling the asset. For example, inventory will usually be sold for more than its carrying amount. However, when calculating tax bases and temporary differences, Section 29 requires the assessment to be performed as if the benefits are equal to the carrying amount of the asset. In other words, Section 29 only considers the amounts already recorded in the financial statements. This is because deferred tax is only recognised in respect of past transactions or events; any profit, arising from selling the inventory for more than its cost, cannot be anticipated because this is a future transaction.

The temporary difference relating to an asset is the difference between the asset's carrying amount and its tax base—see paragraph 29.12. Such temporary differences will be either taxable temporary differences (resulting in an increase in tax being paid in future periods) or deductible temporary differences (resulting in a reduction in tax being paid in future periods).

Examples—Step 1 tax base of assets

Ex 15 **An entity has an amount receivable from a customer of CU5,000 that has no allowance for bad or doubtful debts set against it. The receipt of cash in settlement of the balance will have no tax consequences for the entity because the revenue has already been included in taxable income on sale of the goods or performance of the services.**

The expected manner of recovery of the asset, the receipt of cash, is not taxable; the sale to the customer gave rise to tax when recognised in the financial statements and no amounts are taxable or tax-deductible on receipt of the cash from the customer. Consequently, the tax base is CU5,000 (the carrying amount of the asset).

Ex 16 **An entity has interest income receivable from a bank of CU5,000. The interest income is taxable when received in cash.**

The expected manner of recovery of the asset, the receipt of cash, is taxable; the full amount of CU5,000 is taxable on receipt of the cash from the bank. No amount is deductible for tax purposes when the interest income is received. Consequently, the tax base is nil.

Ex 17 **An entity has dividends receivable of CU5,000 from an investment in equity instruments in another entity. The dividends are not taxable, either when received or when recognised in profit or loss.**

The expected manner of recovery of the asset, the receipt of cash, is not taxable. Consequently, the tax base is CU5,000 (the carrying amount of the asset).

Ex 18 **An entity has cash at bank of CU5,000 on its statement of financial position. No tax arises when the cash is withdrawn from the account or used to settle a liability.**

The expected manner of recovery of the asset, the receipt of cash or the settlement of a liability, is not taxable. Consequently, the tax base is CU5,000 (the carrying amount of the asset).

Ex 19 **An entity holds an inventory of finished goods at cost of CU10,000. The inventories are deductible for tax purposes when they are sold. The deduction is equal to the cost of the inventories.**

The expected manner of recovery of the inventory (through sale) means the amount is taxable. Revenue from selling the inventory will give rise to taxable income. However, a tax deduction on the sale, equal to the carrying amount of the inventory, will be available.

Consequently, the tax base of the inventory is CU10,000, the amount of the deduction available upon sale of the inventory.

Ex 20 **An entity owns land that meets the definition of an investment property and is measured at its fair value of CU210,000 in accordance with Section 16 *Investment Property* (paragraph 16.7). No tax is payable or recoverable on the proceeds of sale, because there is no capital gains tax in this jurisdiction and there are no other tax effects on sale such as clawback of tax deductions given during use of the asset.**

Because land (other than leasehold land) is a non-depreciable asset (meaning it would not be depreciated if it was accounted for under Section 17 *Property, Plant and Equipment* at cost), no part of its carrying amount is expected to be recovered (that is, consumed) through use. The entity expects to recover the carrying amount of the land through sale. No tax will arise on recovery of the investment property through sale, because there is no capital gains tax in this jurisdiction and there are no other tax effects from sale. Consequently, the tax base equals the carrying amount and is CU210,000.

An alternative view might be to argue that the land gives rise to future rental income which is taxable and that, as no amount representing the land can be deducted against this taxable income, the tax base is nil. However, this does not apply in this example—see paragraph 29.30 for an explanation of why the tax base is calculated based on a sale of the land rather than based on the future receipt of taxable rental income.

Ex 21 **An entity owns land that meets the definition of an investment property in accordance with Section 16. The land was acquired for CU200,000 at the beginning of the financial year. If the entity disposes of the land at the reporting date, it would be entitled to a tax deduction of CU201,000 due to indexation of cost for tax purposes. The fair value of the land can be measured reliably without undue cost or effort on an ongoing basis, so the land is measured at fair value with changes in fair value recognised in profit or loss in accordance with Section 16. At the reporting date the fair value of the land is CU210,000.**

Because land (other than leasehold land) is a non-depreciable asset (meaning it would not be depreciated if it were accounted for under Section 17 at cost), no part of its carrying amount is expected to be recovered (that is, consumed) through use. Hence, the entity expects to recover the carrying amount of the land through sale (see paragraph 29.30).

Recovery of the land through sale is taxable in this jurisdiction.

The tax base of the land equals the future tax deduction, which is CU201,000.

If after initial recognition the fair value of the land could not be measured reliably without undue cost or effort (meaning the land is accounted for at cost under

Section 17) the tax base would still be CU201,000. This is because recovery of the land through sale is taxable and CU201,000 is the amount that is deductible on sale.

However, if the tax authorities only allow indexation of the land to the extent it is covered by sale proceeds, the tax deductions would be CU200,000 under the assumption, as required by Section 29, that recovery of the land is at the carrying amount of CU200,000. In this case, the tax base would be CU200,000 (as the deductions against taxable income would be limited to CU200,000).

See paragraph 29.30 for an explanation of why the tax base is calculated based on a sale of the land rather than based on the future receipt of taxable rental income.

Ex 22 **An entity has machinery, which cost CU100,000 on 1 January 20X1, that is measured at depreciated cost. The machinery is deductible from taxable income either as the machinery is used (via tax depreciation) or, alternatively, on sale. Tax depreciation is applied on the same basis as depreciation for financial reporting purposes, which for this machine is CU25,000 in each of the four years of its useful life; this machine has a residual value of nil. Revenue generated by using the machine is taxable and any gain or loss on disposal of the machine will be taxable or deductible for tax purposes through a balancing adjustment (such as clawback of capital allowances claimed).**

Taxable income will arise either from selling the machinery or from using the machinery to generate revenue (or from using the machine for a while before selling it). In reality, an entity will often generate economic benefits in excess of the carrying amount of the machinery, by using the machinery to help generate additional operating profits in excess of the carrying amount of the asset or via a profit on sale. However, Section 29 requires the assessment to be performed as if the benefits are equal to the carrying amount of the asset. This is because deferred tax is only recognised in respect of past transactions or events; any profit, arising from selling the machine or by selling inventory made using the machine, cannot be anticipated because this is a future transaction.

Tax depreciation will be available to set against the taxable income arising.

Consequently, the tax base of the machine will equal the amount available for deduction in future periods. For example, at 31 December 20X1 the tax base will be CU75,000 (being CU25,000 available for deduction in each of 20X2, 20X3 and 20X4).

Ex 23 **The facts are the same as in Example 22 except that tax depreciation is applied on a faster basis than depreciation for financial reporting purposes, with 50% of the cost being deductible for tax purposes in each of the first and second years.**

As in Example 22, taxable income will arise either from selling the machinery or from using the machinery to generate revenue (or from using the machine for a while before selling it). Section 29 requires the assessment to be performed as if the benefits are equal to the carrying amount of the asset.

Tax depreciation, as in Example 22, will be available to set against the taxable income arising.

At 31 December 20X1 the machine's carrying amount in the statement of financial position is CU75,000 and its tax written down value is CU50,000 (cost of CU100,000 less allowances for first year of CU50,000).
Consequently, the tax base of the machine will equal the tax deductions that are available in future periods and at 31 December 20X1 the tax base will be CU50,000 (being the CU50,000 available as a tax deduction in 20X2).

Ex 24 **An entity leases (as lessee) the office building it occupies under an operating lease. It has an asset of CU60,000 for a prepayment of six months of rent. Rent is tax-deductible at the time it is recognised as an expense for financial reporting purposes.**

In most cases such a prepayment will be recovered through use of the building. Alternatively it may be recovered by assigning the lease to another party.

Taxable income arises on the recovery of the asset either through using the building to generate operating profits (which is expected to be the most likely use) or through assignment of the lease. Section 29 requires the assessment to be performed as if the benefits are equal to the carrying amount of the asset.

The rent is tax deductible at the time of the expense recognition and so is available as a deduction in a future period. Consequently, the tax base of the prepayment is CU60,000, (being the amount deductible in a future period).

If, on the other hand, the rent were tax deductible when paid, there would be no future tax deduction when the rent prepayment is recovered. Consequently the tax base would be nil.

Ex 25 **An entity owns a small number of shares in a listed company. The shares cost CU800. If the entity disposes of the shares at the reporting date, it will be entitled to a tax deduction equal to the cost of the shares. At the reporting date the fair value of the shares is CU1,000.**

Equity investments generally have an indefinite life, so their carrying amount will be recovered through sale, even though an entity may choose to hold the shares for the long term to earn dividend income.

The investment in shares will be measured at fair value under Section 11 *Basic Financial Instruments.* Recovery of the shares at their carrying amount of CU1,000 will give rise to taxable income of CU1,000. A tax deduction of CU800, being the cost of the shares, is available to set against the taxable income. Consequently, the tax base equals the future tax deduction and is CU800.

Ex 26 **An entity (functional currency CU) owns shares in an unlisted company overseas (functional currency FCU[2]) which cost CU10,000. The entity has significant influence in the unlisted company and the investment satisfies the definition of an associate—see Section 14 *Investments in Associates*. If the entity disposes of the shares at the reporting date, the proceeds would be taxable and the entity would be entitled to a tax deduction equal to the cost of the shares. At the reporting date the**

[2] In this example, and in all other examples in this module, foreign currency monetary amounts are denominated in foreign currency units (FCU).

carrying amount of the unlisted company is CU11,000 (the entity accounts for associates using the equity method in accordance with Section 14 *Investments in Associates).*

Equity investments generally have an indefinite life. Consequently, their carrying amount will be recovered through sale, even though an entity may choose to hold the shares for the long term to earn dividend income.

Recovery of the shares at their carrying amount of CU11,000 gives rise to taxable income of CU11,000. A tax deduction of CU10,000, being the cost of the shares, is available to set against the taxable income. Consequently, the tax base equals the future tax deduction and is CU10,000.

Ex 27 **On 1 January 20X1 an entity acquired a licence for CU5,000 that has a useful life of 10 years. The intangible asset is expected to be used for the full 10 years. At 31 December 20X1 its carrying amount is CU4,500. No tax deductions can be claimed as the licence is amortised or on its expiry or on its sale.**

The expected manner of recovery of the intangible asset—that is, using it to generate operating profits (taxable income)—will give rise to taxable income. On recovery of the asset there are no tax deductions available. The tax base equals the future tax deductions and so is nil.

Ex 28 **At 31 December 20X1 an entity has gross trade receivables of CU50,000 with an allowance for bad or doubtful debts set against it for CU2,000. The allowance for bad or doubtful debts is only tax-deductible when the debt is six months overdue and has been written off or sold. At 31 December 20X1, the entity's reporting date, the debts to which the allowance related were five months' old or less.**

The carrying amount of the receivables at 31 December 20X1 is CU48,000 (CU50,000 receivables less CU2,000 allowance for bad or doubtful debts).

The CU50,000 revenue will have been taxed when recognised during the year ended 31 December 20X1 and thus is not taxable when the cash is received during 20X2. On the other hand, the CU2,000 allowance was not tax deductible in 20X1 when recognised in the financial statements; it will be tax deductible in the year to 31 December 20X2, assuming the debtors do not pay the entity.

Recovering the carrying amount of CU48,000 will result in a tax deduction of CU2,000. In other words, recovery of the carrying amount creates negative taxable economic benefits. Hence the tax base is the amount that will be deductible for tax purposes on recovery of the carrying amount, that is, CU50,000.

Note: if the jurisdiction required the tax deduction relating to the allowance for bad or doubtful debts to be taken at the same time as it is expensed for financial reporting purposes, the recovery of the receivables at the carrying amount of CU48,000 would not give rise to any future taxable income or taxable deductions and the tax base of the receivables would be CU48,000.

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

Notes—Step 1 tax base of liabilities

The approach to accounting for deferred tax in Section 29 is based on the principle that a liability recorded in the financial statements will be settled for its carrying amount; for example, a payable of CU100 for interest expense will result in a cash outflow of CU100.

If settlement of the liability will make future tax payments higher or lower than they would otherwise be, deferred tax will be recognised.

The tax base of a liability is equal to its carrying amount less any amount that will be deductible for tax purposes in respect of that liability in future periods. For example, the tax base of the CU100 interest expense payable will be CU100 if the interest expense is tax deductible when recognised in the financial statements (CU100 carrying amount less nil amount deductible in future periods) and will be nil if the interest expense is tax deductible only when it is paid (CU100 carrying amount less CU100 deductible in future period).

The tax base of revenue that has been received in advance is its carrying amount less any amount of that revenue that will not be taxable in future periods.

Examples— Step 1 tax base of liabilities

Ex 29 **An entity is required to pay fines and penalties because in the past year it violated minor laws, for example, by filing accounts late. The entity has recognised a liability of CU100 for the fines and penalties that are payable. The fines are not deductible for tax purposes.**

The fines do not give rise to amounts deductible from taxable income. Hence, the expected manner of settlement of the liability, via payment of the fines, does not give rise to a future tax deduction. Consequently the tax base of the liability for the fines and penalties that are payable is CU100, being the carrying amount of CU100 less nil amount deductible in future periods.

Ex 30 **An entity recognises a warranty provision for CU1,000 to cover the repair of defective items sold prior to the year end. The amount recognised as a provision is not deductible for tax purposes until it is paid or used.**

The expected manner of settlement of the liability (that is, paying cash to customers or repairing defective items) will affect taxable profit, because any warranty expense is tax-deductible on payment or use. The tax base of the warranty provision is nil, being the carrying amount of CU1,000 less CU1,000 deductible in future periods.

Ex 31 **An entity has a bank loan of CU50,000. Loan repayment will have no tax consequences.**

The expected manner of settlement of the liability (that is, cash payments) does not affect taxable profit because no amounts are taxable or tax-deductible when cash is repaid to the bank. Consequently, the tax base for the loan is CU50,000 (being the carrying amount of CU50,000 less nil amount deductible in future periods).

Ex 32 **An entity has an amount payable to a supplier, for a purchase of inventory, of CU1,000. The payment of the balance will have no tax consequences for the entity, because the purchase was of items of inventory and the deduction from taxable income will be on sale of the inventory to a customer, not on the cash payment for the inventory.**

The expected manner of settlement of the liability (that is, cash payments) does not affect taxable profit because no amounts are taxable or tax-deductible on payment of the cash to the supplier; the tax deduction takes place when the items of inventory are sold. Consequently, the tax base for the payable to the supplier is CU1,000 (being the carrying amount of CU1,000 less nil amount deductible in future periods).

Ex 33 **An entity has an amount payable to an employee of CU10,000 relating to services already rendered by the employee to the entity. The expense was tax-deductible when incurred (that is, at the same time as expense recognition for financial reporting purposes).**

The expected manner of settlement of the liability (that is, cash payments) does not affect taxable profit because no amounts are taxable or tax-deductible on payment of the cash to the employee. Consequently, the tax base for the payable to the employee is CU10,000 (the carrying amount of CU10,000 less nil amount deductible in future periods).

Alternatively, if the amount is tax-deductible on payment, the expected manner of settlement of the liability (that is, cash payments to the employee) will reduce taxable profit when it is paid. Consequently, the tax base for the payable to the employee is nil (being the carrying amount of CU10,000 less CU10,000 deductible in future periods).

Ex 34 **An entity recognises a liability for short-term employee benefits for CU500 to cover the unused annual leave entitlement that employees can carry forward at the reporting date. The employee benefits are tax-deductible either when used by the employee or if any unused entitlement is paid to the employee by the entity.**

The expected manner of settlement of the liability (that is, employees taking their holiday or forgoing their holiday in return for cash) will affect taxable profit, because the related expense is tax-deductible on use of the holiday or on payment. Consequently, the tax base for the liability is nil (being the carrying amount of CU500 less CU500 deductible in future periods).

Ex 35 **Two years ago when the exchange rate was FCU1:CU2 an entity, functional currency CU, borrowed FCU4,000 from a bank. At the latest reporting date, 31 December 20X1, the exchange rate was FCU1:CU1.8. Exchange gains are taxable and exchange losses are tax-deductible when the loan is repaid to the bank.**

The loan was initially recognised at CU8,000. At the latest reporting date, it was reported at CU7,200. An exchange gain of CU800 has therefore been recognised over the last two years.

The expected manner of settlement of the liability at its carrying amount of CU7,200 (that is, payment of FCU4,000) will affect taxable profit, because the gain of CU800 will be taxable.

On settling the liability for CU7,200 the entity will not get any tax deductions, and will create taxable income. In other words, the amount deductible for tax purposes is negative CU800. The tax base is therefore the carrying amount of CU7,200 plus CU800, that is, CU8,000.

Ex 36 **On 1 December 20X1 an entity received CU5,000 from a customer as a deposit for goods the customer ordered from the entity. The entity delivered the goods, with an invoice value of CU25,000, on 30 January 20X2. The customer paid the remaining balance of CU20,000 on 28 February 20X2. The revenue of CU25,000 is taxable in 20X2 when recognised in the financial statements.**

All CU25,000 in revenue will be taxable in 20X2. The tax base for the deposit from the customer is CU5,000 (being the carrying amount of CU5,000 less nil amount not taxable in future periods).

Ex 37 **A magazine manufacturer and distributor provides customers with one-year subscriptions to different magazines. The customers pay the one-year subscription fee of CU800 in advance. The subscription income is taxed when received in cash.**

The income received in advance will not be taxable in future periods because it is taxable in the period in which the cash was received. Consequently none of the CU800 will be taxable in subsequent accounting periods. The tax base of the subscription income is nil—being the carrying amount (CU800), less the amount of revenue that will not be taxable in future periods (CU800).

Ex 38 **An entity pays rent in arrears. At the year end the entity recognises a liability of CU10,000 for accrued rental expenses. The related expense will be deducted for tax purposes on a cash basis.**

If the accrued expenses were settled for their carrying amount, tax deductions equal to the carrying amount would be available. The tax base of the accrual is therefore nil.

Ex 39 **In determining accounting profit or loss, an entity deducts pension costs as employees provide services. However, pension costs are not deducted in determining taxable profit until the entity either pays retirement benefits or pays contributions to a fund. At the year end the entity has a liability of CU25,000 for outstanding payments due as contributions to the fund.**

If the pension liability were settled for its carrying amount, tax deductions equal to the carrying amount would be available. The tax base of the pension liability is therefore nil.

29.11 Some items have a tax base but are not recognised as assets and liabilities in the statement of financial position. For example, **research** and **development** costs are recognised as an **expense** when determining **accounting profit** in the period in which they are incurred but may not be permitted as a deduction when determining taxable profit (tax loss) until a later period. The difference between the tax base of the research and development costs, being the amount that the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a **deductible temporary difference** that results in a deferred tax asset.

Notes—Step 1 tax base but not recognised in statement of financial position

A temporary difference is the difference between the carrying amount of an asset or liability and its tax base—see paragraph 29.12. Deferred tax is calculated on those temporary differences that are taxable temporary differences and deductible temporary differences.

Where there has been a past event that will affect the tax of future periods, entities calculate a tax base and temporary difference even if there is no asset or liability in the statement of financial position. It is appropriate to calculate a tax base in such cases so that the item/expense is not reported in a different period to its related tax effect.

Examples— Step 1 tax base but not recognised in statement of financial position

Ex 40 **In accordance with Section 18, an entity expenses CU500 research and development costs it incurred during the year ended 31 December 20X1. The amount is tax deductible in 20X3.**

The research and development expense gives rise to a future tax deduction. Consequently the tax base is CU500, being the amount deductible in future periods.

Ex 41 **An entity grants 10 share options to each of its 20 employees. Each grant is conditional upon the employee working for the entity over the next three years. The entity estimates that the fair value of each share option is CU9 on the grant date. Tax deductions equal to intrinsic value at the date of exercise (the entity's share price at the date of exercise minus the exercise price) will be received on the exercise of the share options.**

Assume the exercise price is CU10 and the share price is estimated using a valuation model at each year end as follows:

End of year one: CU13

End of year two: CU16

End of year three: CU19

End of year four: CU18

The share options are an example of equity instruments issued by the entity that do not give rise to assets or liabilities but do give rise to deductions in a future period. The total staff cost recognised over the three years, assuming all options vest, is CU1,800 (20 employees × 10 shares × CU9) (see Section 26 *Share-based Payment*). At no point is an asset or liability recognised, because the cumulative expense is credited to equity (debit to profit or loss) for equity-settled share-based payments.

The tax base will be as follows assuming all options vest:

- After the first year the share-based payment has a tax base of CU200 ((CU13 share price less CU10 exercise price) × 20 employees × 10 shares × 1 year ÷ 3 years). The tax base of the employee services received is based on the intrinsic value of the options, and those options were granted for three years' services. Because only one year's services have been received to date, it is necessary to multiply the option's intrinsic value by one-third to arrive at the tax base of the employee services received in year 1.

- After the second year the tax base is CU800 ((CU16 share price − CU10 exercise price) × 20 employees × 10 shares × 2 years ÷ 3 years).
- After the third year the tax base is CU1,800 ((CU19 share price − CU10 exercise price) × 20 employees × 10 shares).
- After the fourth year the tax base is CU1,600 ((CU18 share price − CU10 exercise price) × 20 employees × 10 shares).

The tax base will change as the valuation of the share price changes until the options are exercised.

29.12 Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. In **consolidated financial statements**, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. The tax base is determined by reference to a consolidated tax return in those jurisdictions in which such a return is filed. In other jurisdictions, the tax base is determined by reference to the tax returns of each entity in the **group**.

Notes—Step 2 temporary differences

A temporary difference is the difference between the carrying amount of an asset or liability and its tax base. Deferred tax is calculated on those temporary differences that are taxable temporary differences and deductible temporary differences.

In consolidated financial statements (financial statements for a parent and its subsidiaries (a group) as though the group were a single economic entity), the carrying amount to be used to calculate temporary differences is the carrying amount in the consolidated financial statements even if this differs from the carrying amount of the same asset or liability in the financial statements of the individual entity. For example, a subsidiary may own an asset it carries in its statement of financial position at the asset's historical cost of CU500, but that is carried in the consolidated statement of financial position at CU700. The difference is due to fair value adjustments arising on the parent's acquisition of the subsidiary. When calculating deferred tax for inclusion in the consolidated financial statements the carrying amount of CU700 is used but when calculating deferred tax for inclusion in the subsidiary's individual financial statements, if presented, the carrying amount of CU500 is used.

The future tax deductions used to calculate the tax base, and thus to calculate the temporary difference, are those available in the relevant jurisdiction.

Some tax jurisdictions permit a group to elect to be treated as a single entity for tax purposes. If the group so elects, it will prepare a single consolidated annual tax return rather than preparing a separate tax return for each group entity.

Consequently, in the consolidated financial statements:

- If the entity files a consolidated tax return, the group must follow the tax laws governing the consolidated tax return when determining the tax base of an asset or liability.
- If the group files separate tax returns for different group entities, the group must follow the tax laws governing the relevant separate tax return for an item when determining the tax base of an asset or liability. For example, if an item of property in the consolidated financial statements belongs to a subsidiary in the group, the tax laws governing the subsidiary's separate tax return will be followed in determining the tax base of the property.

Examples— Step 2 temporary differences

Ex 42 **The facts are the same as in Example 16. That is, an entity has interest income receivable from a bank of CU5,000. The interest income is taxable when received in cash.**

The expected manner of recovery of the asset, the receipt of cash, is taxable; the full amount of CU5,000 is taxable on receipt of the cash from the bank. No amount is deductible for tax purposes when the interest income is received. Consequently, the tax base is nil.

The temporary difference is therefore CU5,000 (CU5,000 carrying amount of the interest income receivable less tax base of nil).

Ex 43 **The facts are the same as in Examples 15–41.**

The following table shows the tax base and the temporary difference for each of Examples 15–41:

Example number	Brief facts	Carrying amount Asset/(Liability)	Tax base	Temporary difference* = Carrying amount less tax base
		CU	CU	CU
15	Amount receivable from customer. Taxed when recognised as income. No bad or doubtful debts.	5,000	5,000	Nil
16	Interest income receivable. Taxable when received.	5,000	Nil	5,000
17	Dividends receivable. Not taxable.	5,000	5,000	Nil
18	Cash at bank. No tax arises.	5,000	5,000	Nil
19	Inventory. Tax deductible when sold.	10,000	10,000	Nil
20	Investment property (land) measured at fair value. No tax on sale.	210,000	210,000	Nil
21	Investment property (land) measured at fair value. Taxable on sale.	210,000	201,000	9,000

Example number	Brief facts	Carrying amount Asset/(Liability)	Tax base	Temporary difference* = Carrying amount less tax base
22	Machinery. Tax depreciation equals accounting depreciation.	75,000	75,000	Nil
23	Machinery. Accelerated tax depreciation.	75,000	50,000	25,000
24	Rental prepayment. Tax deductible when recognised as an expense.	60,000	60,000	Nil
25	Investment—shares. Measured at fair value. Tax deduction on sale.	1,000	800	200
26	Investment—shares in overseas company. Equity method of accounting. Tax deduction on sale.	11,000	10,000	1,000
27	Licence—amortised over 10 years. No tax deduction on sale.	4,500	Nil	4,500
28	Trade receivables less allowance for bad and doubtful debts. Bad and doubtful debts tax deductible in following year.	48,000	50,000	(2,000)
	Bad and doubtful debts tax deductible when recognised.	48,000	48,000	Nil
29	Liability for fines/penalties. Not tax deductible.	(100)	(100)	Nil
30	Warranty provision. Tax deductible when paid/used.	(1,000)	Nil	(1,000)
31	Bank loan. No tax arises.	(50,000)	(50,000)	Nil

Example number	**Brief facts**	**Carrying amount** Asset/(Liability)	**Tax base**	**Temporary difference*** = Carrying amount less tax base
32	Payable to supplier. Tax deduction when goods sold.	(1,000)	(1,000)	Nil
33	Payable to employee. Tax deductible when recognised.	(10,000)	(10,000)	Nil
	Tax deductible when paid.	(10,000)	Nil	(10,000)
34	Liability for accrued holiday pay. Tax deductible when holiday is taken or when pay in lieu of leave given.	(500)	Nil	(500)
35	Foreign currency bank borrowings. Accrued exchange gain of CU800. Exchange gains/losses are taxable/tax deductible when loan repaid.	(7,200)	(8,000)	800
36	Deposit from customer. Taxable income arises on sale of goods to customer.	(5,000)	(5,000)	Nil
37	One year subscription fee received in advance. Taxed when cash received.	(800)	Nil	(800)
38	Rent paid in arrears. Tax deductible when paid in cash.	(10,000)	Nil	(10,000)
39	Liability for contributions to a pension fund. Tax deductible when the entity pays the retirement benefits or pays contributions to a fund.	(25,000)	Nil	(25,000)

Example number	Brief facts	Carrying amount Asset/(Liability)	Tax base	Temporary difference* = Carrying amount less tax base
40	Research & development expenses. Tax deductible in a later year.	Nil	500	(500)
41	Employee share options conditional on 3 years' service. Tax deduction equals intrinsic value at date of exercise. Assume are at end of Year 1.	Nil	200	(200)

* A positive temporary difference is a taxable temporary difference and a negative temporary difference is a deductible temporary difference. Not all temporary differences will result in deferred tax being recognised in the statement of financial position—see paragraphs 29.14, 29.16 and 29.31.

Ex 44 **A parent entity has several subsidiaries. On 31 December 20X1, the last day of its accounting period, it acquired an additional subsidiary. The subsidiary has a property with a carrying amount of CU10,000 in its financial statements; the property was recognised in the consolidated financial statements at CU15,000. The group files separate tax returns for each individual entity in the group. The property has accelerated tax depreciation and at 31 December 20X1 there are no remaining future tax deductions for the property.**

The tax base of the property is determined by the tax law governing the subsidiary's individual tax return. There are no further future tax deductions. Consequently the tax base is nil for the purposes of calculating deferred tax in both the subsidiary's individual financial statements and in the consolidated financial statements.

The temporary difference for the subsidiary's individual financial statements is CU10,000 (CU10,000 carrying amount less nil tax base). In the consolidated financial statements, the temporary difference is CU15,000 (CU15,000 carrying amount less nil tax base).

Ex 45 **A parent entity has several subsidiaries. One subsidiary transfers a property with a carrying amount of CU10,000 to the parent entity for CU15,000. The group files a consolidated tax return. Future tax deductions in the consolidated tax return for the property amount to CU4,000 and remain unchanged as a result of the transfer from one subsidiary to another.**

In accordance with Section 9 *Consolidated and Separate Financial Statements*, the unrealised profit of CU5,000 is eliminated from the consolidated financial statements. Consequently, the carrying amount for the property in the consolidated financial statements is CU10,000 both immediately before and immediately after the transfer.

The tax base of the property is determined by the tax law governing the consolidated tax return. In the consolidated financial statements, the tax base is CU4,000, the amount of future deductions.

The temporary difference is CU6,000 (CU10,000 carrying amount less CU4,000 tax base) both immediately before and immediately after the transfer.

Ex 46 **The facts are the same as in Example 45. However, the parent entity and each individual subsidiary file their own separate tax return. Future tax deductions available to the subsidiary for the property, had it not transferred the property, would have been CU4,000. Future tax deductions available to the parent at the date of transfer amount to CU15,000.**

In accordance with Section 9 *Consolidated and Separate Financial Statements*, the unrealised profit of CU5,000 is eliminated from the consolidated financial statements. Consequently, the carrying amount for the property in the consolidated financial statements is CU10,000 both immediately before and immediately after the transfer.

The tax base is determined by the tax laws governing each tax return. In this case the tax base of the property will be determined by the parent's tax jurisdiction after the transfer whereas it was determined by reference to the subsidiary's tax jurisdiction and tax return prior to the transfer. After the transfer the temporary difference will change because the tax base changes. Immediately before the transfer the tax base would have been CU4,000 and the temporary difference would have been CU6,000 (CU10,000 - CU4,000). Immediately after the transfer the tax base would be CU15,000 and the temporary difference would be CU(5,000) (CU10,000 - CU15,000). However, there will be a taxable profit arising in the subsidiary's single entity financial statements.

29.13 Examples of situations in which temporary differences arise include:

(a) the identifiable assets acquired and liabilities assumed in a **business combination** are recognised at their **fair values** in accordance with Section 19 *Business Combinations and Goodwill*, but no equivalent adjustment is made for tax purposes (for example, the tax base of an asset may remain at cost to the previous owner). The resulting deferred tax asset or liability affects the amount of **goodwill** that an entity recognises.

(b) assets are remeasured but no equivalent adjustment is made for tax purposes. For example, this Standard permits or requires certain assets to be remeasured at fair value or to be revalued (for example, Section 16 *Investment Property* and Section 17 *Property, Plant and Equipment*).

(c) goodwill arises in a business combination, for example, the tax base of goodwill will be nil if taxation authorities do not allow the **amortisation** or the **impairment** of goodwill as a deductible expense when taxable profit is determined and do not permit the cost of goodwill to be treated as a deductible expense on disposal of the subsidiary.

(d) the tax base of an asset or a liability on initial recognition differs from its initial carrying amount.

(e) the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures becomes different from the tax base of the investment or interest.

Not all of these temporary differences will give rise to deferred tax assets and liabilities (see paragraphs 29.14 and 29.16).

Notes—Step 2 temporary differences

A temporary difference is the difference between the carrying amount of an asset or liability and its tax base—see paragraph 29.12. Deferred tax is calculated on those temporary differences that are taxable temporary differences and deductible temporary differences.

Some temporary differences that arise are timing differences; they arise because tax deductions or charges are available in a different accounting period than the expense or income is recognised.

The following are examples of temporary differences that are timing differences:

(a) An expenditure is deductible for tax purposes later than when it is recognised as an expense for financial reporting purposes. For example:
 (i) pension or other employee benefit cost is recognised as an expense in accounting profit over the periods of employee service, but, in some jurisdictions, is deductible for tax purposes only in future periods when contributions or payments are made (see Example 39 within Example 43);
 (ii) warranty expense is recognised in accounting profit when the related sales are made, but, in some jurisdictions, is deductible for tax purposes only when paid (see Example 30 within Example 43); and
 (iii) bad debts expense is recognised in accounting profit when the accounts receivable are estimated to be uncollectible, but, in some jurisdictions, is tax-deductible only at a later date, for example, when the debt is overdue by a specific amount of time or when a customer enters formal bankruptcy proceedings (see Example 28 within Example 43).

(b) Income is taxable earlier than when it is recognised for financial reporting purposes. For example:
 (i) advance payments received from customers, but that do not yet qualify for recognition as revenue in accordance with the *IFRS for SMEs* Standard, are, in some jurisdictions, taxed on a cash basis (see Example 37 within Example 43); and
 (ii) intra-group profits in inventories, unrealised at the group level, are reversed on consolidation but, in some jurisdictions, are taxed on transfer date.

(c) Income is taxable later than when it is recognised for financial reporting purposes. For example:
 (i) interest income is accrued and recognised in one period but is taxed in the following period when it is received in cash (see Example 16 within Example 43);
 (ii) revenue is recognised in accounting profit by reference to the stage of completion of a contract or transaction (sometimes referred to as the percentage of completion method), but in some jurisdictions, for tax purposes, revenue is taxable only when the contract or transaction is completed; and
 (iii) an exchange gain on a foreign currency loan is taxable when the loan is repaid by the entity whereas it is recognised for financial reporting purposes when it arises (see Example 35 within Example 43).

(d) An expense is deductible for tax purposes earlier than when it is recognised as an expense for financial reporting purposes. For example, in some jurisdictions an asset is depreciated more rapidly for tax purposes than for financial reporting purposes (see Example 23 within Example 43).

The examples of circumstances giving rise to temporary differences listed in paragraph 29.13 are situations where there is no timing difference; instead, the part of the carrying amount of the asset or liability that gives rise to the temporary difference is not tax deductible at all. Not all of these temporary differences will give rise to deferred tax assets or liabilities because there are some exemptions—see paragraphs 29.14 and 29.16.

Examples—Step 2 temporary difference that is not a timing difference

Ex 47 **Entity X holds an inventory of finished goods on 31 December 20X1 at a cost of CU10,000. Items of inventory are deductible for tax purposes when they are sold. The deduction is equal to the cost of the items. On 31 December 20X1 Entity Y purchased the whole of the issued share capital of Entity X and Entity X became a subsidiary of Entity Y. When accounting for the acquisition of Entity X in its consolidated financial statements, Entity Y measured the inventory at its fair value of CU12,000.**

Each entity in the group submits its own tax return. The tax deduction available when Entity X sells the inventory is unchanged as a result of the change in ownership of Entity X.

The expected manner of recovery of the inventory, that is, through sale, is taxable. Revenue from selling the inventory will give rise to taxable income. When Entity X submits its tax return, the tax authorities permit a deduction on the sale of the inventory equal to the carrying amount of the inventory (CU10,000).

Consequently, when preparing Entity X's individual financial statements the tax base of the inventory is CU10,000 and the temporary difference is nil. That is, there is no temporary difference.

When preparing Entity Y's consolidated financial statements the tax base of the inventory is CU10,000 and the temporary difference is CU2,000 (carrying amount of CU12,000 less tax base of CU10,000). That is, the temporary difference equals the uplift in carrying amount that is recognised when Entity Y accounts for the acquisition of Entity X.

Assume the inventory is sold for CU12,000 in January 20X2. When the inventory is sold:

(a) in Entity X's financial statements, a profit of CU2,000 will be recognised in profit or loss and tax on this profit will be recognised in current tax.

(b) in Entity Y's consolidated financial statements, no profit on sale will be recognised in profit or loss because sales revenue of CU12,000 will equal the inventory expense of CU12,000. However, current tax will include tax on the CU2,000 profit made by Entity X. Consequently reversing a deferred tax provision (which was set up in Entity Y's consolidated financial statements as part of the fair value exercise on acquisition of Entity X) would allow an equal and opposite amount of tax to be recognised in profit or loss, thus giving an overall (current and deferred tax combined) tax effect in profit or loss of nil.

Ex 48 **An entity acquired a plot of land for CU10,000 on 1 March 20X1. The land was acquired for rental to third parties and meets the definition of investment property. On sale of the land, the tax authorities will permit its cost of CU10,000 to be deducted from the sales proceeds. Any increases in the value of the land are not taxed by the tax authorities while it remains unsold.**

On 31 December 20X1 the entity was able to measure the fair value of the land reliably without undue cost or effort. The fair value was CU10,500. In accordance with Section 16, the entity recognised the land in its statement of financial position at CU10,500 and recognised the increase in value of CU500 in profit or loss.

Paragraph 29.30 states that '…if a deferred tax liability or asset arises from **investment property** that is measured at fair value, there is a rebuttable presumption that the carrying amount of the investment property will be recovered through sale. Accordingly, unless the presumption is rebutted, the measurement of the deferred tax liability or the deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the investment property entirely through sale…'.

The presumption can be rebutted 'if the investment property is depreciable and …'. Because land (other than leasehold land) is a non-depreciable asset (meaning it would not be depreciated if it was accounted for under Section 17 at cost), the presumption cannot be rebutted in this instance. Hence, the entity calculates deferred tax on the assumption that it expects to recover the carrying amount of the land through sale.

Recovery of the land through sale is taxable in the jurisdiction. The tax base of the land equals the future tax deduction of CU10,000, and the temporary difference is CU500 (carrying amount of CU10,500 less tax base of CU10,000). The temporary difference equals the uplift in the carrying amount of the land recognised when restating the land at its fair value.

Consequently, when preparing its financial statements the entity will recognise the increase in fair value of the land of CU500. No current tax will arise on the increase in value of the land as this is taxed only upon a sale of the land. However, the increase in deferred tax provision (from nil to tax on the temporary difference of CU500) will be recognised in profit or loss, thus having the tax effect of the increase in value recognised in the same accounting period as the increase in value.

Note: in some jurisdictions, the remeasurement of an asset or liability to fair value affects taxable profit for the current period. Had the tax authorities, in response to the recognised change in fair value, increased the deduction permitted on sale to CU10,500, the tax base at 31 December 20X1 would have been CU10,500 and no temporary difference would have arisen.

Ex 49 **The facts are the same as in Example 48 except that on sale of the land, the tax authorities permit its cost (CU10,000) as increased by a specified inflation index to be deducted from the sale proceeds.**

On 31 December 20X1 the indexed cost of the land was CU10,167.

At 31 December 20X1, the tax base of the land equals CU10,167 (the future tax deduction) and the temporary difference is CU333 (carrying amount of CU10,500 less tax base of CU10,167).

Ex 50 **An entity acquired an asset for CU5,000 on 1 March 20X1. The tax authorities will not permit any part of its cost to be deducted against taxable profits, either on disposal or as it is used in the business.**

At 31 December 20X1 the asset was recognised in the entity's statement of financial position at CU4,167.

The expected manner of recovery of the asset (that is, using it, in conjunction with other assets, as part of the entity's ordinary activities to generate operating profits (taxable income)) will give rise to taxable income. It is expected to generate taxable income at least equal to its carrying amount, but there are no tax deductions available. The tax base equals the future tax deductions and so is nil. The temporary difference therefore equals the carrying amount of CU4,167 at 31 December 20X1.

Taxable temporary differences

29.14 A deferred tax liability shall be recognised for all **taxable temporary differences**, except to the extent that the deferred tax liability arises from:

(a) the initial recognition of goodwill; or

(b) the initial recognition of an asset or a liability in a transaction that:
  (i) is not a business combination; and
  (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax liability shall be recognised in accordance with paragraph 29.25.

Notes—Step 3 taxable temporary differences

Taxable temporary differences are defined in the Glossary as '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'.

Taxable temporary differences are those temporary differences that will give rise to more tax being paid or to a reduction in tax losses in the future. As such, a deferred tax liability (rather than an asset) is recognised.

For assets in the statement of financial position, a taxable temporary difference arises when the carrying amount of the asset exceeds its tax base (for example, interest receivable which is taxed when cash is received). As the carrying amount of the asset is recovered, the economic benefits that are subject to tax (in the example, the carrying amount of interest receivable) will exceed the future tax deductions available (that is, the tax base, which in the example of the interest receivable is nil). This gives rise to a deferred tax liability in respect of additional taxes, which will be payable in future periods.

For liabilities in the statement of financial position, a taxable temporary difference arises when the tax base of the liability exceeds its carrying amount (for example, a foreign currency loan payable that has been reduced for financial reporting purposes by an exchange gain that will be taxable when the loan is repaid). If the loan is settled at its carrying amount, a taxable gain will arise. Consequently, this gives rise to a deferred tax liability in respect of additional taxes that will be payable in future periods.

For other items that have a tax base but that are not recognised as assets and liabilities in the statement of financial position, a taxable temporary difference will arise if there is future taxable income.

The following table summarises when taxable temporary differences arise, although additional steps are required to determine whether deferred tax liabilities are recognised.

What is included in the statement of financial position	*Taxable temporary differences arises when:*
Asset	carrying amount of asset is **greater** than its tax base
Liability	carrying amount of liability is **lower** than its tax base
Nothing	there is future taxable income as a result of a past event, for example, income recognised in the income statement

A deferred tax liability is recognised for all taxable temporary differences other than one arising from the initial recognition of goodwill and other than on the initial recognition of an asset or liability that neither forms part of a business combination nor affects either accounting profit or taxable profit at the time of the transaction.

Goodwill is a residual; it is the difference between what was paid to acquire a business and the fair value of the identifiable assets, liabilities and contingent liabilities acquired. If after calculating the amount of goodwill, the deferred tax arising on the goodwill were to be calculated and recognised, it would necessitate altering the amount of goodwill recognised, which would necessitate altering the amount of deferred tax recognised. The exercise would continue. Therefore, as a practical expedient deferred tax is not recognised on the initial recognition of goodwill. That is, deferred tax may be recognised on fair value adjustments to identifiable net assets acquired in a business combination but will not be recognised on the goodwill arising in the business combination. If, subsequently, the tax authorities do not permit any deduction for the goodwill, either as an annual tax amortisation deduction as the goodwill helps generate profits or on ultimate disposal of the business, the goodwill will have no impact on deferred tax. However, if the tax authorities permit a deduction against taxable profits as an annual tax amortisation deduction and the timing of this does not exactly match the annual amortisation for financial reporting purposes, temporary differences (that are timing differences) arise and deferred tax is recognised. See Examples 51 and 52.

If a temporary difference arises on the initial recognition of an asset or liability that is neither part of a business combination nor affects either accounting profit or taxable profit at the time of the transaction, no deferred tax is recognised. See Examples 53 and 54.

Examples—Step 3 taxable temporary differences

Ex 51 **In a business combination an entity recognises goodwill of CU200. The tax authorities do not allow reductions in the carrying amount of goodwill as a deductible expense in determining taxable profit. The cost of the goodwill would also not be deductible if the underlying business were to be disposed of. The entity amortises the goodwill over 10 years.**

The goodwill has a tax base of nil. Consequently, there is a temporary difference of CU200. Paragraph 29.14(a) prohibits the entity from recognising the resulting deferred tax liability. If the entity subsequently recognises amortisation of CU20 for that goodwill, the temporary difference relating to the goodwill is reduced from CU200 to CU180, with a resulting decrease in the value of the unrecognised deferred tax liability. That decrease in the value of the unrecognised deferred tax liability is regarded as relating to the initial recognition of the goodwill. Consequently, deferred tax must not be recognised on the temporary difference; the temporary difference is part of the original unrecognised temporary difference.

Similarly, if an impairment of the goodwill is recognised, for example, an impairment loss of CU30 is recognised during Year 6, the CU30 decrease in the temporary difference and the corresponding decrease in the value of the unrecognised deferred tax liability are also regarded as relating to the initial recognition of the goodwill. Consequently, the entity does not recognise the deferred tax liability.

Ex 52 **In a business combination an entity recognises goodwill of CU200 that is deductible for tax purposes at a rate of 20% per year, starting in the year of acquisition. If the business to which the goodwill relates is sold, deductions of 100% of cost are available, but all previous deductions received for use must be returned (that is, there will be a clawback of all previous deductions for the amortisation of goodwill).**

The tax base of the goodwill is CU200 on initial recognition and CU160 at the end of the first year. The goodwill is amortised for financial reporting purposes over 10 years. At the end of the first year, the carrying amount of the goodwill is CU180.

Deferred tax assets and liabilities for temporary differences relating to goodwill are recognised to the extent that they do not arise from the initial recognition of goodwill. In this case there was no temporary difference (carrying amount of CU200 less tax base of CU200) on initial recognition. A temporary difference of CU20 (carrying amount of CU180 less tax base of CU160) arises at the end of the first year. This temporary difference cannot be part of an original unrecognised temporary difference because in this example there was no original unrecognised temporary difference. Instead, this temporary difference arises because the cost of the goodwill is deductible for tax purposes and the tax deductions are accelerated compared to the accounting deductions. Because the carrying amount of the asset (goodwill) is greater than the tax base, a deferred tax liability arises. For example, if the tax rate is 20%, a deferred tax liability of CU4 must be recognised.

Similarly, if an impairment of the goodwill is recognised, for example, an impairment loss of CU30 is recognised during Year 3, and the tax rate remains 20%, the deferred tax liability at the end of Year 3 will be CU6 lower than it would otherwise have been. The CU6 would form part of the movement in the deferred tax liability during the year and it would be recognised in profit or loss. As the impairment would also be recognised in profit or loss during Year 3, the impairment loss and the change in deferred tax, as a result of the impairment, would be recognised in the same accounting period.

Ex 53 **The facts are the same as in Example 27. On 1 January 20X1 an entity acquired a licence for CU5,000 that has a useful life of 10 years. The intangible asset is expected to be used for the full 10 years. At 31 December 20X1 its carrying amount is CU4,500. No tax deductions can be claimed on expiry, sale or amortisation of the licence.**

The expected manner of recovery of the intangible asset (that is, using it to generate operating profits (taxable income)) will give rise to taxable income. There are no tax deductions available on recovery of the asset. The tax base equals the future tax deductions and so is nil on both 1 January 20X1 and on 31 December 20X1. At 1 January 20X1 the temporary difference is CU5,000. However, a deferred tax liability is not recognised—such a liability arises on initial recognition of an asset that was not acquired in a business combination and it, at the time of its acquisition, neither affects accounting profit nor taxable profit.

Amortisation of CU500 is recognised in 20X1 and the temporary difference is reduced to CU4,500 by 31 December 20X1. The temporary difference of CU4,500 is part of the original temporary difference arising on initial recognition of the licence. Consequently, a deferred tax liability is not recognised.

Ex 54 **The facts are the same as in Example 53 except that the cost of the licence is deductible for tax purposes at a rate of 20% per year, starting in the year of acquisition. If the licence is sold, deductions of 100% of cost are available, but there will be a clawback of all previous deductions for the amortisation of the licence.**

Deferred tax assets and liabilities for temporary differences relating to assets are recognised to the extent that they do not arise from the initial recognition of an asset that was not acquired in a business combination and, at the time of the transaction, affects neither accounting profit nor taxable profit. In this case there was no temporary difference on initial recognition (carrying amount of CU5,000 less tax base of CU5,000). A temporary difference of CU500 (carrying amount of CU4,500 less tax base of CU4,000) arises at the end of the first year. This temporary difference cannot be part of an original unrecognised temporary difference because in this example there was no original unrecognised temporary difference. Instead this temporary difference arises because the cost of the licence is deductible for tax purposes and the tax deductions are accelerated compared to the accounting deductions. Because the carrying amount of the licence is greater than the tax base, a deferred tax liability arises. For example, if the tax rate is 20%, a deferred tax liability of CU100 must be recognised.

Similarly, if an impairment of the licence is recognised, for example, an impairment loss of CU800 is recognised during Year 4, and the tax rate remains 20%, the deferred tax liability at the end of Year 4 will be CU160 lower than it would otherwise have been. The CU160 would form part of the movement in the deferred tax liability during the year and it would be recognised in profit or loss. As the impairment would also be recognised in profit or loss during Year 4, the impairment loss and the change in deferred tax as a result of the impairment would be recognised in the same accounting period.

29.15 Some temporary differences arise when **income** or expense is included in accounting profit in one period but is included in taxable profit in a different period. Such temporary differences are often described as **timing differences**. The following are examples of temporary differences of this kind that are taxable temporary differences and that therefore result in deferred tax liabilities:

(a) interest revenue is included in accounting profit on a time-proportion basis but may, in some jurisdictions, be included in taxable profit when cash is collected. The tax base of any receivable with respect to such revenues is nil, because the revenues do not affect taxable profit until cash is collected.

(b) **depreciation** used when determining taxable profit (tax loss) may differ from that used when determining accounting profit. The temporary difference is the difference between the carrying amount of the asset and its tax base, which is the original cost of the asset less all deductions in respect of that asset permitted by the taxation authorities when determining taxable profit of the current and prior periods. A taxable temporary difference arises, and results in a deferred tax liability, when tax depreciation is accelerated. If the tax depreciation is less rapid than the accounting depreciation, a deductible temporary difference arises resulting in a deferred tax asset (see paragraph 29.16).

Notes—Step 3 taxable temporary differences

Temporary differences that are timing differences arise because tax deductions or charges are available in a different accounting period than the one in which the expense or income is recognised. For example, interest income of CU100 is recognised in one year but is not taxed until it is received, that is, in the following year.

Taxable temporary differences that are timing differences arise when:

(a) income is taxable after it is recognised for financial reporting purposes; and

(b) an expense is deductible for tax purposes before it is recognised as an expense for financial reporting purposes.

In addition to the examples in paragraph 29.15, the following are examples of *taxable* temporary differences that are timing differences:

(a) revenue is recognised in accounting profit by reference to the stage of completion of a contract or transaction (sometimes referred to as the percentage of completion method), but for tax purposes revenue is taxable only when the contract or transaction is completed; and

(b) an exchange gain on a foreign currency loan is taxable when the loan is repaid by the entity whereas it is recognised for financial reporting purposes when it arises (see Example 35 within Example 43).

An example of a temporary difference that is not a timing difference is a difference arising when an item of property, plant and equipment is revalued applying Section 17 but no equivalent adjustment is made for tax purposes. See paragraph 29.13 for other examples.

Deductible temporary differences

29.16 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or a liability in a transaction that:

(a) is not a business combination; and

(b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates and for interests in joint ventures, a deferred tax asset shall be recognised in accordance with paragraph 29.26.

Notes—Step 4 deductible temporary differences

Deductible temporary differences are defined in the Glossary as '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'.

Deductible temporary differences are those temporary differences that will give rise to less tax being paid in the future. As such, a deferred tax asset (rather than a liability) arises.

For assets in the statement of financial position, a deductible temporary difference arises when the tax base of the asset exceeds its carrying amount (for example, when a piece of land is carried at its fair value, which due to an economic downturn is below cost and tax allowances deductible on its sale equal the cost of the land). If the asset is settled at its carrying amount, a net deduction will arise. This gives rise to a deferred tax asset in the form of a reduction in taxes payable in future periods.

For liabilities in the statement of financial position, a deductible temporary difference arises when the carrying amount of the liability exceeds its tax base (for example, where a warranty expense and provision have been recognised but no tax deduction is available until the amount is paid or used). If the provision is settled at its carrying amount, a net deduction will arise. This gives rise to a deferred tax asset in the form of a reduction in taxes payable in future periods.

For other items that have a tax base but are not recognised as assets and liabilities in the statement of financial position, a deductible temporary difference will arise if there is expected to be a future tax deductible expense giving rise to a reduction in taxable profit in the future (for example, where research costs are recognised as an expense in determining accounting profit or loss but are not permitted as a deduction in determining taxable profit until a later period).

The following table summarises when deductible temporary differences arise, although additional steps are required to determine whether deferred tax assets are recognised.

What is included in the statement of financial position	*Deductible temporary differences arises when:*
Asset	carrying amount of asset is **lower** than its tax base
Liability	carrying amount of liability is **greater** than its tax base
Nothing	there is a future tax deductible expense as a result of a past event, for example, an expense recognised in the income statement

A deferred tax asset is recognised for all deductible temporary differences to the extent it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, except that a deferred tax asset is not recognised if it arises from the initial recognition of an asset or liability that neither forms part of a business combination nor affects either accounting profit or taxable profit at the time of the transaction.

A deferred tax asset can only be recognised to the extent it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. A future tax deduction is only beneficial, and consequently an asset, to an entity if it reduces future tax payments or results in a future tax loss that can be carried forward to a profitable year or can be carried back and recovered against taxable profit. In order to be able to recognise an asset for a deductible temporary difference, an entity is required to have determined it is probable that taxable profit will be available against which the deductible temporary difference can be utilised—some aspects of the application of this principle are discussed in paragraphs 29.18–29.20.

Probable is defined in the Glossary as 'more likely than not'; generally, more likely than not is interpreted as meaning a probability of more than 50%.

If a temporary difference arises on the initial recognition of an asset or liability that neither forms part of a business combination nor affects either accounting profit or taxable profit at the time of the transaction, no deferred tax is recognised.

29.17 The following are examples of deductible temporary differences that result in deferred tax assets:

(a) retirement benefit costs may be deducted when determining accounting profit at the time that the service is provided by the employee, but deducted when determining taxable profit either when contributions are paid to a fund by the entity or when retirement benefits are paid by the entity. A temporary difference exists between the carrying amount of the liability and its tax base; the tax base of the liability is usually nil. Such a deductible temporary difference results in a deferred tax asset because economic benefits will flow to the entity in the form of a deduction from taxable profits when contributions or retirement benefits are paid.

(b) certain assets may be carried at fair value, without an equivalent adjustment being made for tax purposes. A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.

Examples—Step 4 deductible temporary differences

Ex 55 **Research costs of CU3,000 are recognised as an expense in determining accounting profit or loss but are not permitted as a deduction in determining taxable profit until a later period.**

Although there is no asset or liability in the statement of financial position, a temporary difference of CU3,000 arises. This is the difference between the carrying amount of nil and the tax base of CU3,000. As future tax will be lower, this is a deductible temporary difference (although whether a deferred tax asset is recognised will depend on whether it is probable that taxable profit will be available against which the deductible temporary difference can be utilised—see Step 5).

This may be thought of in another way. Research costs are an asset for tax purposes (they are capitalised and amortised at a later date). For financial reporting purposes the entity has an asset with a carrying amount of zero. For an asset, if the carrying amount is less than the tax base (CU3,000) a deductible temporary difference arises.

Ex 56 **As in Example 41, an entity grants 10 share options to each of its 20 employees. Each grant is conditional upon the employee working for the entity over the next three years. The entity estimates that the fair value of each share option is CU9 on the grant date. The exercise price is CU10 and the share price at the end of Year 1 is estimated at CU13. Tax deductions will be received on exercise of the share options based upon the intrinsic value on the exercise date.**

After the first year a temporary difference of CU200 arises. This is the difference between the carrying amount of nil and the tax base of CU200. Similarly, the temporary differences after years two, three and four are CU800, CU1,800 and CU1,600 respectively (see Example 41). As future tax will be lower, these are deductible temporary differences.

29.18 The reversal of deductible temporary differences results in deductions when taxable profits of future periods are determined. It is probable that taxable profit will be available against which a deductible temporary difference can be utilised when there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity that are expected to reverse:

(a) in the same period as the expected reversal of the deductible temporary difference; or

(b) in periods into which a tax loss arising from the deferred tax asset can be carried back or forward.

In such circumstances, the deferred tax asset is recognised in the period in which the deductible temporary differences arise.

Notes—Step 5 extent to which it is probable that taxable profit will be available to utilise the deductible temporary differences

A future tax deduction is only beneficial, and consequently an asset, to an entity if it reduces future tax payments or results in a future tax loss that can be carried forward to a profitable year or can be carried back and recovered against taxable profit. In order to be able to recognise a deductible temporary difference as an asset, an entity is required to have determined that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised.

Probable is defined in the Glossary as 'more likely than not'; generally, more likely than not is interpreted as meaning a probability of more than 50%.

Paragraph 29.18 specifies that it is probable that taxable profit will be available when there are sufficient **taxable temporary differences relating to the same taxation authority and same taxable entity** that are expected to reverse in the same period as the deductible temporary differences are expected to reverse or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward.

Examples—Step 5 extent to which it is probable that taxable profit will be available to utilise the deductible temporary differences

Ex 57 **Entity X incurred research costs of CU3,000 during 20X1 and these were recognised as an expense in determining accounting profit or loss for 20X1. However, the research costs are not permitted as a deduction in determining taxable profit until 20X2. Entity X has no other deductible temporary differences arising in 20X1. Also arising in 20X1, and expected to reverse in 20X2, are taxable temporary differences of CU20,000. Entity X expects to have taxable profits of approximately CU100,000 for 20X1 and, before reflecting the research costs and the reversing taxable temporary differences, a similar amount of taxable profits for 20X2.**

The research expenditure of CU3,000 is tax deductible in 20X2. Entity X also expects to have taxable temporary differences of CU20,000 reversing in 20X2. The deductible temporary differences are less than the taxable temporary differences. Entity X therefore recognises in its 20X1 financial statements a deferred tax asset for the deductible temporary difference arising from the research costs, as well as a liability in respect of the taxable temporary differences.

Ex 58 **The facts are the same as in Example 57 except that the taxable temporary differences of CU20,000 arose in 20X0, not 20X1. The taxable temporary differences are still expected to reverse in 20X2. In addition, deductible temporary differences of CU12,000 arose in 20X0 that are expected to reverse in 20X2. There are no other taxable or deductible temporary differences.**

Although the taxable temporary differences that are expected to reverse in 20X2 did not arise in 20X1, to the extent they are in excess of other deductible temporary differences reversing in 20X2, they are available to be considered when looking at the recoverability of the research costs of CU3,000.

Of the CU20,000 taxable temporary differences, only CU12,000 are being used to support carrying the CU12,000 deductible temporary differences as an asset. As the excess of CU8,000 is greater than the research expenditure of CU3,000, Entity X recognises in its 20X1 financial statements a deferred tax asset for the deductible temporary difference arising from the research costs.

Ex 59 **Entity X recognises a warranty provision for CU50,000 to cover the repair of defective items sold prior to 31 December 20X1, its year end. The amount recognised as a provision is not deductible for tax purposes until it is actually paid or used.**

Entity X expects to utilise CU35,000 in 20X2 and to utilise CU15,000 in 20X3.

Entity X has no taxable temporary differences.

Entity X has generated tax losses, not profits, of approximately CU1,000,000 in each of the last two years and currently expects to generate a similar tax loss, not profit, in 20X1 and subsequent periods. Tax losses can be carried back for a maximum of two years and forward for a maximum of six years.

Entity X is a subsidiary of Entity Z. Entity Z has generated taxable profits each year and is expected to continue to generate taxable profits in future years in excess of Entity X's taxable losses.

Entity Z has taxable temporary differences arising in 20X1 from a number of different sources; CU45,000 is expected to reverse in 20X2 and CU15,000 in 20X3.

Entity X operates in Jurisdiction X and Entity Z and its five other subsidiaries operate in Jurisdiction Z. The tax authorities in both jurisdictions are separate.

The warranty provision of CU50,000 is expected to be tax deductible in 20X2 and 20X3. However, Entity X does not have any taxable temporary differences that will reverse in 20X2 or 20X3. Entity X does not expect to have any taxable profits in 20X2, 20X3 or any period in which it could benefit from tax losses by carrying them forward or backward.

The group overall does have net taxable profits and has taxable temporary differences that will reverse in 20X2 and 20X3. However, the taxable profits and the taxable temporary differences are generated by a different entity and in a different jurisdiction to the tax losses generated by Entity X.

Entity X therefore does not have the ability to benefit from the warranty provision recognised in 20X1.

Entity X would therefore not recognise a deferred tax asset in respect of the CU50,000 warranty provision in its 20X1 financial statements. Similarly a deferred tax asset would not be recognised in the consolidated financial statements of Entity Z for 20X1.

29.19 When there are insufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, the deferred tax asset is recognised to the extent that:

(a) it is probable that the entity will have sufficient taxable profit relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference (or in the periods into which a tax loss arising from the deferred tax asset can be carried back or forward). When evaluating whether it will have sufficient taxable profit in future periods, an entity ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from those deductible temporary differences will itself require future taxable profit in order to be utilised.

(b) tax planning opportunities are available to the entity that will create taxable profit in appropriate periods.

Notes—Step 5 extent to which it is probable that taxable profit will be available to utilise the deductible temporary differences

When evaluating whether it will have sufficient taxable profit in future periods, an entity ignores amounts arising from deductible temporary differences that are expected to *originate* in future periods, because the deferred tax asset arising from those deductible temporary differences will itself require future taxable profit in order to be utilised. In other words, an entity looks to expected current tax payable for a period when it is determining whether it will have sufficient taxable profit in that period to recover deductible temporary differences. However, in looking at the current tax payable, the entity should reflect any taxable and deductible temporary differences that will *reverse* in that period and thus be part of the current tax payable for that period.

Entities may also consider tax planning opportunities. For example, in some jurisdictions an entity may elect to have interest income taxed on a received or receivable basis. If changing the basis of taxation would permit a deductible item to be recovered when it otherwise would not be recoverable, the entity is permitted to recognise the deductible as an asset.

Tax planning opportunities are actions (including elections for tax purposes) that:

(a) are feasible and rational;

(b) an entity would take in order to create or increase taxable profit in a particular period before the expiry of a tax loss or tax credit carryforward; and

(c) would result in the realisation of deferred tax assets.

For example, in some jurisdictions, taxable profit may be created or increased by:

(a) accelerating taxable amounts to use expiring carryforwards (for example, by electing to have interest income taxed on either a received or receivable basis or by selling, and perhaps leasing back, assets that have appreciated but for which the tax basis has not been adjusted to reflect such appreciation);

(b) deferring the claim for some deductions from taxable profit;

(c) changing the character of taxable or deductible amounts (for example, from being taxable as part of profit to being taxable as a capital gain or loss); and

(d) switching from tax-exempt to taxable investments (for example, by selling an asset that generates non-taxable profit in order to purchase another investment that generates taxable profit).

Examples—Step 5 extent to which it is probable that taxable profit will be available to utilise the deductible temporary differences

Ex 60 **Entity X has deductible temporary differences arising in 20X1 of CU30,000 that it expects to reverse in 20X2. Taxable temporary differences totalling CU20,000 that arose in 20X1 and 20X0 are also expected to reverse in 20X2. There are no other taxable or deductible temporary differences. The estimated current tax calculation for 20X1 shows tax payable of CU150,000. The estimates for 20X2, excluding the effect of the taxable and deductible temporary differences, anticipate a similar level of taxable profits.**

Although Entity X has CU10,000 more deductible temporary differences expected to reverse in 20X2 than taxable temporary differences, Entity X is expected to generate tax profits in 20X2 significantly in excess of the shortfall. Consequently, Entity X expects to reduce its taxable profits in 20X2 by the CU10,000 excess and thus to pay less tax in respect of 20X2 than if it had not incurred the costs in 20X1. In other words, it is probable that Entity X will have sufficient taxable profit in 20X2 to benefit from the deductible temporary differences. In its 20X1 financial statements Entity X therefore recognises a deferred tax asset for the deductible temporary difference arising from the full CU30,000 (and not just CU20,000 of the CU30,000) cost.

Ex 61 **Entity X incurred research costs of CU3,000 during 20X1 and these were recognised as an expense in determining accounting profit or loss for 20X1. However, the research costs are not permitted as a deduction in determining taxable profit until 20X2. Entity X has no other deductible temporary differences and no taxable temporary differences arising in 20X1. Entity X has no taxable temporary differences which will reverse in 20X2. As a result of a major capital project, Entity X expects to have taxable losses (before taking account of the research costs) of approximately CU30,000 for 20X2. It expects to have taxable profits of CU100,000 or more in 20X3 and subsequent years. Tax losses can be carried forward six years.**

The research expenditure of CU3,000 is tax deductible in 20X2. However, Entity X expects to have taxable losses in 20X2 of approximately CU30,000, which will become CU33,000 after deducting the research costs. Because 20X2 is the only year in which Entity X expects to have tax losses and because tax losses can be carried forward for up to six years, Entity X still expects to receive the benefit of the research costs being tax deductible, by carrying forward to 20X3 the losses from 20X2, including the CU3,000 in respect of the research costs, and thereby reducing taxable profits in 20X3. Entity X therefore recognises a deferred tax asset in respect of the research costs in its 20X1 financial statements.

Ex 62 **Entity X recognises a warranty provision for CU50,000 to cover the repair of defective items sold prior to 31 December 20X1, its year end. The amount recognised as a provision is not deductible for tax purposes until it is actually paid or used. Entity X expects to utilise CU35,000 in 20X2 and to utilise CU15,000 in 20X3. Entity X also has taxable temporary differences arising in 20X1; CU30,000 are expected to reverse in 20X2 and CU8,000 in 20X3. Entity X has generated taxable profits of approximately CU1,000,000 in each of the last two years and currently expects to generate a similar tax profit in 20X1 and subsequent periods.**

The amount of taxable temporary differences arising in 20X1 and expected to reverse in 20X2 are CU5,000 less than the deductible temporary differences arising in 20X1 and expected to reverse in 20X2. The shortfall for those arising in 20X1 and expected to reverse in 20X3 is CU7,000.

Although more deductible than taxable temporary differences are expected to reverse in both years, Entity X is expected to generate tax profits in each year significantly in excess of the shortfall. Consequently, using the general principle that a deferred tax asset shall be recognised for deductible temporary differences to the extent it is probable that taxable profit will be available against which the deductible temporary differences can be utilised, Entity X would recognise a deferred tax asset in its 20X1 financial statements for the deductible temporary difference arising from the full warranty provision.

29.20 When an entity has a history of recent losses, the entity considers the guidance in paragraphs 29.21–29.22.

Notes—Step 5 extent to which it is probable that taxable profit will be available to utilise the deductible temporary differences

Paragraphs 29.21 and 29.22 set out guidance for an entity to apply when assessing the probability that it will have taxable profit available against which unused tax losses and unused tax credits can be utilised. This guidance should also be considered by an entity with a history of recent losses when assessing the probability that it will have taxable profits available against which deductible temporary differences can be utilised.

Example—Step 5 deductible temporary differences

Ex 63 **The facts are the same as in Example 62 except that Entity X has generated tax losses, not profits, of approximately CU1,000,000 in each of the last two years and currently expects to generate a similar tax loss, not profit, in 20X1 and subsequent periods. Tax losses can be carried back for a maximum of two years and forward for a maximum of six years.**

The shortfall of taxable temporary differences arising in 20X1 is expected to lead to additional tax losses because Entity X has generated significant tax losses in the last two years and is expected to do so in the current and future years.

Although Entity X will generate additional tax losses, this is only to the extent of the shortfall of taxable temporary differences over deductible temporary differences. In accordance with paragraph 29.14 a deferred tax liability will be recognised in 20X1 for the CU38,000 taxable temporary differences arising. The deferred tax liability is available to utilise CU38,000 of the deductible temporary differences. A corresponding deferred tax asset may therefore be recognised for CU38,000 of the deductible temporary differences.

Because it is not probable that there will be taxable profit available to utilise the CU12,000 that is in excess of the taxable temporary differences, Entity X may not recognise a deferred tax asset for the CU12,000.

In its 20X1 financial statements Entity X would therefore recognise a deferred tax asset for only CU38,000 of the CU50,000 deductible temporary difference in respect of the warranty provision . Under certain circumstances, the deferred tax asset and the deferred tax liability, arising from the deductible and taxable temporary differences of CU38,000, must be offset—see paragraph 29.37.

Unused tax losses and unused tax credits

29.21 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. When assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, an entity considers the following criteria:

(a) whether the entity has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;

(b) whether it is probable that the entity will have taxable profits before the unused tax losses or unused tax credits expire;

(c) whether the unused tax losses result from identifiable causes which are unlikely to recur; and

(d) whether tax planning opportunities are available to the entity that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

To the extent that it is not probable that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the deferred tax asset is not recognised.

Notes—Steps 6 & 7 unused tax losses and unused tax credits

A tax credit is a tax benefit that takes the form of an amount that reduces income taxes payable (the tax credit reduces the actual amount of tax that must be paid directly). Tax credits differ from tax deductions because a tax deduction reduces taxable profits (note: tax payable for the year = taxable profits × tax rate). Tax credits may appear to meet the definition of a government grant. Section 24 *Government Grants*, however, specifically excludes from its scope government assistance that is provided for an entity in the form of benefits limited on the basis of the income tax liability (see paragraph 24.3). Consequently, the requirements of Section 29, not 24, apply in this case.

Unused tax credits that can be carried forward may give rise to a direct reduction in taxes payable in future periods. Where it is probable that future taxable profit will be available against which the unused tax credits can be utilised, a deferred tax asset is recognised.

A tax loss will arise in an accounting period where taxable income is negative (allowable deductions exceed the income that is taxable). Some tax laws allow entities to use a tax loss in one year to offset taxable profits in one or more prior years, in which case a current tax asset may be recognised in the period in which the tax loss occurs (see paragraph 29.5).

If the entity is unable to carry back the tax loss (for example, because it is not permitted by rules in the jurisdiction or the entity does not have enough taxable profits in prior years to offset the entire loss) the entity may be able to carry the tax loss forward with or without a time limit and set the tax loss against taxable income in a future period. Where tax losses can be carried forward against taxable profits of future periods, a reduction in future tax payments may be available. If tax losses may only be carried forward a specified number of years, say, two years, in a jurisdiction and taxable profits are not expected within this timeframe then the benefit of the losses in reducing future taxable profit is not available to the entity.

A deferred tax asset is recognised in respect of unused tax losses available to carry forward to the extent it is probable that future taxable profit will be available against which the unused tax losses can be utilised.

If the entity is unable to either carry forward or carry back the loss, the tax loss is not usable and so it is lost.

Paragraph 29.21 sets out four criteria an entity must consider when assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised. These are:

(a) whether the entity has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;

(b) whether it is probable that the entity will have taxable profits before the unused tax losses or unused tax credits expire;

(c) whether the unused tax losses result from identifiable causes which are unlikely to recur; and

(d) whether tax planning opportunities are available to the entity that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

Examples—Steps 6 and 7 unused tax losses and unused tax credits

Ex 64 **An entity calculates its taxable income to be negative CU9,000 (a tax loss of CU9,000) for the tax period 20X7/20X8 in accordance with the relevant tax rules in its jurisdiction. The tax legislation in the jurisdiction does not permit entities to carry back tax losses. The tax rate in the jurisdiction is 30% (assume for simplicity that this is the rate expected to apply in the period when the tax loss of CU9,000 is expected to be used—measurement is discussed under paragraphs 29.27–29.33). The loss has arisen in 20X7/20X8 due to a specific capital intensive project that has given rise to large deductions from taxable profit; such large deductions are not expected to reoccur in future years. The entity generated taxable profits of approximately CU100,000 in each of the last five years and is expected to do so in future years.**

The entity expects to utilise the tax loss to reduce taxable profit in 20X8/20X9, the immediately following year. The losses arose from an identifiable cause and are not expected to be repeated in future periods. The amount of taxable profit in previous years was significantly higher than the losses and this is expected to be the position in future years; as the losses are expected to be a one-off, it is probable there will be sufficient taxable profit available against which the losses can be utilised. Hence a deferred tax asset of CU2,700 (CU9,000 × 30%) should be recognised in respect of a reduction in taxes payable in future periods.

Ex 65 **In an entity's jurisdiction, in the 20X7/20X8 tax year the government provided all entities with a tax credit of CU3,000 which can be set off against income tax in that year for each additional full-time employee hired in the year. The entity hired two new full-time employees and is therefore entitled to tax credits worth CU6,000. If tax credits cannot be used in the current tax year they may be carried forward to future tax years, up to a maximum of four years. In 20X7/20X8 taxable profits are CU10,000. The tax rate in the jurisdiction for 20X7/20X8 and subsequent years is 25%.**

Current tax payable in 20X7/20X8 is CU2,500 (CU10,000 × 25%). Consequently, the entity can only use CU2,500 of its tax credits to offset current tax for the year. The remaining CU3,500 is available to be carried forward to a future period. A deferred tax asset of CU3,500 would be recognised if the entity considered it probable that sufficient taxable profit would be available in 20X8/X9 to 20Y1/Y2. In making this assessment the entity is likely to look at the level of taxable profit in recent years and to look at budgets for future years and compare these to recent trading results (and how the results related to taxable profits in those years).

Note: the tax rate need not be applied to the tax credit in determining the deferred tax asset because the tax credit is available for offset directly against tax payable, rather than against taxable income.

Ex 66 **An entity has tax losses carried forward of CU200,000 and is not expected to return to profitability in the next few years. The entity has negligible temporary differences that are expected to increase taxable profit in the future.**

The entity owns two office buildings together with their plots of land, which are measured at depreciated cost in accordance with Section 17 ***Property, Plant and Equipment*****. The first building has plenty of excess space. The entity could sell the second building and move all its staff into the first building. The second building has a depreciated cost of CU300,000 and a tax base of CU280,000. However, the market value of the property is CU1,000,000. The tax losses arising from trading can be used to offset against any taxable profit arising on sale of the building. The entity has a tax planning strategy to sell the second building and land if necessary to prevent the carried-forward losses from expiring unused. The tax rate is 40%.**

The entity may recognise a deferred tax asset of CU80,000 (CU200,000 tax losses carried forward × 40%) if it is probable that the tax planning will generate taxable profits within the relevant time frame for the tax losses to be utilised. Judgement is required to determine whether it is probable that the tax planning will generate taxable profits within the relevant time frame for the tax losses to be utilised because selling land and buildings is not a simple automatic process.

29.22 The existence of unused tax losses is strong evidence that future taxable profit may not be available. Consequently, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or to the extent that there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity.

Notes—Steps 6 and 7 unused tax losses and unused tax credits

When an entity has unused tax losses it has a bigger hurdle to overcome in order to recognise a deferred tax asset for tax losses or unused tax credits. This is because the very existence of the unused losses gives rise to a starting presumption that there may be insufficient future taxable profit available to recognise a deferred tax asset.

An entity with a history of recent tax losses recognises a deferred tax asset arising from unused tax losses or unused tax credits only to the extent it has:

(a) sufficient taxable temporary differences; or

(b) convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity.

Examples—Steps 6 and 7 unused tax losses and unused tax credits

Ex 67 **Entity X has taxable temporary differences, totalling CU20,000, that arose in 20X1 and are expected to reverse in 20X2. There are no other taxable or deductible temporary differences. At the start of 20X1 the entity had unused tax losses brought forward of CU500,000. The estimated current tax calculation for 20X1 shows tax losses of CU150,000 and the estimates for 20X2, excluding the effect of taxable and deductible temporary differences, anticipate a similar level of taxable losses. Tax losses can be carried forward for a maximum of three years. The tax rate in the jurisdiction for 20X1 and subsequent years is 25%.**

Entity X recognises, in its 20X1 financial statements, a deferred tax liability of CU5,000 (CU20,000 x 25%) in respect of the taxable temporary differences arising in 20X1. Entity X also recognises a deferred tax asset of CU5,000 (CU20,000 x 25%) in respect of CU20,000 of the tax losses generated in 20X1. The deferred tax liability and the deferred tax asset are likely to be offset—see paragraph 29.37.

Because Entity X is not expecting to generate taxable profits for at least four years, it does not recognise a deferred tax asset for any of the other CU130,000 of the tax losses it generated in 20X1.

Ex 68 **The facts are the same as in Example 67 except that on the last day of 20X1 Entity X purchased the trade and assets of another business operating in the same jurisdiction. That business had been generating significant taxable profits, in excess of CU200,000, in each of the recent years. Entity X's business plans are such that the business should continue to be highly profitable.**

Entity X is now expecting to generate taxable profits (all in one tax jurisdiction) in 20X2 and beyond. It will need to analyse its plans and carefully schedule its expected results. It may be able to recognise a deferred tax asset for some of the other CU130,000 of the tax losses it generated in 20X1.

Reassessment of unrecognised deferred tax assets

29.23 At the end of each **reporting period**, an entity reassesses any unrecognised deferred tax assets. The entity recognises a previously unrecognised deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Notes—Step 10 reassess unrecognised deferred tax assets

It might be that at the start of the year an entity had unrecognised deferred tax assets and some or all of the deferred tax assets are recognised at the year end because it is now probable that there will be future taxable profit available to utilise some or all of the deductible temporary differences, unused tax losses or unused tax credits. Step 10 is about identifying the unrecognised deferred tax assets at the start of the year and determining whether they are still unrecognised at the end of the year. If they are recognised at the end of the year this step is necessary to identify them for disclosure purposes, see paragraph 29.39(e).

Example—Step 10 reassess unrecognised deferred tax assets

Ex 69 **The facts are the same as in Example 67 except that taxable temporary differences of CU30,000 arose in 20X2, which will reverse in 20X3, and Entity X's major competitor ceased trading in the middle of 20X2. As a consequence, Entity X generated a small taxable profit of CU15,000 in 20X2.**

At the start of 20X2, Entity X had unrecognised deferred tax assets of CU157,500 ((CU130,000 x 25%) + (CU500,000 x 25%)).

In its 20X2 financial statements, Entity X recognises a deferred tax liability of CU7,500 (CU30,000 x 25%) in respect of the taxable temporary differences arising in 20X2. Entity X also recognises a deferred tax asset of CU7,500 (CU30,000 x 25%) in respect of CU30,000 of the tax losses brought forward at the start of 20X2.

Entity X will also recognise a current tax credit of CU3,750 (CU15,000 x 25%) in respect of CU15,000 of the tax losses brought forward at the start of 20X2.

Entity X considers whether it can recognise a deferred tax asset for any of the remaining CU146,250 (CU157,500 - CU7,500 - CU3,750) of unrecognised deferred tax assets brought forward. Entity X needs to assess how likely it is that it will make trading profit in 20X3.

Investments in subsidiaries, branches and associates and interests in joint ventures

29.24 Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates and interests in joint ventures (for example, in the **parent**'s consolidated financial statements the carrying amount of a subsidiary is the net consolidated assets of that subsidiary, including the carrying amount of any related goodwill) becomes different from the tax base (which is often cost) of the investment or interest. Such differences may arise in a number of different circumstances, for example:

(a) the existence of undistributed profits of subsidiaries, branches, associates and joint ventures;

(b) changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and

(c) a reduction in the carrying amount of an investment in an associate to its **recoverable amount**.

Investments may be accounted for differently in the parent's **separate financial statements** compared to the consolidated financial statements, in which case the temporary difference associated with that investment may also differ. For example, in the parent's separate financial statement the carrying amount of a subsidiary will depend on the accounting policy chosen in paragraph 9.26.

29.25 An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied:

(a) the parent, investor or **venturer** is able to control the timing of the reversal of the temporary difference; and

(b) it is probable that the temporary difference will not reverse in the foreseeable future.

29.26 An entity shall recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates and interests in joint ventures, only to the extent that it is probable that:

(a) the temporary difference will reverse in the foreseeable future; and

(b) taxable profit will be available against which the temporary difference can be utilised.

Notes—Steps 1 to 5 determining and recognising temporary differences for investments in subsidiaries, branches, associates and interests in joint ventures

Temporary differences arise when the carrying amount of an investment in a subsidiary, branch, associate or a joint venture in the consolidated financial statements, or in separate financial statements, differs from the tax base of the investment. A temporary difference would arise in consolidated financial statements when the parent's share of the net assets of a subsidiary or associate, including the carrying amount of goodwill, differ from the tax base of the investment. The most common reason for this is the existence of undistributed profits in the investee. The tax base of an investment will often be cost or indexed cost. Consequently, there may be no temporary difference for investments in associates or joint ventures that are measured at cost in accordance with Sections 14 or 15 and for investments in subsidiaries, associates or joint ventures that are measured in separate financial statements at cost in accordance with Section 9.

A temporary difference between the carrying amount of the investment and its tax base (sometimes referred to as an 'outside' temporary difference) would normally arise from the perspective of the investor (for example, the parent entity), giving rise to tax payable or recoverable by the investor. This temporary difference is in addition to the temporary differences relating to the investee's underlying assets and liabilities, such as might arise on an item of plant owned by a subsidiary (sometimes referred to as 'inside' temporary differences), which arise from the perspective of the investee, giving rise to tax payable or recoverable by the investee (for example, by a subsidiary).

A temporary difference between the carrying amount of an investment and its tax base (an outside temporary difference) would normally arise from the perspective of the investor, say, the parent entity, and may arise in various circumstances; for example:

(a) the existence of undistributed profits of a subsidiary (where the subsidiary's profits have been consolidated);

(b) the existence of undistributed profits of associates or joint ventures where the equity method is applied (that is, where equity accounting has been applied to the investee's profits);

(c) changes in the fair value of investments in associates or joint ventures where the investment is remeasured at fair value (if the fair value model is applied) but in respect of which no equivalent adjustment is made for tax purposes;

(d) changes in foreign exchange rates when a parent and its investee have different functional currencies (only subsidiaries and associates/joint ventures accounted for using equity accounting);

(e) a reduction in the carrying amount of an investment in an associate or joint venture to its recoverable amount due to impairment (only where such investments are accounted for using the cost model or equity accounting); or

(f) changes in the tax base of the investment (for example, due to indexation allowances).

The carrying amount of an investment may differ between consolidated financial statements and separate financial statements, for example, a subsidiary will be consolidated in consolidated financial statements but may be recognised at cost in separate financial statements. Where this is the case, there will be one (outside) temporary difference in the consolidated financial statements and a different, or no, (outside) temporary difference in the separate financial statements because there will only be one tax base for the investment.

With regard to the consolidated financial statements, the carrying amount is the parent's share of the carrying amount of a subsidiary's assets and liabilities as included in the consolidated financial statements (that is, after adjusting for any fair value adjustments) and includes any goodwill arising on consolidation.

Temporary differences also can arise whenever there are tax consequences of remitting income from one part of an entity to another, for example when there are tax branches that are not separate subsidiaries. Such temporary differences would be dealt with in the same way as temporary differences on investments in subsidiaries.

An entity is required to recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches, and associates and interests in joint ventures unless the exception in paragraph 29.25 applies. That is, a deferred tax liability is not recognised if the parent, investor or venturer can control the timing of the reversal of the temporary difference, such as one arising as a result of unremitted earnings, and it is probable that the temporary difference will not reverse in the foreseeable future.

A deferred tax asset is recognised for deductible temporary differences associated with investments in subsidiaries, branches, and associates and interests in joint ventures only if it is probable that the temporary difference will reverse in the foreseeable future and that taxable profit will be available against which the temporary difference can be utilised.

The reversal of deductible temporary differences results in deductions when taxable profits of future periods are determined (see paragraph 29.18).

Examples—Steps 1 to 5 investments in subsidiaries

Ex 70 **A parent entity has a wholly-owned subsidiary with a carrying amount (net assets) of CU150,000 in the consolidated financial statements, and a tax base of CU100,000. The parent entity expects to sell its subsidiary soon after the year end. The capital gains tax rate in the parent entity's jurisdiction is zero.**

There is a temporary difference of CU50,000. However, because a nil tax rate applies to any taxable or deductible amounts arising from selling the subsidiary, no deferred tax asset or liability is recognised on the investment in the subsidiary.

This would not affect the recognition of deferred tax for temporary differences on the subsidiary's individual assets and liabilities. Deferred tax assets and liabilities that arise on temporary differences on individual assets and liabilities in the subsidiary should be assessed in the context of their recovery or settlement by the subsidiary, not in the context of the parent recovering its interest in the subsidiary.

Ex 71 **A parent entity has a wholly-owned subsidiary with a carrying amount (net assets) of CU150,000 in the consolidated financial statements, and a tax base of CU100,000. The entity expects to hold on to its investment for the foreseeable future. There are no requirements that would force the subsidiary to pay a dividend, and the parent entity does not expect to require the subsidiary to make a distribution. Instead, the parent entity has set up plans for the undistributed profits to be reinvested to expand the subsidiary's business for the foreseeable future. If the entity sold the subsidiary or received distributions from the subsidiary, the entity would pay tax at the rate of 30 % on the gain on disposal or on the distribution.**

There is a temporary difference of CU50,000. Because the entity would pay tax on dividends it received from the subsidiary or upon sale of its investment in the subsidiary, and because the carrying amount is more than the tax base, the difference is a taxable temporary difference. The parent entity does not recognise a deferred tax liability in the consolidated financial statements in respect of the taxable temporary difference of CU50,000 because the parent can control the timing of the reversal of the temporary difference (by choosing to sell the investment or by requiring the subsidiary to pay a dividend) and it is probable that the temporary difference will not reverse in the foreseeable future.

Examples—Steps 1 to 5 investments in associates

Ex 72 **An entity accounts for its investments in associates in its consolidated financial statements using the equity method (see Section 14 *Investments in Associates*). The entity has an investment in an associate with a carrying amount of CU150,000 and a tax base of CU100,000 (equal to the initial cost of the investment). The entity expects to hold on to its investment for the foreseeable future. There are no requirements that would force the associate to pay a dividend. Management of the associate has disclosed plans, which have been approved by a majority of shareholders, for undistributed profits to be reinvested to expand the associate's business for the foreseeable future. If the entity were to sell its investment in the associate or received distributions from the associate it would affect taxable profit.**

The investor should not recognise a deferred tax liability in its consolidated financial statements in respect of the taxable temporary difference of CU50,000 because it is probable that the taxable temporary difference will not reverse in the foreseeable future because: (a) the management of the associate has disclosed plans, approved by a majority of shareholders, for undistributed profits to be reinvested to expand the associate's business for the foreseeable future; and (b) the investor controls whether or not to sell the investment and expects to hold on to its investment for the foreseeable future.

In practice, it will be harder to provide evidence of specific plans for reinvesting an associate's undistributed earnings to demonstrate that it is probable that the temporary difference will not reverse in the foreseeable future than it would be to provide similar evidence if the entity were to invest in subsidiaries. This is because the entity does not control the investee, and cannot make plans for the undistributed profits of the associate to be reinvested without the agreement of other investors.

Unless there is a well-evidenced agreement (as in this example) that profits will not be distributed in the foreseeable future, the investor in an associate should normally recognise deferred tax arising on the unremitted earnings of the associate.

Ex 73 **An entity accounts for its investments in associates in its separate financial statements using the cost method (see Section 14 *Investments in Associates*). The entity has an investment in an associate with a cost, and tax base, of CU100,000. Taxable profit would be affected if the entity were to sell its investment in the associate or receive distributions from the associate; upon a sale a capital profit or loss would be taxed, or relief given, at the capital tax rate of 10%. In 20X1 the entity recognised an impairment of CU10,000 on the investment. As part of a restructuring programme the entity is actively seeking a buyer for its investment in the associate. The entity expects to receive CU90,000 for the associate. As part of the restructuring programme the entity is looking to divest itself of several more investments, all of which would be sold at a profit.**

The investor has a deductible temporary difference of CU10,000. Paragraph 29.26 permits a deferred tax asset to be recognised only to the extent it is probable that: (a) the temporary difference will reverse in the foreseeable future; and (b) taxable profit will be available against which the temporary difference can be utilised.

Paragraph 29.18 states that the reversal of deductible temporary differences results in deductions when the taxable profits of future periods are determined. The investor is actively seeking a buyer for its investment in the associate and concludes it is probable that the temporary difference will reverse. The investor also concludes it is probable that taxable profit will be available against which the temporary difference can be utilised because it is seeking buyers for other investments, the cumulative profit from which is expected to exceed the loss of CU10,000 expected from the sale of the associate.

The investor recognises a deferred tax asset in its separate financial statements of CU1,000 (CU10,000 x 10%) in respect of the deductible temporary difference of CU10,000 arising in respect of its associate.

Measurement of deferred tax

29.27 An entity shall measure a deferred tax liability (asset) using the tax rates and tax laws that have been enacted or substantively enacted by the reporting date. An entity shall regard tax rates and tax laws as substantively enacted when the remaining steps in the enactment process have not affected the outcome in the past and are unlikely to do so.

Notes—Steps 8 and 12 measurement of deferred tax assets and liabilities

An entity does not consider information about future changes in tax laws, tax rates or tax status except if it is substantively enacted. See the notes to paragraph 29.6.

Section 29's requirement to use tax rates and laws that have been enacted or substantively enacted by the reporting date (rather than by the date when the financial statements are authorised for issue) means that enactments or substantive enactments after the reporting date of tax rates and laws are not adjusting events after the end of the reporting period. However, in accordance with Section 32 *Events after the End of the Reporting Period,* changes in tax rates or tax laws enacted or announced after the end of the reporting period that have a significant effect on current and deferred tax assets and liabilities should be disclosed (see paragraphs 32.10 and 32.11(h)).

Paragraph 29.27 requires use of the tax rates and tax laws enacted or substantially enacted by the end of the reporting period that will be in effect at the time the temporary difference reverses. For example, if an entity's reporting period ends on 31 December 20X5 and the entity has a taxable temporary difference that will reverse in 20X7, the entity measures the deferred tax liability using the tax rate applicable in 20X7 that has been enacted or substantively enacted by 31 December 20X5.

Where an entity has a deferred tax asset and/or liability at the end of the year and the same asset and/or liability was also recognised at the start of the year, by following steps 1 to 8 the asset and/or liability will be measured at the tax rate(s) that were substantively enacted at the end of the year. If the tax rate used at the end of the year differs from that used at the end of the previous year, it is important to identify the change in deferred tax asset and/or liability as a result of the change in tax rate so it can be recognised and disclosed—see paragraph 29.39(d).

Examples—Step 8 substantively enacted

Ex 74 **An entity operates in a jurisdiction where a change in tax rate from 25% to 26% was announced on 1 November 20X6 and will take effect from 1 April 20X7. The entity has a year end of 31 March. On 31 March 20X7 the entity has an asset of CU10,000 for interest receivable that will be taxed when cash is received. Assume the announcement on 1 November 20X6 is considered substantive enactment and the actual enactment date was on the date the new tax rate came into effect (1 April 20X7).**

The entity shall measure its deferred tax liability using the tax rates and laws that have been enacted or substantively enacted by the reporting date. Because the new tax rate of 26% that will apply to taxable income from 1 April 20X7 has been substantively enacted by the reporting date (31 March 20X7), it will be used to measure the deferred tax liability because the interest will be taxed after 1 April 20X7.

Deferred tax liability at 31 March 20X7 = CU2,600 (CU10,000 × 26%).

The entity's current tax for the year ended 31 March 20X7 will continue to be measured at 25% because the new tax rate (26%) applies for taxable profits earned on or after 1 April 20X7.

Ex 75 **The facts are the same as in Example 74 except that the announcement on 1 November 20X6 is not considered to be substantive enactment. Substantive enactment takes place only on the actual enactment date.**

The entity measures its deferred tax liability using the tax rates and laws that have been enacted or substantively enacted by the reporting date. Although the new tax rate of 26% is expected to apply to taxable income in 20X7/20X8, and in fact has been enacted by the time the financial statements are authorised for issue, it has not been enacted or substantively enacted by the reporting date (31 March 20X7). Hence, it will not be used to measure the deferred tax liability.

Deferred tax liability 31 March 20X7 = CU2,500 (CU10,000 × 25%).

Although enactment takes place before the financial statements are authorised for issue, Section 29 precludes using the 26% rate to calculate the deferred tax liability, because this rate was neither enacted nor substantively enacted by 31 March 20X7. If the effect of the change is material to the financial statements, the entity would make the appropriate disclosures for non-adjusting events under Section 32.

29.28 When different tax rates apply to different levels of taxable profit, an entity shall measure 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 deferred tax liability to be settled (deferred tax asset to be realised).

Notes—Step 8 measurement of deferred tax assets and liabilities

Tax rates vary based on level of taxable income

It will normally be necessary to calculate an average tax rate only if the enacted or substantively enacted tax rates are graduated, that is, if different rates apply to different levels of taxable income (see Example 76).

Determining the applicable tax rate may require an estimate of future taxable income for the year(s) in which existing temporary differences or carryforwards will enter into the determination of income tax. That estimate of future income includes:

- income or loss exclusive of reversing temporary differences; and
- reversal of temporary differences.

Tax rates vary between future years

Where the tax rates that will apply to the entity are expected to vary in future years (such as in start-up situations where tax concessions are granted in the early years), it is necessary to anticipate the year in which the temporary difference will reverse, so the deferred tax asset or liability can be calculated at the appropriate rate (or average rate).

Income tax holidays (including reduced income tax rates)

An income tax holiday is a temporary reduction in, or elimination of, an income tax. Governments usually create tax holidays as incentives to encourage investment or to stimulate growth in selected industries. For example, the government in a particular jurisdiction may forgive (or reduce) income taxes for a specified period if an entity meets certain criteria, such as operating or investing in a particular area of the jurisdiction. Section 29 does not specifically address accounting for tax holidays. Consequently, the entity should determine the tax base for each asset and liability, and calculate any temporary differences in the usual manner. This means if temporary differences reverse in a tax holiday period where tax is eliminated, the appropriate tax rate is 0%. No deferred tax assets or liabilities would be recognised. If instead a reduced rate applies, the deferred tax assets or liabilities would be measured at the reduced rate.

A temporary difference is measured at the rate that will apply at the time that it is expected to reverse, and not at the rate that applies when that temporary difference initially arises. Consequently, if a temporary difference arises in a tax holiday but is expected to reverse after the tax holiday, then the temporary difference should be measured at the standard tax rate that applies to the entity, not at a 0% tax rate.

Examples—Step 8 progressive tax rates

Ex 76 **An entity operates in a jurisdiction where the first CU50,000 of profit is taxed at the rate of 10% and any excess profit over CU50,000 is taxed at 20%.**

If the entity expects to earn annual taxable profit in excess of CU50,000 in the future, the estimated average rate will need to be calculated for each future year in which temporary differences that exist at the reporting date will reverse. To determine a single average rate between 10% and 20%, it is necessary to estimate future annual taxable profits, including the effect of the reversal of temporary differences. For example, the entity has taxable temporary differences of CU2,000 arising in 20X1 that it expects to reverse in 20X2. The entity expects taxable profits for 20X2, excluding the taxable temporary differences, of CU70,000. The entity therefore expects to have total taxable profits of CU72,000 and expects to pay tax of CU9,400 in respect of 20X2 ((CU50,000 × 10%) + (CU22,000 × 20%)). The effective tax rate on taxable profits of CU72,000 would be 13.06%. Regardless of the effective rate of tax for 20X1, the entity would recognise a deferred tax liability in 20X1 of CU261.20 (CU2,000 x 13.06%).

Ex 77 **An entity has an item of equipment that is depreciated faster for tax purposes than for financial reporting purposes. On 31 December 20X1 there is a temporary difference of CU1,000 for this equipment that is expected to increase taxable profit in the future. The temporary difference is expected to reverse in five years' time. In the entity's jurisdiction, tax is payable at 20% on the first CU100,000 of taxable profit earned, 25% on the next CU200,000 of taxable profit earned, 30% on the next CU200,000 of taxable profit earned, and 35% on any remainder (that is, on any excess above CU500,000). In 20X1 the entity earned taxable profit of CU400,000. In 20X6 the entity expects to earn taxable profit of CU650,000.**

In 20X1, the entity earned taxable profit of CU400,000 and therefore paid tax of CU100,000 ((CU100,000 × 20%) + (CU200,000 × 25%) + (CU100,000 × 30%)). The average tax rate is 25% (CU100,000 ÷ CU400,000).

However, in five years' time, it is expected that taxable profit will be CU650,000. If the entity earns a taxable profit of CU650,000, tax of CU182,500 ((CU100,000 × 20%) + (CU200,000 × 25%) + (CU200,000 × 30%) + (CU150,000 × 35%)) will be payable. This is an average tax rate of 28.08%.

Consequently, the deferred tax liability will be measured at CU281 (CU1,000 × 28.08%).

Ex 78 **An entity has a year end of 31 December. At the end of 20X1, the entity has the following temporary differences:**

- **A temporary difference of CU60,000 that is expected to reduce taxable profit by CU20,000 for the following two years (20X2 and 20X3) and by CU10,000 for the two years after that (20X4 and 20X5). This is due to research and development expenditure that is allowed as a deduction for tax purposes over time (but that is recognised immediately for financial reporting purposes under Section 18 *Intangible Assets Other than Goodwill*).**
- **A temporary difference of CU5,000 that is expected to increase taxable profit by CU5,000 in 20X2. This is due to interest receivable that is taxable only when received.**

The entity operates in a jurisdiction that has a graduated tax rate structure. The graduated tax rates are as follows:

Taxable profit (CU)	*Tax rate*
0–50,000	**10%**
50,000.01–300,000	**20%**
300,000.01–100,000,000	**25%**
Over 100,000,000	**30%**

The projected profits for the next five years (exclusive of reversing temporary differences) are:

20X2	20X3	20X4 and 20X5	20X6
CU260,000	**CU285,000**	**CU350,000**	**CU400,000**

The estimated taxable income (inclusive of reversing temporary difference) for the next four years (20X2—20X5) is:

- 20X2—CU245,000 (CU260,000 - CU20,000 research and development + CU5,000 interest)
- 20X3—CU265,000 (CU285,000 - CU20,000 research and development)
- 20X4—CU340,000 (CU350,000 - CU10,000 research and development)
- 20X5—CU340,000 (CU350,000 - CU10,000 research and development).

Only the four years need to be looked at because there are no temporary differences at 31 December 20X1 that will reverse in 20X6 or afterwards.

Tax based on scale:

	20X2	*20X3*	*20X4*	*20X5*
10%	CU5,000	CU5,000	CU5,000	CU5,000
	(ie CU50,000 × 10%)			
20%	CU39,000	CU43,000	CU50,000	CU50,000
	(ie (CU245,000 - CU50,000) × 20%)	(ie (CU265,000 - CU50,000) × 20%)	(ie (CU300,000 - CU50,000) × 20%)	(ie (CU300,000 - CU50,000) × 20%)
25%	nil	nil	CU10,000	CU10,000
			(ie (CU340,000 - CU300,000) × 25%)	(ie (CU340,000 - CU300,000) × 25%)
Total estimated tax	CU44,000	CU48,000	CU65,000	CU65,000
Estimated average tax rate	17.96%	18.11%	19.12%	19.12%
	(ie CU44,000 ÷ CU245,000)	(ie CU48,000 ÷ CU265,000)	(ie CU65,000 ÷ CU340,000)	(ie CU65,000 ÷ CU340,000)

The tax rate to apply to the temporary difference from the interest receivable is 17.96% because the temporary difference reverses in 20X2. The entity recognises a deferred tax liability of CU898 (CU5,000 × 17.96%).

The deferred tax asset for the research and development costs can be determined by applying the average tax rate in each period to the part of the temporary difference expected to reverse in that period. Based on the level of expected profits when the temporary difference reverses the entity assesses that it is probable there will be sufficient taxable profit available against which the deductible temporary differences can be utilised. Consequently, the entity recognises a deferred tax asset of CU11,038 ((CU20,000 × 17.96%) + (CU20,000 × 18.11%) + (CU10,000 × 19.12%) + (CU10,000 × 19.12%) = CU3,592 + CU3,622 + CU1,912 + CU1,912).

Paragraph 29.37 discusses offset of deferred tax assets and deferred tax liabilities (that is, whether the CU11,038 can be offset against the CU898 to recognise a net deferred asset of CU10,140).

29.29 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 reporting date, to recover or settle the carrying amount of the related assets and liabilities. Consequently, an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement. For example, if the temporary difference arises from an item of income that is expected to be taxable as a capital **gain** in a future period, the deferred **tax expense** is measured using the capital gain tax rate and the tax base that is consistent with recovering the carrying amount through sale.

29.30 If a deferred tax liability or deferred tax asset arises from a non-depreciable asset measured using the revaluation model in Section 17, the measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the non-depreciable asset through sale. If a deferred tax liability or asset arises from **investment property** that is measured at fair value, there is a rebuttable presumption that the carrying amount of the investment property will be recovered through sale. Accordingly, unless the presumption is rebutted, the measurement of the deferred tax liability or the deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the investment property entirely through sale. This presumption is rebutted if the investment property is depreciable and is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, instead of through sale. If the presumption is rebutted, the requirements of paragraph 29.29 shall be followed.

Notes—Step 8 measurement of deferred tax assets and liabilities

In some cases, different tax rates apply to profit arising from use of the asset as compared to profit arising on sale of the asset. Section 29 requires the tax rate and the tax base of an asset or liability to be determined by available tax deductions that are consistent with the expected manner of recovery or settlement. In many cases, the same deductions may be available on either use or sale of the asset (see Examples 79–85). In other cases, deductions for use are materially different from those for sale (see Examples 86–92).

Land that is owned outright is usually considered to have an indefinite economic life and, therefore, in accordance with paragraph 17.16, such land is not depreciated. When the carrying amount of such land is fair value (whether accounted for in accordance with Section 16 *Investment Property* or Section 17 *Property, Plant and Equipment*) the deferred tax asset or liability arising is calculated assuming the land will be recovered by sale.

The deferred tax for any other non-depreciable asset carried at fair value in accordance with Section 17 is similarly calculated assuming the asset will be recovered through sale.

For investment property the Standard sets out a rebuttable presumption that if the asset is carried at fair value, it will be recovered through sale and the deferred tax is to be measured on this assumption. The presumption is rebutted for depreciable assets held within a business model whose objective is to consume the benefits of the asset over time, rather than through sale.

Paragraph 29.30 refers to non-depreciable assets measured using the revaluation model in Section 17, but does not mention non-depreciable assets carried using the cost model in Section 17—see Example 90.

Other items of property, plant and equipment (depreciable assets) might be recovered through a combination of use and sale. For example, the depreciable amount (that is, carrying amount less residual value) is expected to be recovered through use of the asset, and the residual value is expected to be recovered through sale of the asset at the end of the asset's useful life—see Example 85.

Section 29 therefore requires management's expectations of how the carrying amount of an asset will be recovered, through use and/or sale, to be considered in measuring deferred tax assets and liabilities.

Examples—Step 8 measurement of deferred tax assets and liabilities

Ex 79 **On 1 January 20X1 an entity acquires a depreciable asset for CU100,000. Applying Section 17 *Property, Plant and Equipment* the entity accounts for the asset using the cost model and depreciates the asset on the straight-line method over its useful life of 10 years to a nil residual value (CU10,000 per year for 10 years).**

In computing its taxable income, the entity depreciates the asset on the straight-line method to a nil residual value over the first five years of the asset's use (CU20,000 per year for 5 years). If the asset is sold, deductions of 100% of cost are available, but all previous deductions received for use must be reversed (that is, the tax authority claws back all previous deductions). The entity's taxable profits generated from trading are taxed at 30%. On sales of property, plant and equipment the tax rate applicable to the clawback of past allowances is 30% and the tax rate applicable to the excess of the selling price over the CU100,000 cost is 20%.

The entity expects to recover the carrying amount of the asset through use over 10 years.

At the end of the second year the temporary difference is the difference between the carrying amount of CU80,000 (CU100,000 cost - CU20,000 accumulated depreciation) and the tax base of CU60,000.

The tax depreciation claimed is the accumulated tax depreciation deducted in determining the entity's taxable income (CU100,000 cost ÷ 5 years' tax-deductible life × 2 years of deduction = CU40,000).

After two years the tax base is CU60,000 (CU100,000 cost - tax depreciation claimed of CU40,000).

Consequently, there is a temporary difference of CU20,000 at the end of the second year and the entity recognises a deferred tax liability of CU6,000 (applicable tax rate of 30% (the expected manner of recovery) × CU20,000 temporary difference).

Ex 80 **The facts are the same as in Example 79 except that after using the asset for two years, the entity decided to dispose of the asset and sold the asset to a third party for its fair value of CU105,000 on 1 January 20X3 (that is, at the end of the second year the entity intends to recover the carrying amount of the asset through sale).**

The deferred tax liability is CU6,000 (30% tax rate applicable to the clawback on sale (the expected manner of recovery) × CU20,000 temporary difference).

The temporary difference is calculated in the same way it is calculated in Example 79.

The fact that the sales proceeds received from the sale of the asset (its fair value) exceed its carrying amount does not affect the calculation of temporary difference; the principle in Section 29 is that an asset recorded in the financial statements will be realised, for its carrying amount, in the form of economic benefits that will flow to the entity in future periods. In reality, an entity may generate economic benefits in excess of the carrying amount of an asset, such as in this case where the entity sells the asset in the next period for more than its carrying amount. Section 29 requires the assessment to be performed as if the benefits are equal to the carrying amount of the asset. In other words, Section 29 only considers the amounts already recorded in the financial statements. This is because in accordance with Section 29, deferred tax is only recognised in respect of past transactions or events; any profit arising from selling the property for more than its carrying amount cannot be anticipated because this is a future transaction.

Note: the 20% tax rate is not applicable because it applies only to the sale proceeds that exceed the original cost of CU100,000. In this Example, the temporary difference being measured is the difference between the carrying amount of CU80,000 and the tax base of CU60,000 both of which are less than the cost of CU100,000.

Ex 81 **The facts are the same as in Example 79 except that the entity adopts a policy of revaluing all assets in this category of property, plant and equipment. At the end of the second year the asset is recognised in the statement of financial position at its fair value of CU105,000. The tax authorities do not adjust the tax deductible amount either on use or on sale. As in Example 79, the entity expects to recover the carrying amount of the asset through use over 10 years.**

At the end of the second year, if the entity intends recovering the carrying amount of the asset through use, it must generate taxable income of CU105,000. Only a further CU60,000 can be deducted, over the next three years, from taxable profits in respect of the asset. After two years the tax base is CU60,000 (CU100,000 cost less tax depreciation claimed of CU40,000).

At the end of the second year the temporary difference is the difference between the carrying amount of CU105,000 (CU105,000 fair value of the asset) and the tax base of CU60,000. There is a temporary difference of CU45,000.

Consequently, at the end of the second year the deferred tax liability recognised is CU13,500 (applicable tax rate of 30% (the expected manner of recovery) × CU45,000 temporary difference).

Note: the 20% tax rate is not applicable because it applies only to the sale proceeds that exceed the original cost of CU100,000. In this example, the entity expects to recover the carrying amount of the asset through use over 10 years, rather than through sale.

Ex 82 **The facts are the same as in Example 81 except that after using the asset for two years, the entity decided to dispose of the asset and sold the asset to a third party for CU105,000 on 1 January 20X3 (that is, at the end of the second year the entity intends to recover the carrying amount of the asset through sale).**

At the end of the second year, if the entity intends recovering the carrying amount of the asset through sale, the tax base of the asset is CU60,000 (CU100,000 cost deductible for tax purposes when the asset is sold for more than cost less CU40,000 clawback of tax depreciation deducted to date). The CU40,000 is deducted because it will be included in taxable income in the year of sale as a clawback.

At the end of the second year the temporary difference is the difference between the carrying amount of CU105,000 (CU105,000 fair value of the asset) and the tax base of CU60,000. There is a temporary difference of CU45,000.

Consequently, at the end of the second year the deferred tax liability recognised is CU13,000 ((30% × CU40,000 part-temporary difference) + (20% × CU5,000 part-temporary difference)). To measure the deferred tax liability the temporary difference is separated into two components—CU40,000 that is expected to be clawed back on sale and CU5,000 that is expected to be subject to tax at 20%.

Note: the 20% tax rate only applies to the sale proceeds that exceed the original cost of CU100,000.

Ex 83 **On 1 January 20X1 an entity acquires a building, which meets the definition of an investment property, for CU100,000. Applying Section 16 *Investment Property* the entity accounts for the building at fair value with changes in fair value recognised in profit or loss. At 31 December 20X1 the fair value of the investment property is CU120,000.**

In computing its taxable income, the entity depreciates the building on the straight-line method to a nil residual value over the first 10 years of its use by others under operating leases from the entity (that is, in the entity deducted CU10,000 when measuring its taxable profit for the year ended 31 December 20X1). If the building is sold, deductions of 100% of cost are available but all previous deductions received for use must be returned (that is, all previous deductions are clawed back). The tax rate applicable to recovery through rental income is 30%. On sale the tax rate applicable to the clawback of past allowances is 30% and the tax rate applicable to the excess of the selling price over the CU100,000 cost is 20%.

At 31 December 20X1 the entity expects to recover the entire carrying amount of the building through sale early in 20X2.

At 31 December 20X1 the deferred tax liability is CU7,000—calculation: 30% × CU10,000 (the part of the temporary difference expected to be clawed back on sale) + 20% × CU20,000 (the part of the temporary difference expected to be subject to tax at 20% when recovered through sale).

The total temporary difference of CU30,000 is the difference between the carrying amount of CU120,000 (fair value at 31 December 20X1) and the tax base of CU90,000. After one year the tax base is CU90,000 (CU100,000 cost less tax depreciation claimed of CU10,000). Although the asset is a depreciable asset and is accounted for as investment property at fair value, the presumption that its carrying amount will be recovered through sale is not rebutted. Consequently the tax base and tax rates used are established assuming that the asset's carrying amount will be recovered through sale (although in this example the tax base is the same whether the asset's carrying amount is recovered through sale or use).

To measure the deferred tax liability the temporary difference is separated into two components—CU10,000 that is expected to be clawed back on sale and CU20,000 that is expected to be subject to tax at 20%.

Ex 84 **The facts are the same as in Example 83 except that at 31 December 20X1 the entity expects to recover the carrying amount of the property entirely through rental income. At the end of the building's economic life the entity intends to demolish the building. No proceeds are expected to arise from the demolition.**

Although the asset is accounted for as investment property at fair value, the presumption that its carrying amount will be recovered through sale is rebutted in this instance. It is a depreciable asset and is held in a business model designed to consume substantially all the economic benefits of the asset over time rather than through sale. Consequently the tax base and tax rates used are established assuming that the asset's carrying amount will be recovered through use, not sale.

The temporary difference is CU30,000, the difference between the carrying amount of CU120,000 (fair value at 31 December 20X1) and the tax base of CU90,000.

A deferred tax liability of CU9,000 arises (30% tax rate applicable to trading profits × CU30,000 temporary difference).

Ex 85 **An entity acquires a depreciable asset for CU100,000. The cost of the asset is deductible for tax purposes on a straight-line basis over 10 years while the asset is being used. On sale, a deduction is available of cost less the tax depreciation previously received. A tax rate of 30% applies to the income generated from the use of the asset and a tax rate of 25% applies to any taxable profit on sale. Applying Section 17 *Property, Plant and Equipment*, depreciation is based on an expected useful life of 12 years and a residual value of CU40,000.**

The entity has used the asset for 10 years. It expects to use the asset for a further two years and then to sell it.

At the end of the tenth year:

(a) the asset's depreciated carrying amount is CU50,000 (2 remaining years ÷ 12 years useful life × (CU100,000 cost less CU40,000 residual value) + CU40,000 residual value);

(b) the tax base of the asset is zero—CU100,000 cost less tax depreciation CU100,000 (CU100,000 cost ÷ 10 years tax-deductible life × 10 years of deduction); and

(c) the temporary difference is CU50,000 (CU50,000 carrying amount less nil tax base).

The entity expects CU40,000 of the carrying amount to be recovered through sale (the residual value) and CU10,000 of the carrying amount (the remaining depreciable amount) to be recovered through use. Consequently, the deferred tax liability can be determined as CU13,000 (CU10,000 (CU40,000 expected to be recovered from sale × 25%) + CU3,000 (CU10,000 expected to be recovered from use × 30%)).

Ex 86 **On 1 January 20X1 an entity acquires a building for CU100,000. Applying Section 16 *Investment Property* the entity accounts for the building at fair value with changes in fair value recognised in profit or loss. At 31 December 20X1 the fair value of the investment property is CU120,000.**

There is no tax depreciation in computing taxable income. If the asset is sold, deductions of 100% of cost or, if lower, the market value of the asset on the date of sale, are available. The entity's taxable profits generated from trading are taxed at 30%. The tax rate applicable to the excess of the selling price over the CU100,000 cost is 20%.

At 31 December 20X1 the entity expects to recover the entire carrying amount of the building through sale.

The temporary difference of CU20,000 is the difference between the carrying amount of CU120,000 (fair value at 31 December 20X1) and the tax base of CU100,000. The tax base of the asset is cost (CU100,000) as this is lower than market value.

The deferred tax liability is CU4,000 (20% tax rate applicable when sold × CU20,000 temporary difference).

Ex 87 **The facts are the same as in Example 86 except that at 31 December 20X1 the entity expects to recover the carrying amount of the property entirely through rental income. At the end of the building's economic life the entity intends to demolish the building. No proceeds are expected to arise from that demolition.**

In this case, the entity intends to recover the carrying amount of the asset through its use (by rental to others).

Although the asset is accounted for as investment property at fair value, the presumption that its carrying amount will be recovered through sale is rebutted in this instance. It is a depreciable asset and is held in a business model whose objective is to consume the economic benefits of the asset over time rather than through sale. Consequently, the tax base and tax rates used are established assuming that the asset's carrying amount will be recovered through use, not sale.

There are no tax deductions available to the entity while it uses the property to generate rental income. Consequently, the temporary difference is CU120,000. This is the difference between the carrying amount of CU120,000 (fair value at 31 December 20X1) and the tax base of nil (as no amounts are deductible against taxable income from trading).

However, the temporary difference of CU120,000 can be separated into:

(a) CU100,000, which is a taxable temporary difference for which no deferred tax liability is recognised because it arises on the initial recognition of an asset that was not acquired in a business combination and affects neither accounting profit nor taxable profit at the time of the transaction (see paragraph 29.14(b) and Example 53); and

(b) CU20,000 taxable temporary difference which arises on the uplift above cost to fair value (after initial recognition).

A deferred tax liability of CU6,000 arises (30% tax rate applicable to trading profits × CU20,000 temporary difference).

Ex 88 **On 1 January 20X1 an entity acquires a building for CU100,000. Applying Section 16 *Investment Property* the entity accounts for the building at fair value with changes in fair value recognised in profit or loss. At 31 December 20X1 the fair value of the investment property is CU120,000.**

In computing its taxable income the entity depreciates the building on the straight-line method to a nil residual value over the first 10 years of its use by others under operating leases from the entity (the entity deducted CU10,000 when estimating its taxable profit for the year ended 31 December 20X1). If the building is sold, deductions of 100% of cost increased by a specified price index established by the tax authority (5% in 20X1) are available, but all previous deductions received for use must be returned (that is, all previous deductions are clawed back). At 31 December 20X1 the tax rate that applies to recovery through rental income is 30%. On sale the tax rate that applies to the clawback of past allowances is 30% and the tax rate that applies to the excess of the selling price over the CU105,000 (CU100,000 cost + 5% of CU100,000 indexation adjustment) is 20%.

At 31 December 20X1 the entity expects to recover the entire carrying amount of the building through sale.

The temporary difference is CU25,000 which is the difference between the carrying amount of CU120,000 (fair value at 31 December 20X1) and the tax base of CU95,000. The tax base of the asset is CU105,000 adjusted cost less CU10,000 clawback of past allowances.

At 31 December 20X1 the deferred tax liability is CU6,000 (20% × CU15,000 taxable capital gain (CU120,000 carrying amount less CU105,000 adjusted cost) + 30% × CU10,000 clawback of past deductions.

Ex 89 **The facts are the same as in Example 88 except that the entity expects to recover the carrying amount of the asset through use over 50 years. At the end of 50 years the entity intends to scrap the building.**

Now that the entity does not intend to sell the asset, the temporary difference is CU30,000 which is the difference between the carrying amount of CU120,000 (fair value at 31 December 20X1) and the tax base of CU90,000.

In this case, the entity intends to recover the carrying amount of the asset through its use (rental to third parties) and therefore in this case tax deductions of CU90,000 are available to the entity from the use of this asset. The tax base of the asset is therefore CU90,000.

Although the asset is accounted for as investment property at fair value, the presumption that its carrying amount will be recovered through sale is rebutted in this instance. It is a depreciable asset and is held in a business model whose objective is to consume the economic benefits of the asset over time rather than through sale. Consequently, the tax base and tax rates used are established assuming that the asset's carrying amount will be recovered through use, not sale.

At 31 December 20X1 the deferred tax liability is CU9,000 (30% × CU30,000 taxable temporary difference (CU120,000 carrying amount less CU90,000 tax base)).

Examples—Step 8 non-depreciable assets

Ex 90 **On 1 January 20X1 an entity acquires a plot of land outright for CU100,000. The land adjoins the entity's factory and the entity intends to use the land to expand its factory. Applying Section 17** ***Property, Plant and Equipment*** **the entity accounts for the land at cost and does not depreciate it.**

There is no tax depreciation in computing taxable income. If the asset is sold, the cost of the asset (CU100,000) is deductible in determining the taxable capital gain or loss on disposal.

The entity's taxable profits generated from trading are taxed at 30%. The tax rate applicable to capital gains and capital losses is 20%.

At the end of the second year, when the market value of the asset is CU120,000, the entity still expects to use the land for expansion and has engaged architects to draw up plans.

At the end of the second year, the carrying amount of the asset is its cost, namely CU100,000. Paragraph 29.29 requires that the measurement of a deferred tax liability shall reflect the tax consequences that would follow from the manner in which the entity expects to recover the carrying amount of the asset. Since the asset is not depreciated, the only manner in which the carrying amount can be recovered is through sale; the asset's residual value is at least equal to its cost.

A temporary difference of nil arises, that is the difference between the carrying amount of CU100,000 (cost) and the tax base of CU100,000 (the amount deductible on a sale of the asset). Consequently, no deferred tax arises.

Ex 91 **The facts are the same as in Example 90 except that applying Section 17** ***Property, Plant and Equipment*** **the entity adopts a policy of revaluing all assets in this category of property, plant and equipment. Consequently, at the end of the second year, the land is carried in the statement of financial position at its fair value of CU120,000.**

At the end of the second year the temporary difference is CU20,000, which is the difference between the carrying amount of CU120,000 (fair value) and the tax base of CU100,000 (the deduction available on sale of the land).

Since the asset is not depreciated, the only manner in which the carrying amount can be recovered is through sale. This is confirmed by paragraph 29.30 which requires that if a deferred tax liability or deferred tax asset arises from a non-depreciable asset measured using the revaluation model in Section 17, the measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the non-depreciable asset through sale.

At 31 December 20X1 the deferred tax liability is CU4,000 (20% (the rate that applies on a sale) × CU20,000 taxable temporary difference).

Ex 92 **The facts are the same as in Example 90 except that the entity purchased the land to let out to a farmer who uses it to graze sheep. Consequently, applying Section 16 *Investment Property*, the entity accounts for the land at fair value with changes in fair value recognised in profit or loss. At the end of the second year, the land is carried in the statement of financial position at its fair value of CU120,000.**

At the end of the second year the temporary difference is CU20,000, which is the difference between the carrying amount of CU120,000 (fair value) and the tax base of CU100,000 (the deduction available on sale of the land).

Paragraph 29.30 sets out a rebuttable presumption that if a deferred tax liability or asset arises from investment property that is measured at fair value, the carrying amount of the investment property will be recovered through sale. In this case the property, land used for grazing sheep, is non-depreciable and the manner in which the carrying amount will be recovered is through sale.

At 31 December 20X1 the deferred tax liability is CU4,000 (20% (the rate that applies on a sale) × CU20,000 taxable temporary difference).

29.31 The carrying amount of a deferred tax asset shall be reviewed at the end of each reporting period. An entity shall reduce the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that recognised deferred tax asset to be utilised. Any such reduction shall be reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Notes—Step 11 review of carrying amount of previously recognised deferred tax assets

A deferred tax asset is only recognised initially to the extent it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. Having recognised a deferred tax asset initially it should not remain as an asset in a subsequent accounting period if it is no longer probable that taxable profit will be available against which the deductible temporary difference can be utilised, in whole or in part.

In applying steps 1 to 8, an entity will have determined the tax base and temporary difference for each asset and liability, determined which of those temporary differences should be recognised as deferred tax assets and liabilities in the statement of financial position and measured the deferred tax assets and liabilities using the appropriate tax rate.

Consequently, at the end of each reporting period an entity might have concluded, as a result of the above process, that a deferred tax asset should not be recognised because it is not probable that taxable profit will be available against which the deductible temporary difference can be utilised, whereas at the end of the previous reporting period the entity had recognised a deferred tax asset for the same deductible temporary difference (because it had concluded that there would be future taxable profit available to utilise the deductible temporary difference). This step is about identifying a reduction in previously recognised deferred tax assets, or a reversal in previously recognised reductions. This step helps identify both of these for disclosure purposes, see paragraph 29.39(g).

Examples—Step 11 adjusting a recognised deferred tax asset

Ex 93 **Entity X recognises a warranty provision for CU50,000 that it expects to utilise in 20X3, to cover the repair of defective items sold prior to 31 December 20X1, its year end. The amount recognised as a provision is not deductible for tax purposes until it is actually paid or used. Entity X has taxable temporary differences arising in 20X1 that are expected to reverse in 20X3 of CU10,000. Trading profits are taxed at 30%.**

At the end of 20X1, Entity X recognised a deferred tax asset of CU15,000 (CU50,000 × 30%) because Entity X assessed it was probable it would generate sufficient taxable profit against which the deductible temporary difference of CU50,000 could be utilised. CU10,000 would be recovered against the taxable temporary differences. In addition, Entity X had generated taxable profits of approximately CU100,000 in each of the two years prior to 20X1 and expected to generate a similar taxable profit in 20X1 and in subsequent periods.

In November 20X2 a major financial crisis takes hold and the entity revises its projections of future taxable profit. The entity still anticipates the CU10,000 taxable temporary differences will reverse in 20X3. However, it now assesses it is probable taxable profit will be available against which only CU5,000 of the balance of the CU50,000 warranty provision can be utilised.

Tax losses cannot be carried back to earlier years but may be carried forward for up to two years.

At 31 December 20X1 the entity recognised a deferred tax asset of CU15,000 (CU50,000 warranty provision × 30%); the entity expected to be able to benefit from the deductions in 20X3.

At 31 December 20X2, the entity still expects to utilise the CU50,000 provision in 20X3, but now assesses that, in addition to the CU10,000 taxable temporary differences, it is probable taxable profit will be available against which only CU5,000 can be utilised within the time frame for carryforward of losses.

Consequently, the entity reduces the deferred tax asset so that only CU4,500 (CU15,000 (that is, CU10,000 + CU5,000) × 30%) is carried in its statement of financial position at 31 December 20X2.

Measurement of both current and deferred tax

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

Notes—Step 8 measurement of tax

Discounting deferred tax assets and liabilities would require detailed scheduling of the timing of the reversal of each temporary difference. In many cases such scheduling is highly complex, and so discounting is prohibited under Section 29.

29.33 In some jurisdictions, income tax is 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 tax 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 both of those circumstances, an entity shall measure current and deferred tax 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).

Notes—Step 8 measurement of tax

Measurement complications can arise when distributed income is taxed at a different rate from undistributed income. In such situations, deferred tax assets and liabilities should be measured using the tax rates on undistributed profits until the entity recognises a liability to pay a dividend. Any income tax consequences that follow as a result of payment of a dividend are recognised only when the dividend is declared and recognised as a liability in the financial statements. This treatment is consistent with paragraph 32.8 of Section 32 *Events after the End of the Reporting Period* which states that 'if an entity declares dividends to holders of its **equity** instruments after the end of the reporting period, the entity shall not recognise those dividends as a **liability** at the end of the reporting period'. In conformity with this, paragraph 29.33 requires any tax consequences that may follow as a result of payment of a dividend to be recognised only when the dividend is recognised as a liability.

Examples—Step 8 tax rate

Ex 94 **An entity operates in a jurisdiction where income taxes are payable at a higher rate on undistributed profits (50%) with an amount being refundable when profits are distributed. The tax rate on distributed profits is 35%.**

On 31 December 20X1 the entity expects to propose dividends in March 20X2 of approximately CU10,000 for the year ended 20X1. The financial statements will be authorised for issue in April 20X2. Taxable income for 20X1 is CU100,000.
On 31 December 20X1 the entity has taxable temporary differences that are expected to increase taxable profit in the future of CU40,000.

At 31 December 20X0 the entity had no taxable or deductible temporary differences.

The entity recognises a current tax liability and a current income tax expense for the year ended 31 December 20X1 of CU50,000 (CU100,000 × 50%) based on the tax rate applicable to undistributed profits. No asset is recognised for the amount potentially recoverable as a result of future dividends because the dividends are not declared before the reporting date. They are declared before the financial statements are authorised for issue, but the statement of financial position is not adjusted. Disclosure would be included in the financial statements (see Example 105).

The entity also recognises a deferred tax liability and deferred tax expense of CU20,000 (CU40,000 × 50%) representing the additional income tax the entity will pay, based on the tax rate applicable to undistributed profits, when the temporary differences reverse.

Ex 95 **The facts are the same as in Example 94. The current tax liability of CU50,000 is paid on 1 March 20X2. Subsequently, on 15 March 20X2, the entity declares a dividend payable of CU10,000 from operating profits for the year ended 31 December 20X1.**

On 15 March 20X2 the entity recognises a liability for the dividends for CU10,000. On the same date, the entity also recognises a current asset for the recovery of income taxes of CU1,500 (15% × CU10,000 dividends recognised as a liability). The entity recognises the CU1,500 as a current tax asset and as a reduction of current income tax expense for the year ended 31 December 20X2.

The entity continues to recognise deferred tax assets and liabilities using the undistributed rate.

Section 29 does not contain a discussion about where the reduction of current income tax expense for the year ended 31 December 20X2 would be recognised. However, paragraph 52B of IAS 12 explains it is more appropriate to recognise the incremental tax effect of the dividend payment (in this example the additional tax of CU1,500) in profit or loss, rather than in equity, even though the dividend payment is charged to equity. This is because the income tax consequences of dividends are more directly linked to past transactions or events than they are linked to distributions to owners (see paragraph 29.35 for allocation requirements).

Withholding tax on dividends

29.34 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.

Notes—Step 9 presentation

The withholding tax is not attributable to the entity paying the dividend. The entity paying the dividend is effectively acting as an agent collecting tax. Consequently, the total amount of the dividend inclusive of that paid to the tax authorities would be shown as a dividend in the accounts of the payer.

Example—Step 9 withholding tax on dividends

Ex 96 **An entity declares a dividend of CU5,000 to its shareholders (all shareholders have small shareholdings). The entity operates in a jurisdiction where it is required to withhold 25% of the value of the dividend payable to shareholders and pay it to the tax authorities on behalf of those shareholders.**

The entity would make the following journal entries when it declares the dividend to shareholders:

Dr	Retained earnings (dividend)	CU5,000	
	Cr Payable (amount due to shareholders)		CU3,750
	Cr Payable (amount due to tax authority)		CU1,250

To recognise dividends payable to shareholders.

The entity recognises a financial liability for the amount withheld that will need to be paid to the tax authorities of CU1,250 (CU5,000 × 25%) and the net dividend payable to the shareholders of CU3,750 (CU5,000 less CU1,250).

Presentation

Allocation in comprehensive income and equity

29.35 An entity shall recognise tax expense in the same component of **total comprehensive income** (ie continuing operations, **discontinued operations**, or **other comprehensive income**) or equity as the transaction or other event that resulted in the tax expense.

Notes—Step 9 presentation

The tax follows the item that gave rise to it and is recognised in profit or loss (continuing operations or discontinued operations), in other comprehensive income, or directly in equity depending on where the item giving rise to the tax is recognised. For example, if an entity recognises a provision for warranty costs in profit or loss from continuing operations, the current tax or deferred tax effect (income) will also be recognised in profit or loss from continuing operations.

If an entity does not have any items of income or expense that are recognised outside profit or loss as other comprehensive income, all changes in current tax assets and liabilities will be recognised in profit or loss unless they relate to an item recognised directly in equity.

A change in a current or deferred tax liability or asset that is attributable to a transaction recognised under the *IFRS for SMEs* Standard directly in equity shall also be recognised directly in equity.

Entities need only address the allocation of the total tax expense (current tax plus deferred tax), because Section 29 does not require an analysis of total tax expense into current and deferred tax for tax recognised in either profit or loss, other comprehensive income or directly in equity. In some cases, allocating current tax and deferred tax separately can be done only on an arbitrary basis.

Transaction or event recognised in other comprehensive income

Paragraph 5.4(b) identifies four types of income and expenses that may be recognised under the *IFRS for SMEs* Standard in other comprehensive income, outside of profit or loss, namely:

- some gains and losses arising on translating the financial statements of a foreign operation (see Section 30 *Foreign Currency Translation*);
- some actuarial gains and losses depending on an entity's accounting policy for such gains and losses relating to defined benefit plans (see Section 28 *Employee Benefits*);
- some changes in fair values of hedging instruments (see Section 12 *Other Financial Instruments Issues*); and
- changes in the revaluation surplus for property, plant and equipment measured in accordance with the revaluation model (see Section 17 *Property, Plant and Equipment*).

A change in a current and/or deferred tax asset or liability attributable to one of the four items of income or expense above should be recognised in other comprehensive income if that income or expense is recognised in other comprehensive income.

Transaction or event recognised in equity

Current and deferred tax expense should be charged or credited directly to equity if the tax relates to items that are credited or charged directly to equity, either in the same period or a different period. Three examples of items on which deferred tax are credited or charged directly to equity are:

- an adjustment to opening retained earnings resulting from either a change in accounting policy that is accounted for retrospectively or the correction of an error (Section 10 *Accounting Policies, Estimates and Errors*).
- the initial recognition of the equity component on classification of a compound financial instrument (Section 22 *Liabilities and Equity*).
- the issue of shares (Section 22). See Example 96.

Transaction or event recognised in discontinued operations

A discontinued operation is defined in the Glossary as 'a component of an entity that either has been disposed of, or is held for sale, and:

(a) represents a separate major line of business or geographical area of operations;

(b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or

(c) is a subsidiary acquired exclusively with a view to resale.'

Paragraph 5.5 of Section 5 requires entities with discontinued operations to include discontinued operations as a separate line item in the statement of comprehensive income net of the related income tax. Consequently. any income tax on the profit or loss of a discontinued operation, or on the sale of a discontinued operation, or on movements in deferred tax assets or liabilities relating to assets and liabilities of a component while it is classified as discontinued (for example, due to a change in value of the assets and liabilities while the component is considered to be held for sale) should be allocated to discontinued operations.

Examples—Step 9 allocation

Ex 97 **Several years ago a parent entity, functional currency CU, made a loan in a foreign currency, FCU, to a foreign subsidiary. In 20X6 an exchange loss of CU10,000 arose on the loan. The loan is regarded by the parent as part of its net investment in the foreign subsidiary under Section 30 *Foreign Currency Translation* (see paragraph 30.13). Paragraph 30.13 requires such exchange differences to be recognised in other comprehensive income (OCI), and reported as a component of equity in the consolidated financial statements. The exchange loss is the only item in OCI in the parent's consolidated financial statements for 20X6. The exchange loss is tax deductible when incurred for financial reporting purposes (no deferred tax arises on the FCU loan).**

In the year ended 31 December 20X6 the group's taxable profit is CU500,000 (after deducting the exchange loss). The tax rate for 20X6 is 20%. All group entities have a 31 December 20X6 year end.

The current tax expense for 20X6 is CU100,000 (CU500,000 × 20%).

The tax saving related to the exchange loss is CU2,000 (CU10,000 × 20%).

The tax expense is allocated as follows:

Current tax on accounting profit (balancing figure presented in profit or loss)	CU102,000
Current tax relief on exchange loss (presented in OCI)	(CU2,000)
Current tax expense	CU100,000

Ex 98 **An entity issues new shares. In the entity's jurisdiction, transaction costs associated with the issue of the shares are deductible for tax purposes in the period in which they are incurred. The entity incurred transaction costs of CU1,000. The entity's tax rate is 20%.**

Paragraph 22.9 of Section 22 requires that 'an entity shall account for the transaction costs of an equity transaction as a deduction from equity. **Income tax** relating to the transaction costs shall be accounted for in accordance with Section 29 *Income Tax*'. The transaction costs of CU1,000 will be debited directly to equity and the benefit of the reduction in tax of CU200 is credited directly to equity in the same place as the transaction costs (which, for some jurisdictions, will be the share premium account).

Current/non-current distinction

29.36 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 any deferred tax assets (liabilities) as current assets (liabilities).

Note—Step 9 presentation

All deferred tax assets and all deferred tax liabilities are classified as non-current. If a deferred tax liability arises in Year 1, the earliest it would be included in a tax computation for current tax is the following year, Year 2. The current tax payable for Year 2 will generally be payable after the end of Year 2 as it is only after the end of the year that the taxable profit or loss can be calculated. Consequently, there will be more than one year (from the date of the statement of financial position for Year 1) before any tax is payable.

Offsetting

29.37 An entity shall offset current tax assets and current tax liabilities, or offset deferred tax assets and deferred tax liabilities if, and only if, it has a legally enforceable right to set off the amounts and the entity can demonstrate without undue cost or effort that it plans either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Notes—Step 9 presentation

Offset of current tax assets and liabilities

An entity may have a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income taxes levied by the same taxation authority and the taxation authority permits the entity to make or receive a single net payment.

In consolidated financial statements, a current tax asset of one entity in a group is offset against a current tax liability of another entity in the group, if the entities concerned have a legally enforceable right to make or receive a single net payment, and if the entities can demonstrate without undue cost or effort that they plan to make or receive such a net payment or to recover the asset and settle the liability simultaneously.

Offset of deferred tax assets and liabilities

Deferred tax assets and liabilities arising within the same legal entity can generally be offset, assuming the entity is also a single taxable entity. However, this may not be the case if, for example, a taxable entity has unused capital losses that can only be carried forward and used against future capital gains. In this example, the deferred tax asset that relates to the losses would only be offset against deferred tax liabilities to the extent the deferred tax liabilities relate to unrealised capital gains. To the extent the deferred tax liabilities relate to trading profits, the deferred tax asset arising from capital losses could not be offset against the deferred tax liabilities.

In order to offset specifically identified deferred tax assets and specifically identified deferred tax liabilities, the entity must be able to demonstrate, without undue cost or effort, that it plans either to settle on a net basis or to realise the deferred tax asset and settle the deferred tax liability simultaneously. See below for a discussion about the undue cost or effort exemption.

There is no explicit requirement for the balances to be levied by the same taxation authority. However, in practice it is unlikely that tax balances due to and from different taxation authorities could be offset against one another. Consequently, it is unlikely that deferred tax assets and liabilities of group entities in different jurisdictions will be able to be offset against one another. Even for group entities operating in one jurisdiction, the taxation authorities often do not permit net settlement between different taxable entities.

Consequently, in preparing consolidated financial statements, the deferred tax assets of the separate entities are generally aggregated together. The deferred tax liabilities of the separate entities are generally also aggregated but there may be no further offset of the deferred tax assets with the deferred tax liabilities.

Offset in statement of comprehensive income

The ability to offset the amounts in the statement of financial position does not override the requirement for the tax expense (or benefit) to be appropriately classified within the appropriate component of comprehensive income or equity. Consequently, two amounts might be offset in the statement of financial position but one might be recognised in profit or loss while the other is recognised in either other comprehensive income or in equity.

Undue cost or effort

IAS 12 has separate requirements for offsetting deferred tax assets and liabilities to avoid the need for detailed scheduling, whereas under Section 29 the requirements for offsetting deferred tax assets and liabilities are the same as those for offsetting current tax assets and liabilities. Consequently, an entity applying the *IFRS for SMEs* Standard will need to schedule when each deferred tax asset and liability will reverse to identify whether any or all can be offset. The Board added the undue cost or effort exemption so that offsetting income tax assets and liabilities would not be required if significant detailed scheduling is required to be able to demonstrate eligibility. The exemption is intended to provide relief similar to that in IAS 12 without including the more complex wording used in IAS 12.

Considering whether demonstrating that the entity plans either to settle on a net basis or to realise the asset and settle the liability simultaneously would involve undue cost or effort, depends on the entity's specific circumstances and on management's judgement in assessing the costs and benefits. This judgement requires consideration of how the economic decisions of those expected to use the financial statements could be affected by having the information presented as two separate amounts rather than offset. Applying the requirement would involve undue cost or effort by an SME if the incremental cost or additional effort (for example, endeavours by employees in preparing significant detailed scheduling) substantially exceed the benefits that those expected to use the SME's financial statements would receive from having the information offset rather than presented as two separate amounts (see paragraph 2.14B). If an SME already has, or could easily and inexpensively acquire, the information necessary to comply with a requirement, any related undue cost or effort exemption would not be applicable. This is because, in that case, the benefits to users of the financial statements of having the information would be expected to exceed any further cost or effort by the SME.

Assessing whether a requirement would involve undue cost or effort on initial application should be based on information about the costs and benefits of the requirement at the time of initial application. An entity must make a new assessment of whether a requirement will involve undue cost or effort at each subsequent reporting date, based on information available at that subsequent reporting date (see paragraph 2.14C).

If an entity does not offset tax assets and liabilities because it is unable to demonstrate without undue cost or effort that it plans to settle them on a net basis or realise them simultaneously, the entity shall disclose the amounts that have not been offset and the reasons why applying the requirement would involve undue cost or effort (see paragraph 29.41).

Disclosures

29.38 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.

Notes

In addition to the requirement in paragraph 29.38, paragraph 3.2 requires additional disclosures when compliance with the specific requirements in the *IFRS for SMEs* Standard is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position and financial performance. Consequently, in addition to the disclosures specified in paragraphs 29.39 to 29.41, an entity should provide further information about its circumstances in the note disclosures if such information would be helpful to users of the financial statements.

Paragraph 8.5 requires disclosure of accounting policies that are relevant to an understanding of the financial statements.

29.39 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 temporary differences;

(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 temporary difference of a prior period that is used to reduce tax expense;

(f) adjustments to deferred tax expense (income) arising from a change in the tax status of the entity or its shareholders;

(g) deferred tax expense (income) arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 29.31; and

(h) the amount of tax expense (income) relating to those changes in **accounting policies** and **errors** that are included in **profit or loss** in accordance with Section 10 *Accounting Policies, Estimates and Errors*, because they cannot be accounted for retrospectively.

Notes

It is helpful to users of the financial statements to have the major components of the tax expense/income disclosed. The example below illustrates a possible disclosure required by paragraph 29.39.

Example 99 assumes the entity does not have any income tax expense allocated to other comprehensive income, equity or related to discontinued operations.

Example—disclosure required by paragraph 29.39

Ex 99 **Entity A could disclose income tax expense as follows:**

Note 10 Income tax expense

Income tax expense comprises:

	20X2	***20X1***	*Reference to* IFRS for SMEs *Standard*
	CU	***CU***	
Current income tax expense	44,100	35,000	29.31(a)
Adjustment relating to current tax of 20X0	(100)	–	29.31(b)
Amount of deferred tax expense relating to the origination and reversal of temporary differences	4,500	2,000	29.31(c)
Amount of deferred tax expense (income) relating to changes in tax rates	900	–	29.31(d)
Total income tax expense	**49,400**	**37,000**	

29.40 An entity shall disclose the following separately:

(a) the aggregate current and deferred tax relating to items that are recognised as items of other comprehensive income.

(b) the aggregate current and deferred tax relating to items that are charged or credited directly to equity.

(c) an explanation of any significant differences between the tax expense (income) and accounting profit multiplied by the applicable tax rate. For example such differences may arise from transactions such as revenue that are exempt from taxation or expenses that are not deductible in determining taxable profit (tax loss).

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

(e) for each type of temporary difference and for each type of unused tax losses and tax credits:

(i) the amount of deferred tax liabilities and deferred tax assets at the end of the reporting period; and

(ii) an analysis of the change in deferred tax liabilities and deferred tax assets during the period.

(f) the amount (and expiry date, if any) of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognised in the statement of financial position.

(g) in the circumstances described in paragraph 29.33, an explanation of the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders.

Notes

The example below illustrates one way of presenting the disclosures required by paragraph 29.40.

Example—disclosure required by paragraph 29.40(a), (e) and (f)

It is assumed in this example that there is no current tax relating to items that are recognised as items of other comprehensive income.

Ex 100 **Entity B could satisfy the paragraph 29.40(a), (e) and (f) disclosure for its deferred tax expense as follows:**

[Extract from] Note 14 Deferred tax

Deferred tax liabilities (assets) were recognised as follows:

	Software	*Long-term employee benefit*	*Foreign exchange loss on net investment*	*Unused tax credits*	*Total*
	CU	*CU*	*CU*	*CU*	*CU*
1 January 20X1	170	(500)	20	–	(310)
Charge/(credit) to profit or loss for the year	(68)	(17)	–	–	(85)
Charge/(credit) to other comprehensive income for the year	–	–	(40)	–	(40)
1 January 20X2	102	(517)	(20)	–	(435)
Charge/(credit) to profit or loss for the year	(68)	(31)	–	(200)	(299)
Charge/(credit) to other comprehensive income for the year	–	–	10	–	10
31 December 20X2	34	(548)	(10)	(200)	(724)

The tax credits were provided to the entity for operating in a designated development zone and can only be set off against tax relating to income tax payable on profits from that particular zone. Total unused tax credits at 31 December 20X2 is CU300 (31 December 20X1: CU0). A deferred tax asset has not been recognised for CU100 of the unused tax credits because it is not probable that there will be sufficient taxable profit from the designated operating zone before the tax credits expire. Any unused tax credits will expire on 31 December 20X4.

Example—disclosure required by paragraph 29.40(b)

Ex 101 **Entity C could satisfy the paragraph 29.40(b) disclosure for its current and deferred tax expense/income charged/credited directly to equity as follows:**

[Extract from] Note 21 Share capital

On 18 February 20X1 the entity issued 50,000 CU1 ordinary shares for CU5 each, raising CU250,000. Transaction costs, net of tax, of CU2,700 were incurred in issuing the shares. Tax relief in respect of the transaction costs totals CU1,800.

Example—disclosure required by paragraph 29.40(c)

Ex 102 **Entity D could satisfy the paragraph 29.40(c) disclosure as follows:**

[Extract from] Note 11 Income tax expense

Current tax is calculated at 40% in 20X2 (20X1: 40%) of the estimated taxable profit for the year. Deferred tax has also been calculated by applying a rate of 40% in 20X2 (20X1: 40%).

Income tax expense for the year, CU230 in 20X2 (CU197 in 20X1), differs from the amount that would result from applying the tax rate of 40% (both 20X2 and 20X1) to profit before tax because, under the tax laws of Jurisdiction D, some employee compensation expenses (CU31 in 20X2 and CU45 in 20X1) that are recognised in measuring profit before tax are not tax-deductible.

Note: The example note disclosure above is intended to illustrate a possible note and so does not purport to illustrate all possible differences. Other possible differences include:

- recognition of deferred tax assets not previously recognised, and vice versa;
- a change in rate used to compute deferred tax recognised at the start of the period;
- income taxed at a different rate, for example, capital gains; and
- under or over estimation of tax in prior periods.

Example—illustration of paragraph 29.40(d) if there is a change in tax rates

Ex 103 **Entity E could satisfy the paragraph 29.40(d) disclosure as follows:**

[Extract from] Note 10 Deferred tax [from the financial statements for the year ended 31 December 20X2]

A change in the income tax rate from 20% to 22% was enacted on 1 July 20X2, effective from 1 January 20X3. Deferred tax assets and liabilities on temporary differences that are expected to reverse after 1 January 20X3 are measured at 22%. Current tax for 20X2 was calculated at 20%, which is the rate that will apply for that calculation. The effective tax rate for 20X2 (calculated by dividing the tax charge by the profit before tax) is 20.6%.

In 20X1 all deferred tax assets and liabilities, as well as current tax, were measured at 20% and the effective tax rate was 20%.

Example—illustration of paragraph 29.40(g)

Ex 104 **Entity F could satisfy the paragraph 29.40(g) disclosure as follows:**

[Extract from] Note 12 Income tax expense

The entity operates in a jurisdiction where income taxes are payable at a higher rate on undistributed profits (50%) with an amount being refundable when profits are distributed. The tax rate on distributed profits is 35%.

At 31 December 20X1, the entity did not recognise a liability for dividends payable because dividends for the year were declared after the year end. Consequently, the entity recognised current tax expense based on the higher rate of 50%. In 20X2 when the entity declares the dividend of CU10,000, the entity becomes entitled to the recovery of CU1,500 of current tax. This will be recognised as a current tax asset on the date the dividends are declared and a corresponding reduction in the current tax expense will be recognised in 20X2.

During 20X1 the entity recognised a reduction in the current tax expense of CU1,440 when the dividend of CU9,600 was declared on 11 May 20X1.

29.41 If an entity does not offset tax assets and liabilities in accordance with paragraph 29.37 because it is unable to demonstrate without undue cost or effort that it plans to settle them on a net basis or realise them simultaneously, the entity shall disclose the amounts that have not been offset and the reasons why applying the requirement would involve undue cost or effort.

Notes

When an entity uses the undue cost or effort exemption, the Standard requires the entity to disclose this fact so users of the financial statements are alerted to the fact it has been used.

Example—illustration of paragraph 29.41

Ex 105 **Entity G could satisfy the paragraph 29.41 disclosure in its financial statements as follows:**

[Extract from] Note 10 Deferred tax

As shown above, at 31 December 20X1 the entity has a deferred tax asset of CU43,000 and a deferred tax liability of CU105,000. The deferred tax liability all arises from trading, whereas CU10,000 of the deferred tax asset arises from capital transactions and the remaining CU33,000 arises from trading. The CU33,000 asset resulting from trading will be realised and the liability will be settled over a number of years. It would be necessary to undertake significant detailed scheduling to determine whether any of the CU33,000 deferred tax asset arising from trading could be offset against an equivalent amount of the deferred tax liability, and the entity is unable to demonstrate without undue cost or effort the extent to which any of the CU33,000 deferred tax asset could be settled on a net basis or simultaneously with an equivalent amount of the deferred tax liability. Consequently, the entity has presented the asset and the liability separately in its statement of financial position.

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* Standard to transactions and events often requires the exercise of judgement, including making estimates. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful when assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements—apart from those involving estimates—that its management has made when applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.
Furthermore, applying paragraph 8.7, an entity must disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Other sections of the *IFRS for SMEs* Standard require disclosure of information about particular judgements and estimation uncertainties.

Some of the judgements in accounting for income tax are set out below.

Scope

Determining whether a tax is an 'income tax' sometimes requires judgement, based on the specific facts and circumstances (eg the nature of the tax and how it is determined).

Assessing tax on 'revenue less certain specified costs' or on 'a percentage of revenue' is not equivalent to assessing tax on income less expenses. However, to the extent that the amounts are determined as a surrogate for taxable profit (for example, the percentage applied to revenue is determined based on historical net margins and is set to approximate taxable profit), doing so may imply that the tax is an income tax in nature and thus should be accounted for under Section 29. Judgement needs to be applied based on a careful consideration of all the facts.

A tax calculated based on the volume of products sold would not be within the scope of Section 29 because it is not based on taxable profits.

If an entity is required to pay tax calculated as the sum of two components, an amount based on the volume of products sold and an amount based on profits, with the amount based on profits only being payable if the volume of products sold is over a certain minimum level, although the amount based on the volume of products sold would be outside the scope of Section 29, any additional amounts due for the profit-based component would be considered to be income tax within the scope of Section 29.

Recognition of deferred tax

Deferred tax assets

Deferred tax assets can only be recognised for deductible temporary differences, unused tax losses and unused tax credits to the extent it is probable that taxable profit will be available against which the deductible temporary differences, unused tax losses and unused tax credits can be utilised. Determining the extent to which it is probable that taxable profit will be available to utilise the temporary differences, tax losses and/or credits is likely to be an area of significant judgement. Section 29 contains guidance and sets out an order to consider possible sources of future taxable profit, starting with the most objective and more easily identifiable sources, namely, taxable temporary differences relating to the same taxation authority and same taxable entity that are recognised in the financial statements.

Future reversals of existing taxable temporary differences can be objectively verified. Future taxable profit (exclusive of future reductions in existing temporary differences) and tax planning strategies represent future events and, therefore, are more subjective. Thus when deductible temporary differences and/or unused tax losses and tax credits exceed taxable temporary differences, more judgement will be required.

An entity shall consider all available evidence, both positive and negative, to determine whether, on the basis of the weight of that evidence, it is more likely than not that taxable profits will be available.

Ordinarily, information about an entity's present financial position and its results of operations for the current and preceding years is readily available. That historical information is supplemented by all currently available information about future years. Sometimes, however, historical information may not be available (for example, in the case of start-up operations) or it may not be as relevant (for example, if there has been a recent change in circumstances) in which case other evidence is required to support a conclusion that it is more likely than not that taxable profits will be available for the entity to use temporary differences and unused tax losses and credits.

The level of judgement and uncertainty increases even further when the entity has incurred losses in the current and preceding periods and the recovery of the temporary differences, losses and credits depends upon future taxable profits in excess of those arising from the reversals of existing taxable temporary differences. As Section 29 explains, the existence of unused tax losses is strong evidence that future taxable profit may not be available.

Other examples of negative evidence include, but are not limited to, the following:

(a) losses expected in early future years by a currently profitable entity;

(b) uncertain circumstances that, if unfavourably resolved, would adversely affect future operations and profit on a continuing basis. For example if the entity discovers it has sold faulty products to customers and it is concerned that once this is discovered it will affect sales in the future;

(c) a carryback or carryforward period that is so brief that it would limit realisation of tax benefits if a significant temporary difference is expected to reduce to zero in a single year or the entity operates in a traditionally cyclical business.

Examples of other evidence that might support a conclusion that sufficient taxable profit is probable, despite negative evidence include, but are not limited to, the following:

(a) contracts or firm sales backlog that will produce more than enough taxable income to realise the deferred tax asset using existing sales prices and cost structures for example, a five-year contract with lucrative terms.

(b) an excess of unrecognised asset value over the tax basis of the entity's net assets sufficient to realise the deductible temporary differences.

(c) a strong earnings history exclusive of any loss that created the deductible temporary difference, coupled with evidence indicating that the loss results from identifiable causes that are unlikely to recur. For example, the loss may relate to a natural disaster such as flooding.

An entity shall use judgement in considering the relative effect of negative and positive evidence. The weight given to the potential effect of negative and positive evidence shall be commensurate with the extent to which it can be objectively verified. The more negative evidence that exists, the more positive evidence is necessary, and the more difficult it is to conclude that it is probable there will be sufficient taxable profit to utilise the deductible temporary differences, unused tax losses or tax credits.

Investments in subsidiaries, branches and associates, and interests in joint ventures

Paragraph 29.25 exempts an entity from recognising a deferred tax liability for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures where the parent, investor or venture is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. In some cases significant judgement is required to determine whether it is probable that a temporary difference will not reverse in the foreseeable future. In consolidated financial statements a temporary difference could arise when there are undistributed profits in the investee and the following are examples of some of the factors that would be considered in making the assessment in this case:

- any specific plans made for reinvestment such as to grow the investee;
- any agreements in place that would require a dividend payment to be made or established policies for paying dividends; and
- whether any legal requirements exist that would force the investee to pay distributions.

It will be harder to provide evidence of specific plans for reinvesting an associate's undistributed earnings to demonstrate that it is probable that the temporary difference will not reverse in the foreseeable future than it would be to provide similar evidence about a subsidiary. This is because the investor does not have control over an associate, and so it will not be able to set up plans for the undistributed profits of the associate to be reinvested without the agreement of other investors.

Temporary differences may arise in various other circumstances; for example:

- changes in the fair value of investments in associates or joint ventures where the investment is remeasured at fair value (if the fair value model is applied) and no equivalent adjustment is made for tax purposes;
- changes in foreign exchange rates when a parent and its investee have different functional currencies (only subsidiaries and associates/joint ventures accounted for using equity accounting);
- changes in the tax base of the investment (eg indexation allowances); or
- a reduction in the carrying amount of an investment in an associate or joint venture to its recoverable amount due to impairment (only where such investments are accounted for using the cost model or equity accounting).

Whether or not the first three reverse depends on movements in fair value, exchange rates and indices and thus are not within the investor's control. Although in some circumstances, the fourth difference may be unlikely to reverse, it is unlikely to be in the control of the investor.

Paragraph 29.26 only permits an entity to recognise a deferred tax asset for deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint ventures to the extent it is probable that the temporary difference will reverse and that taxable profit will be available against which the temporary difference can be utilised. Similar to the discussion above about deferred tax liabilities arising from investments in subsidiaries, branches and associates, and interests in joint ventures, significant judgement may be required in determining whether a deferred tax asset can be recognised. The factors affecting the judgement about whether the difference will reverse are the same as discussed above for a liability. Additionally, for assets, judgement is required to determine whether there will be sufficient taxable profit available against which the temporary difference can be utilised. This is also discussed above.

Measurement

Graduated tax rates

When different tax rates apply to different levels of taxable profit, an entity may need to apply judgement in estimating the average rates that will be applicable when it expects the taxable and deductible temporary differences to reverse. For example, an entity may need to estimate taxable profits in a future year to determine the tax rate that will apply in that year.

Substantive enactment

In some jurisdictions particular actions by the government relating to tax rates and tax laws have the substantive effect of actual enactment, even though official enactment may not have taken place. In such cases, judgement will need to be applied in determining whether or not the actions by the government mean a change in tax rates or tax laws has been substantively enacted. Normally, whether or not substantive enactment constitutes actual enactment will be decided for all entities within a single tax jurisdiction for consistency (this would generally be determined by a consensus of the accounting profession, rather than by each entity individually).

Uncertain tax positions

Judgement needs to be applied when there is uncertainty over the treatment of amounts reported on the tax return, for example if an entity is unsure whether a particular expense meets the requirements to be tax-deductible. The assessment may be quite a subjective process.

COMPARISON WITH FULL IFRS STANDARDS

Full IFRS Standards (see IAS 12 *Income Taxes*) and Section 29 of the *IFRS for SMEs* Standard share similar principles for recognising and measuring income tax, although Section 29 is modified to be consistent with the other requirements of the *IFRS for SMEs* Standard.

The main differences set out below between Section 29 and full IFRS Standards are prepared on the basis of requirements for periods beginning on 1 January 2017:

- The *IFRS for SMEs* Standard is drafted in simpler language and includes less guidance on how to apply the principles.
- Section 29 contains additional clarification that 'substantively enacted' means the remaining steps in the enactment process have not affected the outcome in the past and are unlikely to do so. This guidance is not in IAS 12.
- An amendment to IAS 12 in 2016 (which is not in Section 29) states that when an entity assesses whether sufficient future taxable profits will be available against which it can utilise a deductible temporary difference:
    - if tax law restricts the utilisation of losses to deduction against income of a specific type, a deductible temporary difference is assessed in combination only with other deductible temporary differences of the appropriate type;
    - the entity compares the deductible temporary differences with future taxable profit that excludes tax deductions resulting from the reversal of those deductible temporary differences; and
    - the estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this.
- Section 29 precludes the discounting of current and deferred tax assets and liabilities whereas IAS 12 only precludes the discounting of deferred tax assets and liabilities.
- Section 29 contains guidance on recognising withholding tax on dividends paid to shareholders. IAS 12 does not contain such guidance.
- IAS 12 has separate requirements for offsetting deferred tax assets and liabilities to avoid the need for detailed scheduling, whereas under Section 29 the requirements for offsetting deferred tax assets and liabilities are the same as for offsetting current tax assets and liabilities. However, Section 29 includes an undue cost or effort exemption so that offsetting income tax assets and liabilities would not be required if significant detailed scheduling is required. The exemption is intended to provide similar relief to IAS 12 without including the more complex wording used in IAS 12.
- Section 29 contains simplified presentation requirements compared to IAS 12.
- Section 29 contains fewer, and more simplified, disclosures than IAS 12.

Module 29 – Income Tax

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for accounting and reporting income tax applying the *IFRS for SMEs* Standard by answering the questions provided.

You should assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those set out beneath it.

Mark the box next to the most correct statement.

Question 1

Income tax consists of:

☐ (a) domestic taxes that are based on taxable profits.

☐ (b) foreign taxes that are based on taxable profits.

☐ (c) taxes that are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.

☐ (d) all the above.

Question 2

An entity determines its taxable profit for the year ended 30 April 20X8 to be CU200,000. The tax rate for 20X8 is 40%. Which of the following journal entries is appropriate to record the current tax for the year?

☐	(a)	Debit Current tax asset	CU80,000	
		Credit Current tax income		CU80,000
☐	(b)	Debit Current tax asset	CU200,000	
		Credit Current tax income		CU200,000
☐	(c)	Debit Current tax expense	CU80,000	
		Credit Current tax liability		CU80,000
☐	(d)	Debit Current tax expense	CU200,000	
		Credit Current tax liability		CU200,000

Question 3

An entity makes a taxable loss for the year ended 30 April 20X8 of CU30,000. For the year ended 30 April 20X7 the entity had taxable profits of CU20,000. In the entity's jurisdiction, tax losses are allowed to be carried back to the prior year only. The tax rate is 40% for both the tax year 20X7/20X8 and the tax year 20X6/20X7. What journal entry should the entity make on 30 April 20X8 for the tax loss carryback?

☐	(a)	Debit Current tax asset	CU8,000	
		Credit Current tax income		CU8,000
☐	(b)	Debit Current tax asset	CU12,000	
		Credit Current tax income		CU12,000
☐	(c)	Debit Current tax expense	CU8,000	
		Credit Current tax liability		CU8,000
☐	(d)	Debit Current tax expense	CU12,000	
		Credit Current tax liability		CU12,000

Question 4

On 31 December 20X1, an entity has an asset of CU4,000 for interest receivable that will be taxed when the cash is received in 20X2. Tax is payable at 20% on the first CU500,000 of taxable profit earned and 30% on any remainder (that is, any excess above CU500,000). In 20X1 the entity earned taxable profit of CU450,000. In 20X2 the entity expects to earn taxable profit of CU550,000. What is the tax base?

☐ (a) CU4,000.
☐ (b) CU800.
☐ (c) Nil.
☐ (d) CU836.
☐ (e) CU1,200.

Question 5

The facts are the same as in question 4. Which of the following is the temporary difference?

☐ (a) CU4,000.
☐ (b) CU800.
☐ (c) Nil.
☐ (d) CU836.
☐ (e) CU1,200.

Question 6

The facts are the same as in question 4. Which amount should the entity recognise for the deferred tax liability relating to the interest receivable?

- ☐ (a) CU4,000.
- ☐ (b) CU800.
- ☐ (c) Nil.
- ☐ (d) CU836.
- ☐ (e) CU1,200.

Question 7

Which of the following deferred tax liabilities should not be recognised by an entity?

- ☐ (a) A deferred tax liability for temporary differences associated with unremitted earnings from foreign subsidiaries, branches, associates and joint ventures to the extent that the parent, investor or venture is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.
- ☐ (b) A deferred tax liability for a temporary difference associated with the initial recognition of goodwill.
- ☐ (c) Both (a) and (b).

Question 8

What is the correct treatment regarding discounting of current and deferred tax assets and liabilities?

- ☐ (a) Current tax assets and liabilities are discounted. Deferred tax assets and liabilities are not discounted.
- ☐ (b) Current tax assets and liabilities are not discounted. Deferred tax assets and liabilities are discounted.
- ☐ (c) Current and deferred tax assets and liabilities are discounted.
- ☐ (d) Current and deferred tax assets and liabilities are not discounted.

Question 9

In 20X1 an entity reports taxable profit of CU50,000 to the tax authority, which will be taxed at the corporate income tax rate in the jurisdiction. The applicable income tax rate is 30% and this has been the rate for at least 10 years. In February 20X2, one month before the entity finalised its financial statements for the year ended 31 December 20X1, the Government in the jurisdiction unexpectedly announced a change in the income tax rate to 32% effective for profits earned during the year ended 31 December 20X1 and enacted this within a week of the announcement. The capital gains tax rate is 10%; this has been the rate for the last decade and no change to the rate was announced or enacted in February 20X2. In addition to the taxable profit of CU50,000, the entity has a capital gain of CU6,000.

How should the entity measure its current tax liability at 31 December 20X1?

- ☐ (a) CU16,600.
- ☐ (b) CU17,920.
- ☐ (c) CU15,600.
- ☐ (d) CU16,800.

Question 10

An entity operates in a jurisdiction where income taxes are payable at a lower rate on undistributed profits (20%) with an additional amount (10%) being payable when profits are distributed (that is, the tax rate on distributed profits is 30%). On 31 December 20X1 the entity expects to propose dividends in March 20X2 of approximately CU20,000 for the year ended 20X1. The financial statements will be authorised for issue in April 20X2. Taxable profit for 20X1 is CU100,000. The entity has temporary differences that are expected to increase taxable profit in the future for the year 20X1 of CU30,000. The entity was formed on 1 January 20X1. On 31 December 20X1 the entity should recognise the following:

- ☐ (a) A current tax liability (and expense) of CU20,000 and a deferred tax liability (and expense) of CU6,000.
- ☐ (b) A current tax liability (and expense) of CU20,000 and a deferred tax liability (and expense) of CU8,000.
- ☐ (c) A current tax liability (and expense) of CU20,000 and a deferred tax liability (and expense) of CU9,000.
- ☐ (d) A current tax liability (and expense) of CU22,000 and a deferred tax liability (and expense) of CU6,000.
- ☐ (e) A current tax liability (and expense) of CU30,000 and a deferred tax liability (and expense) of CU9,000.

Module 29 – Income Tax

Answers

Q1 (d) see paragraph 29.1
Q2 (c) see paragraph 29.4—CU200,000 × 40%
Q3 (a) see paragraph 29.5—CU20,000 × 40%
Q4 (c) see paragraph 29.9
Q5 (a) see paragraph 29.12
Q6 (d) see paragraph 29.19—
((CU500,000 × 20%) + (CU50,000 × 30%)) ÷ CU550,000 = CU115,000 ÷ CU550,000 = 20.91%.
CU4,000 × 20.91% = CU836
Q7 (c) see paragraphs 29.14(a) and 29.25
Q8 (d) see paragraph 29.32
Q9 (c) see paragraph 29.6 and 29.32—(CU50,000 × 30%) + (CU6,000 × 10%)
Q10 (a) see paragraph 29.33—(CU100,000 × 20%) + (CU30,000 × 20%)

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for accounting and reporting income tax applying the *IFRS for SMEs* Standard by completing the case studies provided.

Once you have completed a case study, check your answers against those set out beneath it.

Case study 1

SME A has a financial year end of 31 March. The tax year in SME A's tax jurisdiction runs from 1 April to 31 March. The tax law permits entities to carry tax losses back two years and set them off against any taxable profits of those prior years. Tax law also permits any tax losses that cannot be carried back, to be carried forward 10 years. The income tax liability due for the year ended 31 March is payable by 15 December of the same year.

SME A is not part of a group.

In the year ended 31 March 20X0, SME A made a tax loss of CU80,000 because of an unexpected localised flood and the unanticipated closure of a major supplier. These two events are considered one-off events and at the time SME A was expected to return to profitability and remain profitable for the foreseeable future. At 1 April 20X0 CU9,000 of that tax loss could not be carried back to the years ended 31 March 20W8 and 20W9, and remains unused.

In SME A's tax jurisdiction the standard income tax rate of 30% has applied for many years. On 1 November 20X0 the tax authority announced a change in tax rate from 30% to 32% which will take effect for taxable income arising in accounting periods beginning on or after 1 April 20X1. The announcement on 1 November 20X0 is considered substantive enactment.

For the year ended 31 March 20X1, SME A recognised total comprehensive income before tax of CU125,000 and profits are expected to grow in the near future. SME A had no items of other comprehensive income.

In the year ended 31 March 20X0 and 20X1 the rules for determining taxable profit are identical to determining profits for financial reporting purposes under the *IFRS for SMEs* Standard except in respect of the five transactions/items described separately below. Also assume there are no other assets, liabilities or items that will affect the recognition and measurement of deferred tax.

Machinery

On 31 March 20X1, SME A has machinery costing CU500,000 that was purchased on 1 April 20X9 and is measured at depreciated cost. The cost of the machine is deductible from taxable income either as the machine is used (via tax depreciation) or, alternatively, on sale. Tax depreciation is applied on a straight-line basis over five years. For financial reporting purposes, the machinery is being depreciated on a straight-line basis over 10 years to its residual value of nil. Income generated by using the machine is taxable, and any gain or loss on disposal of the machine will be taxable or deductible for tax purposes through a balancing adjustment (such as clawback of capital allowances claimed). At 31 March 20X1 CU200,000 of tax depreciation has been deducted in the years ended 31 March 20X0 and 31 March 20X1 and the remaining cost will be deductible in future periods either as depreciation or through a deduction on disposal.

Research costs

Research costs of CU4,000 were recognised as an expense in determining accounting profit for 20X1, but are permitted as a deduction in determining taxable profit in the next two years (CU2,000 in 20X2 and CU2,000 in 20X3). No research costs were charged in previous years.

Employee benefits

On 31 March 20X1, SME A has a liability for an amount due to employees of CU50,000 relating to services already rendered by the employees to the entity. It is due to be paid in April 20X1. The expense is tax-deductible when paid. On 31 March 20X0 there was a similar liability for CU60,000 which was paid in April 20X0. The CU60,000 is tax-deductible in the year ended 31 March 20X1, but is expensed in 20X0 for financial reporting purposes, and the CU50,000 is tax-deductible in the year ended 31 March 20X2, but expensed in 20X1 for financial reporting purposes giving an additional decrease in taxable profit over accounting profit for the year ended 31 March 20X1 of CU10,000.

Trade receivables

On 31 March 20X1, SME A has gross trade receivables of CU300,000 with an allowance for bad or doubtful debts set against it for CU20,000. An allowance for bad or doubtful debts is only tax-deductible when the debt is six months overdue and formally written off. At 31 March 20X1 all the CU20,000 receivables to which the allowance related were less than six months' old and SME A anticipated that all CU20,000 receivables would be written off during the following year. On 31 March 20X0 the entity had gross trade receivables of CU250,000 with an allowance for bad or doubtful debts set against it for CU15,000. All CU15,000 receivables to which the allowance related became more than six months' old, and were formally written off, during the year ended 31 March 20X1, but at 31 March 20X0 all were less than six months' old.

Fine

On 15 January 20X1 SME A paid a fine of CU30,000 for accidental pollution of a nearby lake. This amount is recognised as an expense from accounting profit for 20X1. However, the fine is not tax deductible.

Part A
Prepare journal entries to record the current tax expense and deferred tax expense for the year ended 31 March 20X1.

Part B
Prepare extracts from the financial statements for the year ended 31 March 20X1 showing how to present and disclose income tax (that is, extracts from the statement of income and retained earnings, statement of financial position and accounting policy note, and also notes satisfying the disclosure requirements in Section 29).

Ignore the statement of cash flows.

Some of the comparatives will not be determinable. If this is the case, mark 'X' in place of the number.

Answer to Case study 1

Part A

Year ended 31 March 20X1

Current tax

Dr Income tax—current tax (profit or loss)	CU28,500[(a)]	
Cr Current tax liability		CU28,500

To recognise the current tax expense for the year ended 31 March 20X1 in profit or loss.

Deferred tax

Dr Income tax—deferred tax (profit or loss)	CU18,520[(b)]	
Cr Deferred tax asset		CU1,520[(b)]
Cr Deferred tax liability		CU17,000[(b)]

To recognise the change in the deferred tax assets and liabilities between 1 April 20X0 and 31 March 20X1 in profit or loss.

Part B

SME A

[Extract from] Statement of income and retained earnings for the year ended 31 March 20X1

	Note	*Year ended 31 March 20X1 CU*	*Year ended 31 March 20X0 CU*
Revenue		X	X
Cost of sales		X	X
Gross profit		X	X
Other income		X	X
Distribution costs		X	X
Administrative expenses		X	X
Other expenses		X	X
Finance costs		X	X
Profit before tax		125,000	X
Income tax expense	10	47,020 [(b)]	X
Profit after tax		X	X
Retained earnings at the start of the year		X	X
Dividends		X	X
Retained earnings at the end of the year		X	X

SME A

[Extract from] Statement of financial position at 31 March 20X1

	31 March 20X1 *CU*	*31 March 20X0* *CU*
ASSETS		
Current assets		
Cash	X	X
Current tax asset	–	21,300 [(d)]
Trade and other receivables	X	X
Inventories	X	X
	X	X
Non-current assets		
Property, plant and equipment	X	X
Intangible assets	X	X
Deferred tax asset	23,680[(e)]	25,200 [(c)]
	X	X
Total assets	X	X
LIABILITIES AND EQUITY		
Current liabilities		
Bank overdraft	X	X
Trade payables	X	X
Interest payable	X	X
Current tax liability	28,500 [(a)]	–
Non-current liabilities		
Bank loan	X	X
Deferred tax liability	32,000 [(e)]	15,000[(c)]
Total liabilities	X	X
Equity		
Share capital	X	X
Retained earnings	X	X
	X	X
Total liabilities and equity	X	X

SME A

[Extract from] Notes

Note 2 Accounting policies [extract]

Income tax

Income tax expense represents the sum of the amounts charged in the reporting period in respect of current tax and deferred tax.

Income tax expense is recognised in profit or loss, other comprehensive income or directly in equity depending on the transaction or other event that resulted in the tax expense.

Current tax

Current tax for the year is based on taxable profit for the year. Current tax is calculated using tax rates and laws that have been enacted or substantively enacted by the end of the reporting period. A formal government announcement of changes in tax rates or tax laws is considered substantive enactment in the jurisdiction.

Deferred tax

Deferred tax is recognised on differences (known as temporary differences) between the carrying amounts of assets, liabilities or other items in the financial statements and their respective tax bases.

Deferred tax liabilities are recognised for all temporary differences that are expected to increase taxable profit in the future when the carrying amount of the asset or liability is recovered or settled, except to the extent that the deferred tax liability arises from the initial recognition of goodwill or the initial recognition of an asset or a liability in a transaction that is not a business combination and, at the time of the transaction, neither affects accounting profit nor taxable profit or loss.

Deferred tax assets are recognised for all temporary differences that are expected to reduce taxable profit in the future when the carrying amount of the asset or liability is recovered or settled, but: (i) only to the extent that it is probable that taxable profits will be available against which the deductible temporary differences can be utilised; and (ii) not if the deferred tax asset arises from the initial recognition of an asset or a liability in a transaction that is not a business combination and, at the time of the transaction, neither affects accounting profit nor taxable profit or loss.

Deferred tax assets are also recognised for the carryforward of unused tax losses and unused tax credits to the extent it is probable that taxable profits will be available against which the tax losses or credits can be utilised.

The carrying amount of deferred tax assets is reviewed at each reporting date and is adjusted to reflect the current assessment of future taxable profits. Any adjustments are reflected in profit or loss.

Deferred tax is calculated using the tax rules and at the tax rates that are expected to apply to the taxable profit (tax loss) of the periods in which it expects the deferred tax asset to be realised or the deferred tax liability to be settled, on the basis of tax rules and rates that have been enacted or substantively enacted by the end of the reporting period.

SME A

[Extract from] Note 10 Income tax expense

	Year ended 31 March 20X1 *CU*	*Year ended 31 March 20X0* *CU*
Tax expense comprises:		
Current tax expense	28,500[a]	–
Adjustments recognised in period for current tax of prior periods	–	–
Amount of deferred tax expense relating to the origination and reversal of temporary differences	18,000[f]	X
Amount of deferred tax expense (income) relating to changes in tax rates	520[f]	–
Total tax expense	47,020[b]	X

The following deferred tax liabilities (assets) are recognised by the Company[c] & [e]:

	Machinery	*Research and development costs*	*Employee Benefits*	*Trade receivables*	*Unused tax losses*	*Total*
	CU	*CU*	*CU*	*CU*	*CU*	*CU*
1 April 20W9	–	–	X	X	–	X
Charge (credit) to profit or loss for the year	15,000	–	X	X	–	X
31 March 20X0	15,000	–	(18,000)	(4,500)	(2,700)	(10,200)
Charge (credit) to profit or loss for the year	17,000	(1,280)	2,000	(1,900)	2,700	18,520
31 March 20X1	32,000	(1,280)	(16,000)	(6,400)	–	8,320

Taxable profit differs from profit as reported in the statement of income, because of items of income or expense that are taxable or deductible in different years, and items that are never taxable or deductible. Current tax is calculated at 30% in 20X1 (20X0: 30%) of the estimated taxable profit for the year. A change in the income tax rate from 30% to 32% was substantively enacted on 1 November 20X0, effective for taxable income arising in accounting periods beginning on or after 1 April 20X1. Deferred tax assets and liabilities on temporary differences that are expected to reverse after 1 April 20X1 are measured at 32% (20X0: 30%).

Tax law permits entities to carry tax losses back two years and to set them off against profits of that prior year. Tax law also permits any tax losses that cannot be carried back to be carried forward 10 years.

The income tax expense for the year (the sum of the amounts charged in the reporting period in respect of current tax and deferred tax) of CU47,020 in 20X1 differs from the amount that would result from applying the tax rate of 30% to profit before tax in the statement of income because:

a. Under the tax laws of [name of the SME A's tax jurisdiction], some expenses that are deducted in measuring accounting profit are not tax deductible. In 20X1 SME A incurred a fine of CU30,000 when it accidently polluted a nearby lake; this amount is not deductible for tax purposes but has been charged in the income statement.
b. During the year a change in tax rate was substantively enacted. This will take effect for taxable income arising in accounting periods beginning on or after 1 April 20X1. Consequently, the deferred tax asset and liability at 31 March 20X1 have been calculated using 32%, not 30%.

The following calculations and explanatory notes do not form part of the journal entries or the financial statement disclosure:

(a) Current tax payable on taxable profit may be determined as follows:

	CU
Total comprehensive income for the year ended 31 March 20X1	125,000
Less additional depreciation deductible (CU100,000 less CU50,000)	(50,000)
Plus research expenses not tax deductible until 20X2 and 20X3	4,000
Plus bad debt allowance provided in year not tax deductible	20,000
Less bad debts written off in year which are tax deductible	(15,000)
Less additional employee benefits tax deductible in 20X1 (CU60,000 less CU50,000)	(10,000)
Plus fine for polluting lake which is not tax deductible	30,000
Taxable profit before consideration of unused tax losses	104,000
Tax loss brought forward and utilised	(9,000)
Taxable profit on which current tax payable	95,000
Current tax payable (30% × CU95,000)	28,500

In this case study taxable profit has been calculated by starting with accounting profit and adjusting for the differences arising when the tax rules require something different from what was included in the accounting profit. Other methods of determining taxable profit and current tax expense are equally appropriate, such as determining taxable profit separately from accounting profit. The method used in this case study is usually the simplest method if the tax rules are similar to accounting under the *IFRS for SMEs* Standard (that is, they differ only in a few instances).

(b) The movement in the net deferred tax asset/liability for the year is an expense of CU18,520 (CU10,200[c] + CU8,320[e]). This comprises an increase in the deferred tax liability of CU17,000 (CU32,000[e] less CU15,000[c]) and a decrease in the deferred tax asset of CU1,520 (CU25,200[c] less CU23,680[e]). Hence the total income tax expense for the year ended 31 March 20X1 is CU47,020 (CU18,520 deferred tax + CU28,500[a] current tax).

(c) Deferred tax assets and liabilities on 31 March 20X0:

Item – Whether recovery or settlement of carrying amount expected to affect taxable profit	*Carrying amount*	*Tax base*	*Temporary difference*	*Deferred tax @30%*
Machinery - Yes	CU450,000	CU400,000	CU50,000	DT liability of CU15,000
Employee benefits - Yes	CU(60,000)	–	CU(60,000)	DT asset of CU18,000
Trade receivables - Yes	CU235,000	CU250,000	CU(15,000)	DT asset of CU4,500

Including the deferred tax asset of CU2,700 (CU9,000[d] × 30%) for the unused tax losses of 20X0, SME A has a deferred tax asset of CU25,200 (CU2,700 + CU18,000 + CU4,500) and a deferred tax liability of CU15,000.

SME A has taxable temporary differences of CU15,000 that will result in future taxable amounts and expects to have sufficient future taxable profits to realise the full deferred tax asset. However, the deferred tax liability reverses later than the deferred tax asset and, consequently, SME A is not able to offset the two.

(d) In the year ended 31 March 20X0, SME A made a tax loss of CU80,000. Of that tax loss, CU9,000 remains unused on 1 April 20X0 which cannot be carried back to prior years. This means CU71,000 (CU80,000 less CU9,000) was carried back to the years ended 31 March 20W8 and 20W9. SME A should recognise a current asset for the tax refund of CU21,300 (CU71,000 × 30%) on 31 March 20X0.

(e) Deferred tax assets and liabilities on 31 March 20X1:

Item – Whether recovery or settlement of the carrying amount of the item expected to affect taxable profit	*Carrying amount*	*Tax basis*	*Temporary difference*	*Deferred tax @32%*
Machinery – Yes	CU400,000	CU300,000	CU100,000	DT liability of CU32,000
Research costs – Yes	–	CU(4,000)	CU(4,000)	DT asset of CU1,280
Employee Benefits – Yes	(CU50,000)	–	CU(50,000)	DT asset of CU16,000
Trade receivables – Yes	CU280,000	CU300,000	CU(20,000)	DT asset of CU6,400

SME A has a deferred tax asset of CU23,680 (CU1,280 + CU16,000 + CU6,400) and a deferred tax liability of CU32,000.

SME A has sufficient taxable temporary differences that will result in future taxable amounts to realise the deferred tax asset. Consequently the full deferred tax asset can be recognised. However, the deferred tax asset and liability may not be offset because the temporary differences giving rise to the deferred tax asset reverses earlier than, not simultaneously with, those giving rise to the deferred tax liability.

(f) At 31 March 20X1 there is a deferred tax liability of CU8,320. Although the effective tax rate applying during the year ended 31 March 20X1 was 30%, the deferred tax liability was provided using the tax rate of 32% because, on 1 November 20X0, the tax rate for taxable income arising in accounting periods beginning on or after 1 April 20X1 changed to 32%. If the tax rate had remained at 30%, the net deferred tax liability at 31 March 20X1 would have been CU7,800 (8,320[e] × 30 ÷ 32). Accordingly, CU520 (CU8,320 less CU7,800) of the deferred tax expense is due to the change in tax rates from 30% to 32%. The remaining CU18,000 (CU18,520[b] less CU520) deferred tax expense is due to the origination and reversal of temporary differences.

Case study 2

On 1 January 20X5, Entity A acquired 100% of the shares of Entity B at a cost of CU600,000. At the acquisition date the tax base of Entity A’s investment in Entity B is CU600,000. Reductions in the carrying amount of goodwill are not deductible for tax purposes, and the cost of the goodwill would also not be deductible if Entity B were to dispose of its underlying business. The tax rate in Entity A’s tax jurisdiction is 30% and the tax rate in Entity B’s tax jurisdiction is 40%.

The following table sets out the fair value of the identifiable assets acquired and liabilities assumed (excluding deferred tax assets and liabilities) by Entity A on 1 January 20X5, together with their tax bases in Entity B’s tax jurisdiction and the resulting temporary differences:

	Amounts recognised at acquisition in consolidated financial statements	*Tax base in Entity B’s jurisdiction*	*Temporary differences*
	CU	*CU*	*CU*
Property, plant and equipment	270,000	155,000	115,000
Accounts receivable	210,000	210,000	–
Inventory	174,000	124,000	50,000
Retirement benefit obligations	(30,000)	–	(30,000)
Accounts payable	(120,000)	(120,000)	–
Fair value of the identified assets acquired and liabilities assumed excluding deferred tax	504,000	369,000	135,000

The temporary difference arising on the retirement benefit obligations will reverse at the same time as CU40,000 of the temporary differences arising on the property, plant and equipment.

Part A

Calculate both the deferred tax liability acquired and the goodwill arising on acquisition of Entity B.

Part B

The goodwill is amortised over 10 years.

In 20X5 Entity B’s equity (after incorporating the fair value adjustments that were made as a result of the business combination and after including goodwill) as included in Entity A’s consolidated financial statements changed as follows:

At 1 January 20X5	CU600,000
Retained profit for 20X5 (excluding goodwill amortisation)	CU70,000
Goodwill amortisation for the year	(CU15,000)
At 31 December 20X5	CU655,000

Calculate the amount of the deferred tax liability at 31 December 20X5 that is attributable to the temporary difference in Entity A’s consolidated financial statements as a result of its investment in Entity B (sometimes referred to as an ‘outside’ temporary difference).

Answer to Case study 2

Part A

The deferred tax asset arising from the retirement benefit obligations is offset against the deferred tax liabilities arising from the property, plant and equipment and inventory (see paragraph 29.37 for offsetting requirements). Accordingly, a net deferred tax liability of CU54,000—calculation 40% × CU135,000 (CU115,000 based on property, plant and equipment + CU50,000 based on inventory less CU30,000 based on retirement benefit obligations) will be recognised on Entity B's individual assets and liabilities. The deferred tax is provided at 40%, not 30%, because as the assets are realised and the liabilities settled the tax will be payable or recoverable by Entity B in its jurisdiction.

No deduction is available in Entity A or Entity B's tax jurisdiction for the cost of the goodwill. Consequently, the tax base of the goodwill is nil. However, paragraph 29.14(a) prohibits the recognition of a deferred tax liability on the initial recognition of goodwill.

Hence, on acquisition, the carrying amount of Entity B in Entity A's consolidated financial statements is made up as follows:

	CU
Fair value of identifiable assets acquired and liabilities assumed, excluding deferred tax	504,000
Deferred tax liability	(54,000)
Fair value of identifiable assets acquired and liabilities assumed	450,000
Goodwill	150,000
Carrying amount	600,000

Because, at the acquisition date, the tax base in Entity A's tax jurisdiction of Entity A's investment in Entity B is CU600,000, there is no temporary difference in Entity A's tax jurisdiction for the investment. Consequently, there is no additional deferred tax in the consolidated financial statements over and above the CU54,000 calculated above.

Part B

At 31 December 20X5 the carrying amount in Entity A's consolidated financial statements of its investment in Entity B is CU655,000.

The temporary difference associated with Entity A's underlying investment is CU55,000 (CU655,000 carrying amount less CU600,000 tax base). This amount is equal to the cumulative retained profit since the acquisition date as reduced by the goodwill amortisation since the acquisition date.

Entity A would recognise a deferred tax liability for the temporary difference of CU55,000 unless Entity A controls the timing of the reversal of the temporary difference (that is, unless Entity A controls when the retained profits will be paid out as a dividend or when Entity B is sold) and it is probable that the temporary difference will not reverse in the foreseeable future.

If Entity A has determined it will not sell its investment in the foreseeable future and that Entity B will not distribute its retained profit in the foreseeable future, no deferred tax liability arises on the CU55,000 retained profits (CU70,000 profit less CU15,000 goodwill amortisation). On the other hand, if Entity A expects to sells its investment in Entity B or expects that Entity B will distribute the retained profits, Entity A recognises a deferred tax liability of CU16,500 (CU55,000 × 30%) for the temporary difference arising due to the difference between the carrying amount of the investment in the consolidated financial statements and the tax base of the investment.

Note: the deferred tax liability of CU16,500 is recognised in addition to any deferred tax recognised on the individual assets and liabilities of the subsidiary (for example, changes in the deferred tax liability of CU54,000 recognised on Entity B's inventory and property, plant and equipment and changes, in the deferred tax asset recognised on Entity B's retirement benefit obligation).

Case study 3

Before 1 February 20X1 a group consisted of a parent (Entity Z) and a wholly-owned subsidiary (Subsidiary A) that the parent formed some years ago. With effect from 1 February 20X1 the group also included Subsidiary B (see *Business combination* below). All entities are in the same tax jurisdiction and all have financial year ends of 31 December. The tax year in the jurisdiction also ends on 31 December. The group files a consolidated tax return, as permitted in the jurisdiction, and is taxed on consolidated taxable profits.

Tax losses

Tax law permits entities to carry tax losses back two years and set them off against any taxable profits of those prior years. Tax law also permits any tax losses that cannot be carried back, to be carried forward four years. Capital losses may only be set off against capital gains. A capital gain or loss is a gain or loss arising on the sale of a capital item (for example, property, plant and equipment and investments).

At 31 December 20X0, the group has unused tax losses of CU110,000 (CU40,000 of these losses are capital losses) that cannot be carried back because the group made losses in the last three years. At 31 December 20X0, neither the parent nor its subsidiary is expected to generate trading profits for the foreseeable future. Consequently the group did not recognise a deferred tax asset at 31 December 20X0 for the CU70,000 trading losses. However, CU8,000 of the capital losses are expected to be offset when the subsidiary sells one of its properties and the group recognised a deferred tax asset for this. The tax authorities permit losses of one group entity to be set against profits of another group entity.

Tax rates

In the group's tax jurisdiction, income tax rates have remained unchanged for many years. The standard income tax rate is 40%. However, a tax rate of 20% applies to any capital gains (capital gains tax).

Business combination

On 1 February 20X1, the parent acquired 100% of the shares in another entity (Subsidiary B) in the same tax jurisdiction at a cost of CU400,000. At the acquisition date the tax base of the parent's investment in Subsidiary B is CU400,000. Reductions in the carrying amount of goodwill are not deductible for tax purposes, and the cost of the goodwill would also not be deductible if Subsidiary B were to dispose of its underlying business.

The following table sets out the fair value of the identifiable assets and liabilities of Subsidiary B (excluding deferred tax assets and liabilities) as they are acquired by the parent on 1 February 20X1, together with their tax bases and the resulting temporary differences:

	Amounts recognised at acquisition in consolidated financial statements	*Tax base*	*Temporary differences*
	CU	*CU*	*CU*
Property, plant and equipment	170,000	55,000	115,000
Accounts receivable	100,000	100,000	–
Inventory	74,000	44,000	30,000
Accounts payable	(110,000)	(110,000)	–
Fair value of identified assets and liabilities excluding deferred tax	**234,000**	**89,000**	**145,000**

Between 1 February 20X1 and 31 December 20X1, Subsidiary B made profits of CU101,867 (after adjustments for consolidation purposes, for example, elimination of intra-group transactions such as Subsidiary B's dividend payment) that are recognised in the consolidated financial statements. The CU101,867 includes the impact of the change in Subsidiary B's deferred tax liability and the amortisation of goodwill. On 15 December 20X1, Subsidiary B declared a dividend of CU16,400 to the parent which was authorised by the parent in December 20X1 and will be paid in January 20X2. Withholding tax is charged on the dividend to the parent at 20% and the balance is remitted to the parent. The parent is not further taxed on receipt of the dividend.

At the year end, the assets and liabilities (excluding the deferred tax liability and goodwill) of Subsidiary B (as adjusted for consolidation, that is, for removal of intercompany balances etc) are as follows:

	Amounts to be recognised in consolidated financial statements on 31 December 20X1	*Tax base*	*Temporary differences*
	CU	*CU*	*CU*
Property, plant and equipment	150,000	55,000	95,000
Accounts receivable	120,000	120,000	–
Inventory	85,000	85,000	–
Cash	80,000	80,000	–
Accounts payable and other payables	(115,000)	(115,000)	–
Assets and liabilities excluding deferred tax and goodwill	**320,000**	**225,000**	**95,000**

Subsidiary B has a financial year end of 31 December. Assume that at both 1 January and 31 December 20X1, all items of Subsidiary B's property, plant and equipment are expected to be used by Subsidiary B until the end of their useful lives and all items of Subsidiary B's inventory are expected to be sold in day-to-day business. Goodwill is amortised over 10 years with $^{11}/_{12}$ths of a full year's amortisation in the year ended 31 December 20X1.

Jointly-controlled entity

Entity Z has an investment in a jointly-controlled entity (JCE) which was purchased five years ago. The JCE is based in a different tax jurisdiction, although the functional currency of the JCE is the same as that of the group. At 1 January 20X1, the carrying amount of the JCE in the consolidated financial statements was CU55,000 (measured using the equity method) and on 31 December 20X1 the carrying amount was CU60,000. The tax base of the investment at both dates was CU40,000. There are two other venturers and it has been agreed in writing with the two other venturers that the JCE will not distribute profits for the foreseeable future but instead reinvest them in the business. Entity Z also has no plans to sell its investment.

Unused tax losses

Of the unused tax losses of CU110,000 existing at 1 January 20X1, the non-capital losses of CU70,000 may be set against Subsidiary B's profits between the acquisition date and 31 December 20X1. Because none of the group entities made any capital gains in the year, the capital losses cannot be used.

Subsidiary A expects to sell a property in 20X2 that will allow CU10,000 of the capital losses to be used (at the end of 20X0 it was expected that CU8,000 could be used). It is more likely than not that the remaining CU30,000 will expire unused.

Other assumptions

Assume tax deductions on sale and use of assets are always equal. Also, assume there are no assets, liabilities or other items, other than those referred to in this case study, that will affect the recognition and measurement of deferred tax.

Part A
Calculate both the deferred tax liability acquired and the goodwill arising on acquisition of Subsidiary B.

Part B
Prepare journal entries to show the changes between 1 February 20X1 and 31 December 20X1 to the deferred tax assets and liabilities determined in Part A relating to Subsidiary B's own assets and liabilities.

Part C
Prepare journal entries to show the changes between 1 February 20X1 and 31 December 20X1 to the goodwill determined in Part A which arose on acquisition of Subsidiary B.

Part D
Prepare journal entries to record the dividend from Subsidiary B to the parent entity. Consider the entries in both Subsidiary B's individual financial statements, the parent's individual financial statements and the consolidated financial statements.

Part E

Show the deferred tax asset for tax losses, if any, as at 1 January 20X1 and 31 December 20X1 and prepare the journal entry to record the movement in the year.

Part F

Using the assumption that Subsidiary B will distribute its retained profits in the foreseeable future, prepare journal entries to recognise the deferred tax effect of the temporary differences associated with unremitted earnings of Subsidiary B.

Part G

Prepare journal entries to recognise the deferred tax effect of the temporary differences associated with unremitted earnings of the JCE.

Part H

Calculate the deferred tax expense/benefit for the year ended 31 December 20X1 and the deferred tax asset/liability as at 31 December 20X1.

Answer to Case study 3

Part A

The deferred tax liability acquired as part of the assets and liabilities of Subsidiary B is CU58,000. This is calculated as (CU115,000 × 40%) + (CU30,000 × 40%).

No deduction is available in the tax jurisdiction for the cost of the goodwill. Consequently, the tax base of the goodwill is nil. However, paragraph 29.14(a) prohibits the recognition of a deferred tax liability on the initial recognition of goodwill.

Hence, on acquisition, the carrying amount of Subsidiary B in the consolidated financial statements is made up as follows:

	CU
Fair value of identifiable assets acquired and liabilities assumed, excluding deferred tax	234,000
Deferred tax liability	(58,000)
Fair value of identifiable assets acquired and liabilities assumed	176,000
Goodwill (CU400,000 paid less CU176,000 identifiable net assets acquired)	224,000
Group carrying amount	400,000

On 1 February 20X1, no deferred tax arises from the parent's investment in Subsidiary B because equal taxable income and amounts deductible from taxable income would arise if the investment were to be sold for its carrying amount of CU400,000, having a nil net effect. This is because, the tax base (available deductions on sale) of the parent's investment in Subsidiary B at this date is CU400,000.

Part B

The deferred tax liability at 31 December 20X1 on Subsidiary B's assets and liabilities is CU38,000. This is calculated as CU95,000 × 40%.

The movement in the deferred tax liability between 1 February 20X1 and 31 December 20X1 is recognised as follows:

Dr	Deferred tax liability	CU20,000	
	Cr Profit or loss—income tax (deferred tax)		CU20,000

To recognise the decrease in deferred tax liability during the year ended 31 December 20X1.

Part C

The tax base of the goodwill is nil. The carrying amount of the goodwill is reduced to CU203,467[(a)] due to amortisation for the 11 months to 31 December 20X1. Consequently, the temporary difference is now CU203,467. However, because the cost of the goodwill is not tax deductible either as it is amortised nor on a subsequent sale, subsequent temporary differences are also regarded as arising from the initial recognition of goodwill and are therefore not recognised. Consequently, no deferred tax liability is recognised for goodwill.

The amortisation is recognised as follows:

Dr	Amortisation	CU20,533[(a)]	
	Cr Goodwill—accumulated amortisation		CU20,533

To recognise the amortisation of goodwill during the year ended 31 December 20X1.

Part D

Subsidiary B would make the following journal entries during the year ended 31 December 20X1 in its own financial statements for the dividend declared on 15 December 20X1:

Dr	Retained earnings—dividends declared	CU16,400	
	Cr Payable (amount due to parent)		CU13,120[(b)]
	Cr Payable (amount due to tax authority)		CU3,280[(b)]

To recognise the dividend declared on 15 December.

Subsidiary B recognises a liability for the amount withheld that will need to be paid to the tax authorities and a liability for the balance of the dividend payable to the parent. The payment to the tax authorities is income tax payable by the group. In Subsidiary B's financial statements, the full CU16,400 is charged to equity as it represents a dividend to the parent.

In Entity Z's financial statements the dividend receivable will be recognised as follows:

Dr	Income tax—current tax	CU3,280	
Dr	Receivable (amount due from Subsidiary B)	CU13,120	
	Cr Dividend income		CU16,400

To recognise the dividend receivable from Subsidiary B.

On consolidation the above journal entries would be reversed and replaced with the journal entries below to show that the withholding tax payable is actually income tax payable by the consolidated group. The tax is effectively collected by Subsidiary B on the tax authority's behalf.

Dr	Income tax—current tax	CU3,280	
	Cr Current tax payable (amount due to tax authority)		CU3,280

To recognise the income tax liability arising on an intra-group dividend.

Note—withholding tax is charged on the dividend to the parent at 20% and the parent is not further taxed on receipt of the dividend. The effective tax rate to the group on dividends from the subsidiary to the parent is 20%.

Part E

At 31 December 20X0 the group recognised a deferred tax asset of CU1,600. This represents capital gains tax at 20% on CU8,000 capital losses expected to be offset when Subsidiary A sells one of its properties. At 31 December 20X0, the possibility of using Subsidiaries B's profits to use the losses may not be considered because Subsidiary B had not yet been acquired. Only on 1 February 20X1 would this be allowed. Consequently, at 31 December 20X0 no deferred tax asset is recognised for the trading losses. The CU70,000 of trading losses would be utilised in the year and thus there is also no deferred tax asset at 31 December 20X1 for the trading losses.

At 31 December 20X1 the group has unused capital losses of CU40,000 and expects to utilise CU10,000 of them. Consequently, it recognises a deferred tax asset of CU2,000, an increase of CU400 since 31 December 20X0.

The following journal entry is recognised during the year ended 31 December 20X1:

Dr	Deferred tax asset	CU400	
	Cr Income tax expense—deferred tax benefit		CU400

To recognise the tax benefit of the increase in capital losses expected to be utilised in a future year.

Part F

The entries in the consolidated financial statements for the year ended 31 December 20X1 are:

Dr	Income tax—deferred tax	CU17,093 [(c)]	
	Cr Deferred tax liability		CU17,093[(c)]

To recognise the increase in deferred tax liability during the year ended 31 December 20X1.

Subsidiary B will distribute its retained profits in the foreseeable future, so a deferred tax liability is recognised in accordance with paragraph 29.25. The temporary difference associated with the parent's underlying investment in Subsidiary B is CU85,467[(c)]. This amount is equal to the cumulative retained profit since the acquisition date.

Note: the deferred tax liability of CU17,093 is recognised in addition to the deferred tax liability of CU38,000 recognised on Subsidiary B's individual assets and liabilities.

Part G

The recovery of the carrying amount of the JCE through sale or earning dividend income would affect taxable profit. In accordance with paragraph 29.25 the group should recognise a deferred tax liability at 31 December 20X1 for the temporary difference of CU20,000[(d)] and at 1 January 20X1 for the temporary difference of CU15,000[(d)] unless the venturer is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The temporary difference is not expected to reverse in the foreseeable future; it has been agreed in writing with the two other venturers that the JCE will not distribute profits for the foreseeable future but instead reinvest them in the business.

Can Entity Z control the timing of the reversal of the temporary difference? While Entity Z cannot demand a change to the plans that a dividend will not be paid out, it can block any proposal by either or both of the two other venturers to change the plans (and pay out a dividend) because for joint control all decisions need unanimous consent of the venturers and so any one venturer can block a proposal. In addition, Entity Z is in control of whether to sell its investment in the JCE, which is the other way of reversing the temporary difference and realising the gain.

Consequently, there are no deferred tax entries to recognise in the year.

Part H (summary)

The movement in deferred tax assets and liabilities can be summarised as follows:

Dr	Deferred tax liability (Subsidiary B's PPE and inventory)	CU20,000	
Dr	Deferred tax asset (unused losses)	CU400	
	Cr Deferred tax liability (investment in subsidiary)		CU17,093[(c)]
	Cr Income tax expense—deferred tax benefit		CU3,307[(e)]

To recognise the movement in deferred tax assets and liabilities for the year ended 31 December 20X1.

The income tax expense or benefit relating to deferred tax for the year ended 31 December 20X1 is a benefit (credit) of CU3,307.

At 31 December 20X1 the group should recognise a deferred tax asset for CU2,000 (CU1,600 at the start of the year increased by CU400 increase during the year). The deferred tax asset cannot be offset against the deferred tax liabilities at 31 December 20X1 because the asset relates to capital losses whereas the liabilities arise from trading transactions. The total deferred tax liability recognised by the group at 31 December 20X1 is CU55,093[(f)].

The following calculations and explanatory notes below do not form part of the journal entries or financial statement disclosure:

(a) Carrying amount of goodwill at 31 December 20X1 after amortisation is CU203,467 (CU224,000 less CU20,533).

One year of amortisation is CU22,400 (CU224,000 × 1 ÷ 10).

$^{11}/_{12}$ths of one year's amortisation = CU22,400 × 11 ÷ 12 = CU20,533.

(b) Subsidiary B recognises a financial liability for the amount withheld that will need to be paid to the tax authorities of CU3,280 (CU16,400 × 20%) and the net dividend payable to the parent of CU13,120 (CU16,400 less CU3,280).

(c) The carrying amount of Subsidiary B on 31 December 20X1 in Entity Z's consolidated financial statements is CU485,467 (CU400,000 cost + CU101,867 profit less CU16,400 dividend). The temporary difference is CU85,467 (CU485,467 less CU400,000). The group will recognise a deferred tax liability of CU17,093 (CU85,467 × 20%) for the temporary difference arising due to the difference between the carrying amount of the investment in the consolidated financial statements and the tax base of the investment.

	CU
Goodwill	203,467 [(a)]
Property, plant and equipment	150,000
Accounts receivable	120,000
Inventory	85,000
Cash	80,000
Accounts payable	(115,000)
Deferred tax liability	(38,000)
Carrying amount at 31 December 20X1	485,467
Carrying amount at 31 December 20X0	400,000
Cumulative retained earnings	85,467

(d) At 31 December 20X1 the temporary difference of the investment in the JCE is CU20,000 (the difference between the tax basis of CU40,000 and the carrying amount of CU60,000). At 1 January 20X1 the temporary difference of the investment in the JCE is CU15,000 (the difference between the tax basis of CU40,000 and the carrying amount of CU55,000).

(e) Deferred tax benefit credited to profit or loss = CU3,307 (CU20,000 Part B + CU400 Part E less CU17,093 Part F).

(f) Deferred tax liability = CU55,093 (CU38,000 Part B + CU17,093 Part F).