Income tax: IFRS accounting issues

Skopje, North Macedonia

The views expressed in this presentation are my own and not necessarily those of any organization with which I am associated.

CFRR Centre for Financial Reporting Reform
WORLD BANK GROUP

EAASURE

EAASURE is co-funded by:
Federal Ministry Republic of Austria Finance

1

Disclaimer and applicable version of IFRS Accounting Standards

» The sponsors, the authors, the presenters and the publishers do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this PowerPoint presentation, whether such loss is caused by negligence or otherwise.

» Unless specified otherwise, the accounting requirements that are the subject matter of this presentation are IFRS Accounting Standards as issued by the International Accounting Standards Board (IASB) that are applicable for annual period beginning on or after 1 January 2024 without early applying new and amended IFRSs that have a later mandatory application date.

2

2

Aims

» develop a more cohesive understanding of accounting and reporting income taxes in accordance with IAS 12 *Income Tax*

» enhance capacity to make/audit/regulate the judgements in applying IAS 12

3

3

Overview

» Income tax: current and deferred

» Deferred tax asset: tax losses

» Tax rate reconciliations

» Uncertain tax positions

» Pillar Two income taxes

» Appendix A: Regulatory updates

» Appendix B: Mini-case studies: other income tax issues

» Q&A session

4

4

Income tax: current and deferred

5

Scope of IAS 12 *Income Taxes*

» Income tax (IAS 12) includes all taxes that are based on taxable profit (tax loss)
  » Excludes taxes that are not based on taxable profit (tax loss)
» Taxable profit (tax loss) = the amount for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable/recoverable.
» Tax expense/income = current tax + deferred tax.

Source: paragraphs 2, 5 and 6 of IAS 12 *Income Taxes*

6

6

Scope of IAS 12 Income Taxes
Regulatory issues

» Research and Development Expenditure Credits had been accounted for under IAS 12. IAS 20 *Accounting for Government Grants and Disclosure of. Government Assistance* is often the more appropriate standard.

» We asked some companies to clarify the accounting policy they had applied to Research and Development Expenditure Credits and related tax implications.

Source: FRC (UK), *Annual Review of Corporate Reporting 2023/2024* (p24) and *Annual Review of Corporate Reporting 2022/2023* (p32)

7

7

Current tax

» **Current tax =** the amount of income tax payable/recoverable in respect of the taxable profit (tax loss) for the current period or past periods.

» **Recognise** a current tax:

- » liability for tax payable on taxable profit for the current and past periods (current tax)
- » asset for overpayments of tax (and for tax losses carried back)

» **Measure** current tax liability/asset at the amount the entity expects to pay/recover using substantively enacted tax rates

Source: paragraphs 5, 6, 12-15 and 46 of IAS 12 *Income Taxes*

8

8

Deferred tax definitions

» **Deferred tax =** income tax payable (recoverable) in respect of the taxable profit (tax loss) for future periods as a result of past transactions or events.

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

» **Tax base =** the tax base of an asset or a liability is the amount attributed to the asset or liability for tax purposes.

Source: paragraphs 5-11 of IAS 12 *Income Taxes*

9

9

Deferred tax overview of the recognition requirements

» **Recognise** a **deferred tax asset (liability)** for tax recoverable (payable) in future periods as a result of past transactions or events.

  » for example, when it is probable that recovery of the carrying amount of an asset will make future tax payments larger than they would be if such recovery were to have no tax consequences.

» Deferred tax assets also arise from the carry forward of **unused tax losses** and tax credits.

Source: paragraphs 15-45 of IAS 12 *Income Taxes*

10

10

Deferred tax
overview of the recognition requirements

- By exception, deferred tax is **not recognised**:
  - on Pillar Two income taxes;
  - on the initial recognition of goodwill (unless goodwill amortisation is deducted when calculating taxable income); and
  - outside of a business combination, when the initial recognition of an asset or a liability affects neither taxable profit nor accounting income.

Source: paragraphs 4A, 15-45 of IAS 12 *Income Taxes*

11

11

Regulatory issues: non-recognition of deferred tax

- An issuer entered into various **interest rate swaps**, which were accounted for as cash flow hedges. Whilst correctly accounting for the fair value consequences for these derivative instruments, **the issuer neglected to consider the deferred tax** consequences thereof.
- Not only did this **result in other comprehensive income being overstated**, but the case also concerned us in that there were no accounting processes in place to ensure that the tax consequences for all class of assets had been considered.
- We also uncovered an instance where a deferred tax asset on the **revaluation of land and buildings** was erroneously **not raised**.

Source: *Combined findings of the JSE proactive monitoring of financial statements* (p38-40) (**emphasis** added)

12

12

Regulatory issues: non-recognition of deferred tax

» We queried the **apparent non-recognition of deferred tax assets** where disclosures indicated that there were taxable temporary differences relating to the same tax authority and taxable entity.

Source: FRC (UK), *Annual Review of Corporate Reporting 2022/2023* (p33) (**emphasis** added)

13

Deferred tax overview of the measurement requirements (1)

» Measure deferred tax liability (asset) using
  - » undiscounted amounts the entity expects to pay (recover)
  - » substantively enacted tax rates that apply to undistributed profits reflecting the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover the carrying amount of the asset/settle the liability
  - » (when **differential tax rates** apply) the average substantively enacted rate that is expected to apply to its taxable profits of the relevant future periods (for example, when the taxable temporary differences reverse)

Source: paragraphs 47-56 of IAS 12 *Income Taxes*

14

Deferred tax
overview of the measurement requirements (2)

» Measure deferred tax liability (asset) using substantively enacted tax rates that reflect the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover the carrying amount of the asset/settle the liability. **However:**

- » recovery of revalued **non-depreciable PPE** is through sale (IAS 12.51B, *a principle)*
- » **rebuttable presumption** that **investment property** carried at fair value is recoverable through sale (rebutted if **depreciable** and the objective is to recover substantially all of its carrying amount through use) (IAS 12.51C, *a rebuttable 'rule')*

Source: paragraphs 47-56 of IAS 12 *Income Taxes*

15

15

Regulatory issues: measurement of deferred tax balances (1)

» Paragraph 51 of IAS 12 *Income Taxes* explains that the measurement of deferred tax balances shall reflect the tax consequences that follow from the way the entity expects to recover or settle the carrying amount of the respective asset or liability.

» Land and buildings are separate asset classes.

» Land is not depreciated, whilst buildings are depreciated over the period the entity expects to use them.

» **IAS 12 is very specific in that the deferred taxation on a non-depreciable asset, such as land, must be measured to reflect the tax consequence of recovering that asset through sale.**

Source: *Combined findings of the JSE proactive monitoring of financial statements* (p37-39) (**emphasis** added)

16

16

Regulatory issues: measurement of deferred tax balances (2)

- On querying the extent of the deferred tax movement for revaluation gains on owner occupied land and buildings, it emerged that an **issuer had erroneously raised a deferred tax liability at the capital gains tax ("CGT") rate** for the revaluation of both land and buildings elements.
- The CGT rate **was appropriate for land element**, being a non-depreciable asset; IAS 12.51B.
- The deferred tax liability recognised on the revaluation gain for the **building** however should have been calculated with reference to how the carrying amount was to be recovered, **which was through use**. Consequently, the deferred tax liability on buildings should have been calculated using a higher tax rate (28% vs the effective CGT rate applicable at that time of 18.67%).

Source: *Combined findings of the JSE proactive monitoring of financial statements* (p37-39) (**emphasis** added) 17

17

Deferred tax
overview of the presentation requirements

- **Present** income tax expense/income outside profit or loss (e.g. OCI or directly in equity) if the tax relates to items that are presented , in the same or a different period, outside profit or loss (e.g. OCI or directly in equity).
  - If needs be, amount so presented is based on a reasonable pro rata allocation
- Must not **offset** tax assets and tax liabilities unless the entity:
  (a) has a legally enforceable right to set off the recognised amounts; and
  (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Source: paragraphs 58-78 of IAS 12 *Income Taxes* 18

18

Regulatory issues: presentation—OCI and directly in equity

» It was **unclear why** movements in deferred tax balances had been recognised in other comprehensive income (OCI) or directly in equity.

» We questioned a company when it was **unclear why** a movement in deferred tax assets had been recognised directly in equity.

» We asked a company to explain **why no tax** appeared to have been charged on gains recognised in OCI.

Source: FRC (UK), *Annual Review of Corporate Reporting 2023/2024* (p24) and *Annual Review of Corporate Reporting 2022/2023* (p33) (**emphasis** added)

19

19

Regulatory issues: presentation—OCI and directly in equity

» Paragraph 61A of IAS 12 states that: "Current tax and deferred tax that relates to items that are recognised, in the same or a different period:

a) in other comprehensive income, shall be recognised in other comprehensive income (see paragraph 62).

b) directly in equity, shall be recognised directly in equity (see paragraph 62A).

» In other words, **the tax effects effectively 'follow' the original item** when being recognised in OCI or directly in equity.

Source: *Combined findings of the JSE proactive monitoring of financial statements* (p37) (**emphasis** added)

20

20

Regulatory issues: presentation—why offsetting?

» Deferred tax assets and liabilities can only be **offset** in limited circumstances.

» More specifically:

  » if they relate to the income taxes levied by the **same taxation authority** on the **same taxable entity** (or if there is a **legal right of set-off**); and

  » the entity **intends to settle on a net** basis or simultaneously.

Source: *Combined findings of the JSE proactive monitoring of financial statements* (p39) (**emphasis** added)

21

21

Regulatory issues: presentation—why not offsetting?

» **We asked** a company that had presented deferred tax asset and liability balances on a gross basis for more information as the extent to which it had assessed the balances against the qualifying criteria for offsetting deferred tax assets and liabilities was not clear.

» Tyman Plc had presented deferred tax asset and liability balances on a gross basis, although they arose in the same tax jurisdiction and **met the criteria for offsetting** under IAS 12.74.

» The company agreed to **restate its comparatives**, offsetting the balances.

Source: FRC (UK), *Annual Review of Corporate Reporting 2022/2023* (p33 and 68) (**emphasis** added)

22

22

Example: current and deferred tax

Example: current and deferred tax

» On 31 December 2023 a company buys a machine for $500,000.

» **Accounting:**

  » depreciate machine on **straight-line method over 5 years** to nil residual value

  » accounting **profit = $300,000 per year** (ie $400,000 less $100,000 machine depreciation)

» **Tax information:**

  » corporate tax **rates: 30%** on taxable profit (accounting profit less tax depreciation)

  » depreciate machine on **straight-line method over 24 months** to nil residual value

Example: current and deferred tax
What do you think?

Income tax expense for 2024 is? Choose one of:

1) $45,000 current tax expense
2) $90,000 current tax expense
3) $45,000 deferred tax expense
4) $45,000 deferred tax income
5) Nil ($45,000 current tax expense less $45,000 deferred tax income)
6) $90,000 expense ($45,000 current + $45,000 deferred)

25

Example: financial asset—debt instrument (two scenarios)

Example: debt instrument held (an asset)

- **01/01/2025:** Entity A purchases a debt instrument for $100,000 that promises to pay (contractual cash flow) $106,121 on 01/01/2028.
- **Income tax:**
  - Tax rate = 30%
  - All gains and losses are taxed when realised.
- The debt instrument's fair value (Level 1), is as follows:

	01/01/2025	31/12/2025	31/12/2026	31/12/2027
Market interest rate	2%	10%	1%	5%
Fair value	$100,000	$87,703	$105,070	$106,121

30

30

Example: financial asset—debt instrument
Scenario A: debt instrument accounted for using amortised cost model. What do you think?

Deferred tax income/expense for 2025 is? Choose one of:

1) Nil
2) $600 expense
3) $600 income
4) $2,000 expense
5) $2,000 income

31

31

Example: financial asset—debt instrument
Scenario B: debt instrument accounted for using fair value model
What do you think?

Deferred tax income/expense for 2025 is? Choose one of:

1) Nil
2) $3,690 expense
3) $3,690 income
4) $12,297 expense
5) $12,297 income

34

34

Example: financial liability—debt instrument (two scenarios)

37

Example: debt instrument issued (a liability)

- 1 January 2025 Entity Z issues a debt instrument for $100,000 with the following contractual cash flow:
  - on 1 January 2028: $106,121 (redemption capital and interest)
- In the jurisdiction in which Entity A is based
  - income tax is levied at **30%** on taxable profits
  - taxable profits (losses) = all **realised** gains (losses)
- Changes in market interest rates result in fair value (Level 1), as follows:

	01/01/2025	31/12/2025	31/12/2026	31/12/2027
Market interest rate	2%	10%	1%	5%
Fair value	$100,000	$87,703	$105,070	$106,121

38

38

Example: financial liability—debt instrument Scenario A: debt instrument accounted for using amortised cost model. What do you think?

Deferred tax income/expense for 2025 is? Choose one of:

1) Nil
2) $600 expense
3) $600 income
4) $2,000 expense
5) $2,000 income

39

39

Example: financial liability—debt instrument
Scenario B: debt instrument accounted for using fair value model
What do you think?

Deferred tax income/expense for 2025 is? Choose one of:

1) Nil
2) $3,690 expense
3) $3,690 income
4) $12,297 expense
5) $12,297 income

42

42

Example: deferred tax—investment property (four scenarios)

45

Deferred tax
recall the measurement requirements

» Measure deferred tax liability (asset) using

- » undiscounted amounts the entity expects to pay (recover)
- » substantively enacted tax rates that apply to undistributed profits reflecting the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover the carrying amount of the asset/settle the liability
  - » recovery of revalued **non-depreciable PPE** is through sale (IAS 12.51B *a principle)*
  - » **rebuttable presumption** that **investment property** carried at fair value is recoverable through sale (rebutted if the **depreciable** and objective is to recover substantially all of its carrying amount through use) (IAS 12.51C *a rebuttable 'rule')*
- » (when **differential tax rates** apply) the average substantively enacted rate that is expected to apply to its taxable profits of the relevant future periods (for example, when the taxable temporary differences reverse)

46

46

Example: deferred tax—investment property

» **31/12/2020:** Entity A buys a factory building for $1 million

» **31/12/2030:** fair value of building is $1.2 million

» Depreciation

- » **accounting** (when relevant): straight-line to nil residual value over **50 years**
- » **tax:** straight-line to nil residual value over **20 years**

» Tax rates

- » 30% on **taxable income** (including recoupment of past depreciation on sale of an asset but excluding capital gains)
- » 15% on **capital gains** (for example, proceeds from sale of investment property less its original cost)

47

47

Example: deferred tax—investment property Four scenarios

- » **Scenario A:** fair value model, intention to recover through capital appreciation and **sale**
- » **Scenario B:** fair value model, intention to recover substantially all through **rental income**
- » **Scenario C:** cost model, intention to recover through capital appreciation and **sale**
- » **Scenario D:** cost model, intention to recover substantially all through **rental income**

48

48

Fair value model investment property: presumption recover through sale (Scenario A: is inconsistent with nil residual value) What do you think?

The carrying amount of deferred tax at 31/12/2030 is?
Choose one of:

	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Applicable tax rate	Deferred tax liability
1)	1,200,000	1,000,000	200,000	30%	**60,000**
2)	1,200,000	1,000,000	200,000	15%	**30,000**
3)	1,200,000	500,000	700,000	30% on $300,000; 15% on $400,000	**120,000**
4)	1,200,000	500,000	700,000	30% on $500,000; 15% on $200,000	**180,000**

49

49

Fair value model investment property: rebutted presumption, ie intend to recover through use (Scenario B) What do you think?

The carrying amount of deferred tax at 31/12/2030 is?

Choose one of:

	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Applicable tax rate	Deferred tax liability
1)	1,200,000	500,000	700,000	30%	**210,000**
2)	1,200,000	500,000	700,000	15%	**105,000**
3)	1,200,000	500,000	700,000	30% on $300,000; 15% on $400,000	**150,000**
4)	1,200,000	500,000	700,000	30% on $500,000; 15% on $200,000	**180,000**

51

51

Cost model (investment property) (Scenarios C and D) What do you think?

The carrying amount of deferred tax at 31/12/2030 is?

Choose one of:

	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Applicable tax rate	Deferred tax liability
1)	800,000	500,000	300,000	30%	**90,000**
2)	800,000	500,000	300,000	15%	**45,000**
3)	1,200,000	500,000	700,000	30% on $300,000; 15% on $400,000	**150,000**
4)	1,200,000	500,000	700,000	30% on $500,000; 15% on $200,000	**180,000**

53

53

Deferred tax example: items acquired in a business combination

56

Regulatory issues: deferred tax on fair value adjustment on the recognition of an intangible asset in a business combination

» We asked a company for more information where the description of deferred tax liabilities recognised in a business combination **appeared inconsistent** with the nature of the assets acquired.

Source: FRC (UK), *Annual Review of Corporate Reporting 2022/2023* (p33) (**emphasis** added)

57

57

Regulatory issues: deferred tax on fair value adjustment on the recognition of an intangible asset in a business combination

- We also requested further details of the purchase price allocation for the acquisition of AAP, including **why no deferred tax arose on the recognition of the Master Franchise Agreement ('MFA').**
- The company provided the explanations requested, but **acknowledged that deferred tax should have been recognised on the fair value adjustment uplift on the MFA.**
- It proposed to correct this by way of a **restatement of the comparative information in the 2023 annual report** and accounts. It also agreed to provide more transparent disclosure of the judgements made by management regarding the purchase price allocation.

Source: www.frc.org.uk/library/supervision/corporate-reporting-review/crr-case-summaries-and-entity-specific-press-notices/?query=DP+Poland&quarter=2024-06-01#crr-case-studies (**emphasis** added)

58

Deferred tax example 1: business combination

- **On 31 December 2023** Entity A acquire all of the issued share capital of Entity Z, when the fair value of Entity Z's machine is \$750,000 (ie \$250,000 > its \$500,000 cost model carrying amount in Entity Z's books).
  - **Group A's accounting:** uses the cost model for machines
  - **Accounting and income tax:** depreciate the machines on the straight-line method; over its **remaining useful life of 5 years**; to nil residual value.
- Corporate tax **rate = 30%**

59

Deferred tax example 1: machine acquired in business combination
What do you think?

Group A's deferred tax asset/liability for the machine at 31/12/2024 is? Choose one of:

1) Nil
2) $15,000 asset
3) $15,000 liability
4) $60,000 asset
5) $60,000 liability
6) $200,000 asset
7) $200,000 liability

60

60

Deferred tax example 2: business combination

» **Accounting:**
  » On **31 December 2023** Entity A recognized $100,000 goodwill asset in accounting for a business combination in which it acquire all of the issued share capital of Entity Z.
  » Goodwill is unimpaired for the duration of this example.

» **Income tax:**
  » Tax rate = 30%
  » Scenario A: goodwill is amortised evenly over 5 years in calculating taxable income.
  » Scenario B: goodwill is NEITHER expensed at acquisition nor amortised in calculating taxable income.

63

63

Deferred tax example 2: goodwill recognised in business combination **Scenario A:** goodwill is amortised evenly over 5 years in calculating taxable income. What do you think?

Group A's deferred tax asset/liability for goodwill at 31/12/2024? Choose one of:

1) Nil
2) $6,000 asset
3) $6,000 liability
4) $20,000 asset
5) $20,000 liability

64

64

Deferred tax example 2: goodwill recognised in business combination **Scenario B:** goodwill is NEITHER expensed at acquisition nor amortised in calculating taxable income. What do you think?

Group A's deferred tax asset/liability for goodwill at 31/12/2024? Choose one of:

1) Nil
2) $6,000 asset
3) $6,000 liability
4) $20,000 asset
5) $20,000 liability

67

67

Deferred tax assets: tax losses

70

Deferred tax assets
overview of the recoverability recognition requirements (1)

» **Deferred tax asset** is recognised only to the extent that its recovery is probable, ie:

- » tax planning opportunities are available to create taxable profit for the entity in the appropriate future periods; or
- » it is probable that the entity will have sufficient taxable profit relating to the **same taxation authority** and the **same taxable entity** and in the **same period** as the reversal of the deductible temporary difference (or tax loss carryback or carryforward)
  - » in making this assessment ignore any deductible temporary differences **originating** in a period after the reporting date because they will themselves require future taxable income in order to be utilised.

71

71

Deferred tax assets
overview of the recoverability recognition requirements (2)

- The existence of tax losses is strong evidence that future taxable profit may not be available
  - convincing evidence of probable recovery is needed

72

Deferred tax assets
recoverability recognition requirements: application guidance (1)

- **Deferred tax asset** is recognised only to the extent that its recovery is probable
  - KPMG observe that (p779 and p782 of Insights into IFRS 2015/16):
    - probable is not defined in IAS 12
    - consistently with IAS 37 entities often take probable to mean 'more likely than not'
    - however, IAS 12 does not prohibit a **higher threshold**
    - a 'virtually certain' threshold should not be used
    - portions of unused tax losses should be used when applying the probability threshold

73

Deferred tax assets
recoverability recognition requirements: application guidance (2)

- **Deferred tax asset** is recognised only to the extent that its recovery is probable
  - Deloitte observe that (p830 iGAAP 2015)
    - probable is not defined in IAS 12
    - probable is generally agreed to mean '**at least more likely than not** (ie a probability of greater than 50%)'

74

74

Regulatory issues: disclosure of evidence justifying the recognition of deferred tax assets

- Another problem relating to the application of this Standard was the **omission of the required disclosure** of unused assessed losses.
- Problems were again identified for numerous issuers with regards to their disclosure justifying the recognition of deferred tax assets.
  - Not only is this disclosure required by IAS 12, but **insufficient disclosure** raises concern as to whether or not the deferred tax asset should have been raised.
  - The **disclosure must be detailed** and **specific to the issuer**.

Source: *Combined findings of the JSE proactive monitoring of financial statements* (p39) (**emphasis** added)

75

75

Regulatory issues: disclosure of evidence justifying the recognition of deferred tax assets

» Were companies with a recent history of losses had recognised material DTAs, **we asked for details of the convincing evidence** supporting their recognition, as required by IAS 12.29.

» In such instances, the companies were encouraged, or agreed, to **improve the related disclosures** in future annual report and accounts.

Source: FRC (UK), *Annual Review of Corporate Reporting 2022/2023* (p32 and 33) (**emphasis** added)

76

76

Regulatory issues: disclosure of evidence justifying the recognition of deferred tax assets

» We asked the company to provide **more information** on the nature of the evidence supporting the recognition of a net deferred tax asset, given the company's recent history of losses.

» In the course of our enquiry, the company identified additional information that enabled more accurate projections of the level of future taxable profits to be made.

» Consequently, the company agreed to **derecognise the net deferred tax asset in full and to restate the 31 March 2022 financial information accordingly in its next financial statements**. The company agreed to disclose the fact that the matter had also come to its attention as a result of our enquiry.

Source: www.frc.org.uk/library/supervision/corporate-reporting-review/crr-case-summaries-and-entity-specific-press-notices/?query=lloyds&quarter=2023-12-01#crr-case-studies (**emphasis** added)

77

77

Example: deferred tax asset—tax loss carried forward (four scenarios follow)

78

Example: deferred tax asset—tax loss carried forward (four scenarios follow)

- In 2024 a manufacturer incurs **a tax loss of $100 million.**
- In the jurisdiction in which the manufacturer is based
  - income tax is levied at **30%** on taxable profits
  - taxable profit/loss = accounting profit/loss determined in accordance with the IFRS Accounting Standards.
  - tax losses are carried forward for **three (3) years** (after which any unutilised tax loss is forfeited).

79

79

Example: deferred tax asset—tax loss carried forward (four scenarios follow) Scenario 1. What do you think?

» **Scenario 1:** in 2024 the manufacturer incurred a $500 million impairment expense when a meteorite strike obliterated one of its factories. The manufacturer's other factories are unaffected and all operate profitably generating millions of profit each year for decades past, and there is nothing to suggest that they will not continue doing so for the foreseeable future.

» **The manufacturer's deferred tax asset at 31 December 2024 is?** Choose one of:

1) $100 million;
2) $30 million;
3) nil; or
4) another amount.

80

80

Example: deferred tax asset—tax loss carried forward (four scenarios follow) Scenario 2. What do you think?

» **Scenario 2:** in 2024 the manufacturer incurred a trading loss for the first time following a steep decline in its profitability due to the elimination of import tariffs resulting in a flood of cheaper imports cannibalising the manufacturer's domestic market. There is little prospect of the manufacturer generating a profit in the next 3 years.

» **The manufacturer's deferred tax asset at 31 December 2024 is?** (choose one of):

1) $100 million;
2) $30 million;
3) nil; or
4) another amount.

82

82

Example: deferred tax asset—tax loss carried forward (four scenarios follow)
Scenario 3. What do you think?

» **Scenario 3:** same as scenario 2 except, at 31/12/2024 :

» **Government is consulting on whether to reintroduce import tariffs**; and

» there is a **50% probability** that tariffs will be reintroduced in the near term.

» The manufacturer's deferred tax asset at 31 December 2024 is? (choose one of): 1) $100 million; 2) $50 million; 3) $30 million; 4) $25 million; 5) $15 million; or 6) nil; or 7) another amount.

84

84

Example: deferred tax asset—tax loss carried forward (four scenarios follow)
Scenario 4

» **Scenario 4:** at 31 December 2024 on the basis of its experience the manufacturer of bespoke heavy machinery **reliably forecasts cumulative profit before tax** over the next three years as follows:

Probability	Forecast cumulative profit before tax over the next 3 years
40%	$100 million profit (2 new orders)
60%	$40 million profit (1 new order)
100%	break-even (no new orders)

86

86

Example: deferred tax asset—tax loss carried forward (four scenarios follow)
Scenario 4. What do you think?

» The manufacturer's deferred tax asset at 31 December 2024 is? Choose one of:

	Amount	Calculation
1)	$30 million	30% tax rate x $100 million profit (ie profit with 40% probability)
2)	$12 million	30% tax rate x $40 million profit (ie profit with 60% probability)
3)	nil	30% tax rate x nil profit (ie profit with 100% probability)
4)	$14.4 million	Expected value: 30% tax rate x [(40% x $100 million) + (20% x $40 million) + (40% x nil)]
5)	another	Specify……………

87

87

Example: deferred tax asset—tax loss carried forward during a tax holiday

89

Example: deferred tax asset—tax loss carried forward during a tax holiday

» Government grants Entity a tax holiday for 2023 and 2024 (2 years).

» In **2023** Entity's **tax profit** = its **accounting profit** determined in accordance with the IFRS = $200 million profit.

» In **2024** Entity's **tax loss** = its **accounting loss** determined in accordance with the IFRS = $100 million loss.

» Government levies income tax at **30%** on tax profit

  » specifies that the tax loss carried forward that arose during the tax holiday can be utilsed to reduce income tax payable in 2025 only (**if unutilized in 2025 will expire unused**).

» Entity realistically forecasts accounting and tax profit for 2025 = $40 million; and 2026 = $50 million.

90

90

Example: deferred tax asset—tax loss carried forward during a tax holiday What do you think?

» **The carrying amount of the manufacturer's deferred tax at 31/12/2024 is?** (choose one of):

1) $30 million asset (30% x $100 million tax loss carried forward);
2) $27 million asset (30% x $90 million forecast tax profit for 2023 and 2024);
3) $12 million asset (30% x $40 million forecast tax profit for 2023); or
4) another amount.

91

91

Example: capital gains and capital losses—tax capital loss carried forward

93

Example: capital gains tax

- Corporate **normal tax** rate = 30%
  - Tax loss may be set off against taxable income in the **next five (5) tax periods**, earlier losses being set off before later losses.
- Corporate **capital gains** tax rate = 15%
  - Capital losses may be **carried forward indefinitely** and offset against capital gains of the same class.

94

94

Example: capital gains tax What do you think?

» Entity determines accounting profit and taxable profit for 2023 in accordance with IFRS to be $1,100,000 (including capital gain on sale of building = $100,000).

» **Entity's current tax expense for 2023 is?** Choose one of:

1) $330,000;
2) $315,000; or
3) $300,000.

Example: capital gains tax What do you think?

» Entity determines accounting profit for 2024 to be $900,000 (including accounting loss and tax capital loss = $100,000).

» **Entity's current tax for 2024 is?** Choose one of: 1) $300,000 expense; 2) $285,000 expense; 3) $270,000 expense; 4) $300,000 income; 5) $285,000 income; 6) $270,000 income; or 7) nil.

» **Entity's deferred tax for 2024 is?** Choose one or more of: 1) $30,000 expense; 2) $15,000 expense; 3) $30,000 income; 4) $15,000 income; or 5) nil.

Tax rate reconciliations

101

Regulatory issues: tax rate reconciliations

- We **asked for explanations** when:
  - it was **unclear** what significant items in the effective tax rate reconciliation related to, or why they were reconciling items.
  - information in the tax rate reconciliation was **inconsistent** with information elsewhere in the financial statements
- Baltic Classifieds Group PLC's effective **tax rate reconciliation included the reversal of a temporary difference**. In response to our query on why this was a reconciling item, the company identified that it related to a deferred tax liability that should have been released in the previous year. The company agreed to **restate its comparatives**.

Source: FRC (UK), *Annual Review of Corporate Reporting 2023/2024* (p24) and *Annual Review of Corporate Reporting 2022/2023* (p32 and 68) (**emphasis** added)

102

102

Regulatory issues: tax rate reconciliations

» Issuers should ensure that the tax rate reconciliation and the descriptions used therein **allow the reader to ascertain**:
  » the real **nature** of the reconciling items and their **impact on the effective tax rate**;
  » the **relationship** between accounting profit and the tax expense (IAS 12.81(c)); and
  » whether or not the relationship between the tax expense and accounting profit is **unusual** and if there are significant factors that could affect the relationship in **the future** (IAS 12.84).
    » **For example, the inclusion of one line item called 'non-deductible expenses' is insufficient disclosure, even as it relates to permanent differences.**

Source: *Combined findings of the JSE proactive monitoring of financial statements* (p38 and 39) (**emphasis** added)

103

103

Regulatory issues: tax rate reconciliations

» We questioned the basis on which a company had used the standard UK tax rate for its reconciliation when its **business operated outside** the UK.
  » In such cases, where a group operates in several jurisdictions, it **may be more meaningful to aggregate reconciliations prepared using the domestic rate in each individual jurisdiction** (IAS 12.85) and to disclose a weighted average tax rate applied to accounting profit.

Source: FRC (UK), *Annual Review of Corporate Reporting 2022/2023* (p32)

104

104

Example: permanent differences and tax loss carry forward

105

Example: permanent differences and tax loss carried forward

- Government specifies that:
  - entities must each year pay a **tax = 30%** of taxable profit for the year
  - taxable profit is determined in accordance with IFRS adjusted for specified expenses that are excluded from the calculation of taxable income (ie **donations and entertainment**)
  - If the determination of taxable business income results in a **loss in a tax period** that loss may be set off against taxable income in the **next three (3) tax periods**, earlier losses being set off before later losses.

106

106

Example: permanent differences and tax loss carried forward
What do you think?

- » Entity determines accounting profit for 2023 in accordance with IFRS to be $900,000 (donation expense = $100,000).
  - **Entity's current tax expense for 2023 is?** Choose one of: 1) $1,000,000; 2) $900,000; 3) $800,000; 4) $300,000; 5) $230,000; or 6) $200,000.
- » Entity determines accounting loss for 2024 to be $400,000 (entertainment expense = $100,000)
  - **Entity's current tax income for 2024 is?** Choose one of: 1) $500,000; 2) $400,000; 3) $300,000; 4) $130,000; 5) $100,000; 6) $90,000; or 7) nil.

107

107

Example: permanent differences and tax loss carried back

113

Example: permanent differences and tax loss carried back

» Government specifies that:

- » entities must each year pay a **tax = 30%** of taxable profit for the year
- » taxable profit is determined in accordance with IFRS adjusted for specified expenses that are excluded from the calculation of taxable income (ie **donations and entertainment**)
- » If the determination of taxable business income results in a **loss in a tax period** that loss may be **carried back** and set off against taxable income of the **previous year**.

114

114

Example: permanent differences and tax loss carried back What do you think?

» Entity determines accounting profit for 2023 in accordance with IFRS to be $900,000 (donation expense = $100,000).

Entity's current tax expense for 2023 is? Choose one of: 1) $1,000,000; 2) $900,000; 3) $800,000; 4) $300,000; 5) $230,000; or 6) $200,000.

» Entity determines accounting loss for 2024 to be $400,000 (entertainment expense = $100,000)

Entity's current tax income for 2024 is? Choose one of: 1) $500,000; 2) $400,000; 3) $300,000; 4) $130,000; 5) $100,000; 6) $90,000; or 7) nil.

115

115

Uncertain tax positions

Regulatory issues: uncertain tax positions

» We asked a company to provide further explanation of its uncertain tax provision when it was unclear from the disclosures provided what the provision related to.

» IFRIC 23 *Uncertainty over Income Tax Treatments*, has been issued. Companies should refer to IFRIC 23 for clarification of the recognition, measurement and disclosure requirements in relation to uncertain tax positions.

Source: FRC (UK), *Annual Review of Corporate Reporting 2022/2023* (p33) and *Thematic Review: Offsetting in the financial statements* (2024)

120

IFRIC 23 *Uncertainty over Income Tax Treatments* overview (1)

- **An 'uncertain tax treatment' has uncertainty over whether the tax authority will accept the tax treatment under tax law.**
- Assume taxation authority has full knowledge and examination rights.
- Determine whether to consider each uncertain tax treatment **separately or collectively**, based on which approach better predicts the resolution of the uncertainty.

Source: IFRIC 23 *Uncertainty over Income Tax Treatments*

121

121

IFRIC 23 *Uncertainty over Income Tax Treatments* overview (2)

- **Is it probable that the taxation authority will accept an uncertain tax treatment used (or planned to be used) in reporting entity's income tax filings?**
- **If yes:** determine accounting on the basis of the tax filing.
- **If no:** reflect effects of uncertainty in the accounting using the approach that better predicts the resolution of the uncertainty:
  - **the most likely amount** (typically when the possible outcomes are binary or are concentrated on one value); or
  - **the expected value** (typically when there is a range of possible outcomes that are neither binary nor concentrated on one value).

Source: IFRIC 23 *Uncertainty over Income Tax Treatments*

122

122

Current tax: uncertain tax position
What do you think?

- » Corporate tax rate is 30%
- » Taxable income before uncertain item to be $1,000,000
- » **Scenario A:** Entity determines for the year ended 31 December 2024:
  - » **60% probability** that a further $100,000 gain on the sale of a single item is taxable (issue is **binary**, $100,000 is either in or out of taxable profit)
  - » **$100,000 gain included in taxable profit in tax return**
- » **Entity's current tax expense for 2024 is?** Choose one of: 1) $300,000 (most favorable outcome); 2) $308,000; 3) $318,000 (expected value—probability weighted outcome); 4) $330,000 (most likely outcome); or 5) it depends (specify on what it depends….).

123

123

Current tax: uncertain tax position
What do you think?

- » Corporate tax rate is 30%
- » Taxable income before uncertain item to be $1,000,000
- » **Scenario B:** Entity determines for the year ended 31 December 2024:
  - » **60% probability** that a further $100,000 gain on the sale of a single item is taxable (issue is **binary**, $100,000 is either in or out of taxable profit)
  - » **$100,000 gain excluded from taxable profit in tax return**
- » **Entity's current tax expense for 2024 is?** Choose one of: 1) $300,000 (most favorable outcome); 2) $308,000; 3) $318,000 (expected value—probability weighted outcome); 4) $330,000 (most likely outcome); or 5) it depends (specify on what it depends….).

125

125

Current tax: uncertain tax position
What do you think?

» Corporate tax rate is 30%

» Taxable income before uncertain item to be $1,000,000

» **Scenario C:** Entity determines for the year ended 31 December 2024:

  » 40% **probability** that a further $100,000 gain on the sale of a single item is taxable (issue is **binary**, $100,000 is either in or out of taxable profit)

  » **$100,000 gain excluded from taxable profit in tax return**

» **Entity's current tax expense for 2024 is?** Choose one of: 1) $300,000 (most favorable outcome); 2) $308,000; 3) $318,000 (expected value—probability weighted outcome); 4) $330,000 (most likely outcome); or 5) it depends (specify on what it depends….).

127

127

Current tax: uncertain tax position
What do you think?

» Corporate tax rate is 30%

» Taxable income before uncertain item to be $1,000,000

» **Scenario D:** Entity determines for the year ended 31 December 2024:

  » 60% **probability** that a further $100,000 total gains on the separate sales of multiple items each with different ToCs are taxable (issues are **not binary**, there is a range of possible outcomes that are neither binary nor concentrated on a single amount)

  » **$100,000 total gains excluded from taxable profit in tax return**

» **Entity's current tax expense for 2024 is?** Choose one of: 1) $300,000 (most favorable outcome); 2) $308,000; 3) $318,000 (expected value—probability weighted outcome); 4) $330,000 (most likely outcome); or 5) it depends (specify on what it depends….).

129

129

Pillar Two income taxes

131

Pillar Two income taxes

- » Must recognise (and disclose separately) Pillar Two **current tax**, if any.
- » Must disclose that applied the **Pillar Two deferred tax** recognition and disclosure exception.
- » When Pillar Two legislation is enacted or substantively **enacted but not yet in effect**, disclose:
  - » **Known or reasonably estimable information** that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation. Qualitative and quantitative information (for example, indicative range).
  - » **If not known or reasonably estimable**, instead disclose a statement to that effect and information about the entity's progress in assessing its exposure.

Source: paragraphs and 4A and 88A-88D of IAS 12 *Income Taxes*

132

132

Appendix A: Regulatory updates

133

Appendix B: Mini-case studies: other income tax issues

135

Mini-case studies

1. PPE revaluation model
2. Investment property and goodwill

136

Mini-case study 1: PPE revaluation model

Deferred tax
recall overview of the measurement requirements

» Measure deferred tax liability (asset) using

- » undiscounted amounts the entity expects to pay (recover)
- » substantively enacted tax rates that apply to undistributed profits **reflecting the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover the carrying amount of the asset/settle the liability**
  - » recovery of **revalued** **non-depreciable items of PPE** is through sale *(a principle)*
  - » **rebuttable presumption** that **investment property** carried at fair value is recoverable through sale (rebutted if the **depreciable** and objective is to recover substantially all of its carrying amount through use) *(a rebuttable 'rule')*
- » (when **differential tax rates** apply) the average substantively enacted rate that is expected to apply to its taxable profits of the relevant future periods (for example, when the taxable temporary differences reverse)

138

138

Mini-case study: revaluation model, depreciable machine

31 December 2020 Entity A buys a commercial building for $1 million.

» **Accounting**

- » **depreciation: straight-line** to nil residual value over **10 years**
- » revaluation model:
  - » **31/12/2022:** fair value = $1.2 million
  - » **31/12/2024:** recoverable amount (fair value less costs to sell) = $300,000
  - » **31/12/2026:** fair value = $800,000

139

139

Case study: revaluation model, depreciable machine
the facts

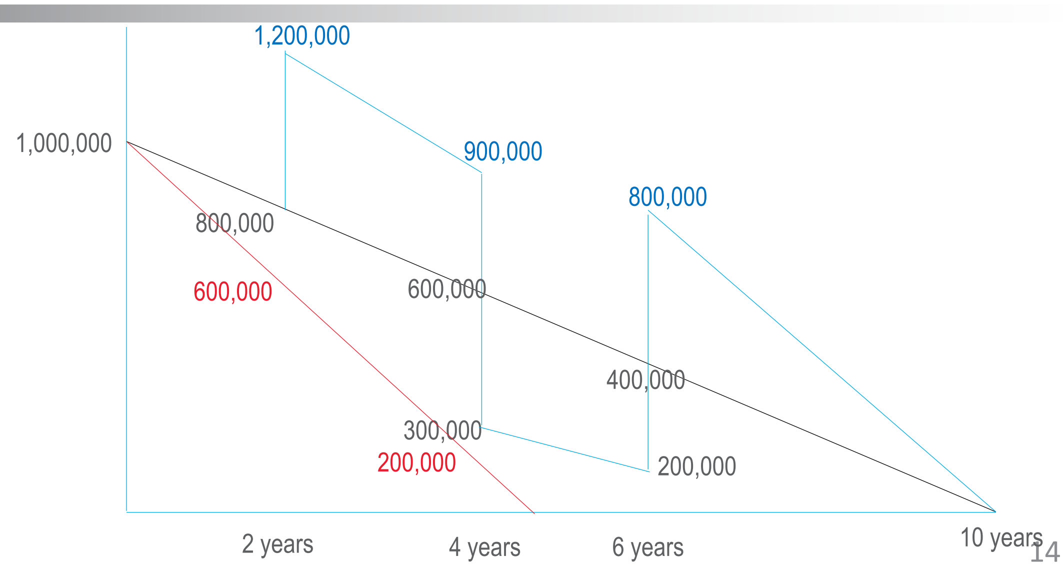
» **Tax**

- » depreciation: straight-line to nil residual value over **5 years**
- » tax rates
  - » **30% on taxable income** (including recoupment of past depreciation on sale of an asset but excluding capital gains)
  - » **15% on capital gains** (for example, proceeds from sale of building less its original cost)

140

140

Case study: revaluation model, depreciable machine
the accounting and tax



141

141

Case study: revaluation model, depreciable machine accounting for deferred tax What do you think?

Date	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Deferred tax liability	Deferred tax expense (income)
31/12/2020					
depreciation					
31/12/2021					
depreciation					
revaluation					
31/12/2022					
depreciation					
31/12/2023					

142

Case study: revaluation model, depreciable machine accounting for deferred tax What do you think?

Date	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Deferred tax liability	Deferred tax expense (income)
31/12/2023					
depreciation					
revaluation decrease					
impairment					
31/12/2024					
depreciation					
31/12/2025					

143

Case study: revaluation model, depreciable machine accounting for deferred tax What do you think?

Date	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Deferred tax liability	Deferred tax expense (income)
31/12/2025					
depreciation					
reverse impairment					
revaluation					
31/12/2026					
depreciation					
31/12/2027					

144

144

Case study: revaluation model, depreciable machine accounting for deferred tax What do you think?

Date	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Deferred tax liability	Deferred tax expense (income)
31/12/2027					
depreciation					
31/12/2028					
depreciation					
31/12/2029					
depreciation					
31/12/2030					

145

145

Mini case study 2: investment property
Scenario 1: cost model

150

Deferred tax
overview of the measurement requirements

» Measure deferred tax liability (asset) using
  » undiscounted amounts the entity expects to pay (recover)
  » substantively enacted tax rates that apply to undistributed profits reflecting the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover the carrying amount of the asset/settle the liability
    » recovery of revalued non-depreciable items of PPE is through sale *(a principle)*
    » **rebuttable presumption** that **investment property carried at fair value** is recoverable through sale (rebutted if the **depreciable** and objective is to recover substantially all of its carrying amount through use) *(a rebuttable 'rule')*
  » (when **differential tax rates** apply) the average substantively enacted rate that is expected to apply to its taxable profits of the relevant future periods (for example, when the taxable temporary differences reverse)

151

151

Case study: investment property

- **31/12/2020** Entity A buys an investment property (building) cost = $1,000,000
- on **31/12/2024** impairment event
- on **31/12/2026** the condition that gave rise to the impairment reverses

152

152

Case study: investment property

- **Tax**
  - depreciation **buildings:** straight-line to nil residual value over **5 years**
  - tax rates
    - **30%** on **taxable income** (including recoupment of past depreciation on sale of an asset but excluding capital gains)
    - **15%** on **capital gains** (for example, proceeds from sale of land less its original cost)

153

153

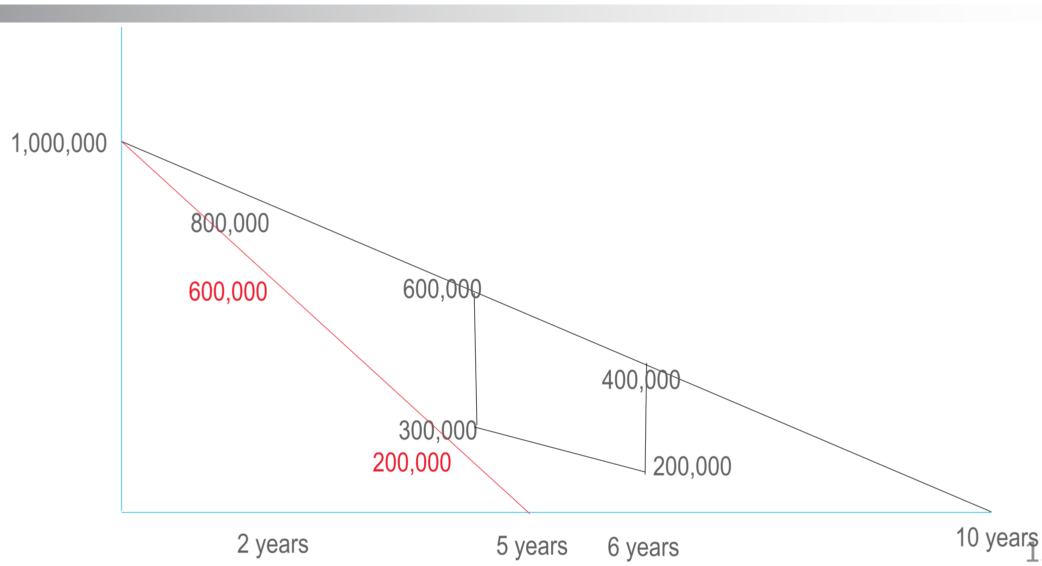
Case study: investment property
the facts

- **Accounting**
  - cost model
  - depreciation buildings: straight-line; nil residual value; **10 years**
- on **31/12/2024** **recoverable amount of** building = $300,000

154

154

Case study: investment property <u>building cost model</u>
*the accounting **and tax***



155

155

Case study: investment property building cost model accounting for deferred tax
What do you think

Date	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Deferred tax liability	Deferred tax expense (income)
31/12/2020					
depreciation					
31/12/2021					
depreciation					
31/12/2022					
depreciation					
31/12/2023					

156

156

Mini-case study 2: investment property
Scenario 2: fair value

161

Deferred tax
overview of the measurement requirements

» Measure deferred tax liability (asset) using
- » undiscounted amounts the entity expects to pay (recover)
- » substantively enacted tax rates that apply to undistributed profits reflecting the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover the carrying amount of the asset/settle the liability
  - » recovery of revalued non-depreciable items of PPE is through sale *(a principle)*
  - » **rebuttable presumption** that **investment property carried at fair value** is recoverable through sale (rebutted if the **depreciable** and objective is to recover substantially all of its carrying amount through use) *(a rebuttable 'rule')*
- » (when **differential tax rates** apply) the average substantively enacted rate that is expected to apply to its taxable profits of the relevant future periods (for example, when the taxable temporary differences reverse)

162

162

Case study: investment property

» **31/12/2020** Entity A buys an investment property (buildings) for $1,000,000.

163

163

Case study: investment property

» **Tax**

» depreciation **buildings:** straight-line to nil residual value over **5 years**

» tax rates

» **30%** on **taxable income** (including recoupment of past depreciation on sale of an asset but excluding capital gains)

» **15%** on **capital gains**

164

164

Case study: investment property

» **Accounting** fair value model for the building.

» Management intend never to sell the building (**rebut presumption**).

» **Fair value** of the building:

Date	Fair value	Date	Fair value
31/12/2020	1,000,000	**31/12/2026**	800,000
31/12/2021	900,000	**31/12/2027**	600,000
31/12/2022	1,200,000	**31/12/2028**	400,000
31/12/2023	1,050,000	**31/12/2029**	200,000
31/12/2024	300,000	**31/12/2030**	-
31/12/2025	250,000		

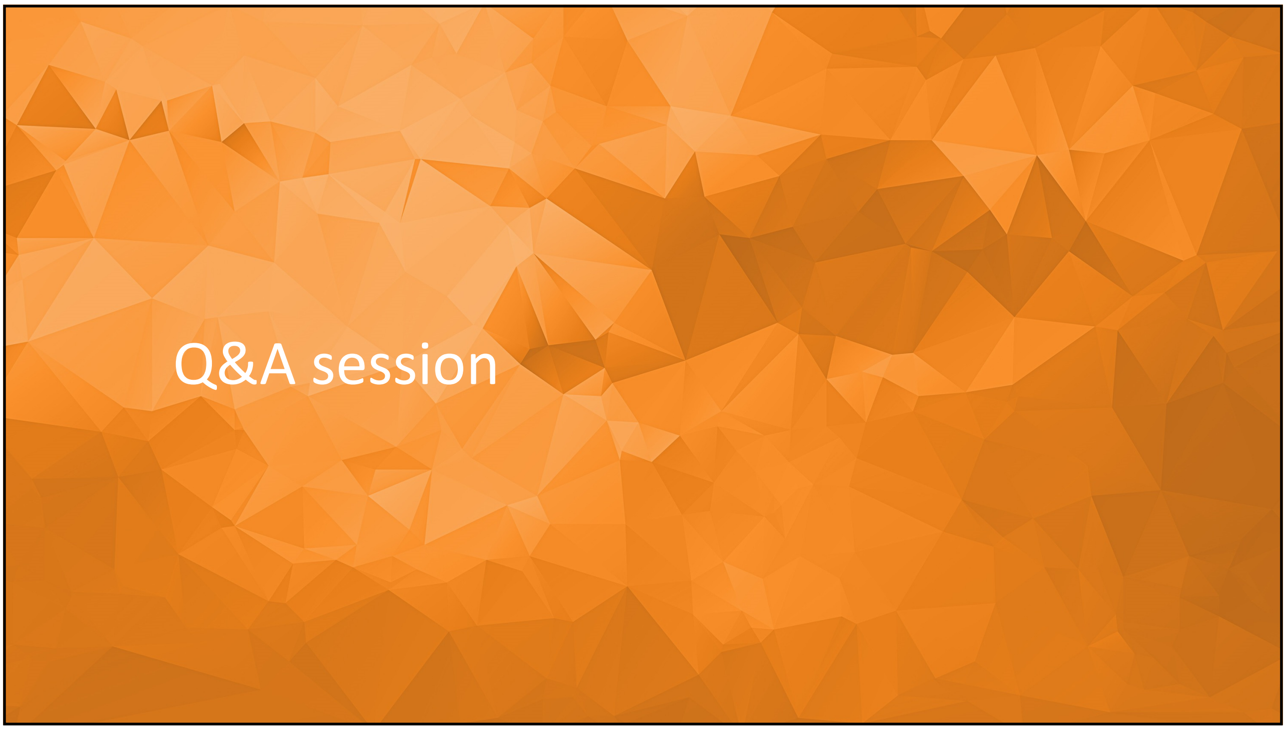
165

165

Case study: investment property building fair value model accounting for deferred tax What do you think?

Date	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Deferred tax liability	Deferred tax expense (income)
31/12/2020					
2011					
31/12/2021					
depreciation					
fair value					
31/12/2022					
2013					
31/12/2023					

166



171