**IAS 12 INCOME TAXES**

The objective of IAS 12 is to prescribe the accounting treatment for income taxes.

**Definitions: Accounting profit.**

Net profit or loss for a period before deducting tax expense. It is the PBT.

**Taxable profit (tax loss).**

The profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

**Current tax.**

The amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period. It is the amount actually payable to the tax authorities in relation to the trading activities of the entity during the period.

**RECOGNITION OF CURRENT TAX ASSETS AND LIABILITIES**

IAS 12 requires any unpaid tax in respect of the current or prior periods to be recognised as a liability. Conversely, any excess tax paid in respect of current or prior periods over what is due should be recognised as an asset in the balance sheet.

**DEFERRED TAX**

**Deferred tax** is an accounting measure used to match the tax effects of transactions with their accounting impact. It is the estimated future tax consequences of transactions and events in the financial statements of the current period and the future period.

**Deferred tax liabilities** are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

**Deferred tax assets** are the amounts of income taxes recoverable in future periods in respect of:

 Deductible temporary differences

 The carry forward of unused tax losses

 The carry forward of unused tax credits

**The tax base of an asset or liability** is the amount attributed to that asset or liability for tax purposes.

**Temporary differences** are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base.

Temporary differences may be either:

1. **Taxable temporary differences**, these are 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 give rise to deferred tax liabilities.

Deferred Tax Liability = Tax rate X Taxable Temporary Differences

Taxable temporary differences arise for assets when the Carrying Amount of the asset is greater than the tax base. (CA>TB)

**Examples of Circumstances that give rise to Taxable Temporary**

**Differences**

 Interest revenue received in arrears and included in accounting profit on the basis of time apportionment. It is included in taxable profit, however, on a cash basis.

 Sale of goods revenue is included in accounting profit when the goods are delivered, but only included in taxable profit when cash is received.

 Depreciation of an asset is accelerated for tax purposes. When new assets are purchased, allowances may be available against taxable profits which exceed the amount of depreciation chargeable on the assets in the financial accounts for the year of purchase.

 Development costs which have been capitalized will be amortized in the statement of profit or loss, but they were deducted in full from taxable profit in the period in which they were incurred.

 Prepaid expenses have already been deducted on a cash basis in determining the taxable profit of the current or previous periods.

2. **Deductible temporary differences**, these are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled. Deductible temporary differences give rise to Deferred Tax Assets.

Deferred Tax Assets = Tax rate X Deductible temporary differences

Deductible temporary differences arise for assets when the Carrying Amount of the asset is less than the tax base. (CA<TB)

**Examples of Circumstances that give rise to Deductible Temporary**

**Differences**

 Retirement benefits (Pension costs) are deducted from accounting profit as service is provided by the employee. They are not deducted in determining taxable profit until the entity either pays retirement benefits/contributions to a fund.

 Accumulated depreciation of an asset in the financial statements being

greater than the accumulated depreciation allowed for tax purposes.

 The Net Realisable value of inventory or revalued amount of PPE falling but ignored for tax purposes.

**Example: June 2016 Qn. 1b**

The following information relates to Zee Ltd’s depreciable assets as at 31

March, 2015.

Shs ‘000’

Computers at cost 80,000

Motor vehicles at cost 50,000

Machinery at cost 100,000

The depreciation rates applied to the assets are 20%, 10% and 8% for computers, motor vehicles and machinery respectively. For tax purposes, the assets are depreciated at the rates of 40%, 35% and 30% respectively for computers, motor vehicles and machinery. The corporation tax rate is

30%.

**Required:**

(i) According to IAS 12: Income Taxes, explain what is meant by ‘deductible’ and ‘taxable’ temporary differences giving any **two** examples of each. **(6 marks)**

(ii) Compute the deferred tax for the period ended 31 March, 2015, and state its nature with reasons. **(9 marks)**

**Determining the tax base: Shs’000’**

**Computers Motor vehicles Machinery**

Cost 80,000 50,000 100,000

Less: Tax Depn/

Capital allowances

40%

(32,000)

35%

(17,500)

30%

(30,000)

Tax base 48,000 32,500 70,000

**Taxation in the statement of profit or loss**

In the Statement of profit or loss the income tax charge is obtained by aggregating:

(a) Income tax on taxable profits for the current period

(b) Adjustment for increase or decrease in deferred tax liability

(c) Any under provision or overprovision of income tax on profits of previous years

**Taxation in the statement of financial position**

In the statement of financial position, there are several items which are normally found.

(a) Amounts underprovided/overprovided in the prior year. These will appear as debits/credits to the tax payable account.

(b) If no tax is payable, then there might be an income tax recoverable asset disclosed in current assets.

(c) There will usually be a liability for tax assessed as due for the current

year. It appears as a current liability

(d) We may also find a liability on the deferred taxation account. Deferred taxation is shown under 'non-current liabilities' in the statement of financial position.

**Example:**

Prime Limited made a PBT of Shs 450 million in the year ended 31/12/2018. The income tax on the operating profit was estimated at Shs 190 million. In the previous year 2017 the income tax had been estimated at Shs 153 million but subsequently agreed to Shs 163 million. The deferred tax liability in 2017 was Shs 64 million while in 2018 it was at Shs 80 million.

**Required:**

a) Calculate the income tax charge that appears in the statement of profit or loss for the year ended 31/12/2018.

b) Extracts of financial statements for the year ended 31/12/2018

**Why do we recognise deferred tax?**

(a) Adjustments for deferred tax are made in accordance with the accruals concept and in accordance with the definition of a liability in the Conceptual Framework, i.e. a past event has given rise to an obligation in the form of increased taxation which will be payable in the future. The amount can be reliably estimated. A deferred tax asset similarly meets the definition of an asset.

(b) If the future tax consequences of transactions are not recognised, profit can be overstated, leading to overpayment of dividends and distortion of share price and EPS.

**Disclosure requirements for IAS 12**

IAS 12 requires the following disclosures:

 aggregate current and deferred tax relating to items recognized directly in equity

 tax relating to each component of other comprehensive income

 explanation of the relationship between tax expense (income) and the tax that would be expected by applying the current tax rate to accounting profit or loss (this can be presented as a reconciliation of amounts of tax or a reconciliation of the rate of tax)

 changes in tax rates

 amounts and other details of deductible temporary differences, unused tax losses, and unused tax credits

 temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements

 for each type of temporary difference and unused tax loss and credit,

the amount of deferred tax assets or liabilities recognized in the statement of financial position and the amount of deferred tax income or expense recognized in profit or loss

 tax relating to discontinued operations

 tax consequences of dividends declared after the end of the reporting period

 information about the impacts of business combinations on an acquirer's deferred tax assets

 recognition of deferred tax assets of an acquiree after the acquisition date.