PASSFR.EU

A Digital Learning Platform for Generation Z:
Passport to IFRS®

IAS® Standard 12 Income Taxes

Co-funded by the
Erasmus+ Programme
of the European Union

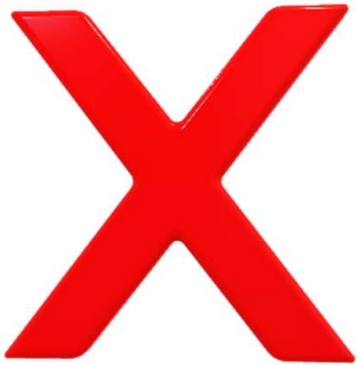
SCOPE

IAS Standard 12 Income Taxes prescribes the accounting treatment for income taxes.

SCOPE

Financial reporting treatments

Tax treatments



EXAMPLE 1

a) An entity purchases equipment on 1 January 20x1 for CU600. Its management estimate an even use of the asset, over 3 years, and no residual value. For tax purposes though, the asset is depreciated on 2 years, also by using the straight-line method.

a) But what if the asset is depreciated on 2 years for financial reporting purposes, and on 3 years for tax purposes? The entity also uses the straight-line method of depreciation for both purposes.

Accounting profit for the year is CU1,000 and the applicable income tax rate is 16% in both cases. Discuss any differences between the financial reporting and the tax treatments corresponding to this asset.

EXAMPLE 1 SOLUTION CASE A

Financial reporting depreciation schedule (in CU)			Tax depreciation schedule (in CU)		
Date	Annual depreciation	Carrying amount	**Date**	Annual tax depreciation	Tax base
1.1.20x1		600	**1.1.20x1**		600
31.12.20x1	200	400	**31.12.20x1**	300	300
31.12.20x2	200	200	**31.12.20x2**	300	0
31.12.20x3	200	0	**31.12.20x3**	0	0

EXAMPLE 1 SOLUTION CASE B

Financial reporting depreciation schedule (in CU)			Tax depreciation schedule (in CU)		
Date	Annual depreciation	Carrying amount	**Date**	Annual tax depreciation	Tax base
1.1.20x1		600	**1.1.20x1**		600
31.12.20x1	300	300	**31.12.20x1**	200	400
31.12.20x2	300	0	**31.12.20x2**	200	200
31.12.20x3	0	0	**31.12.20x3**	200	0

DEFINITIONS

Accounting profit

Is profit or loss for a period before deducting tax expense.

Taxable profit (tax loss)

Is profit or loss for a period, determined in accordance with tax rules.

DEFINITIONS

Tax expense (income)

Current income tax:

- Is based on taxable profit
- It refers to the current period

Deferred income tax:

- Is based on temporary differences
- It refers to future periods

DEFINITIONS

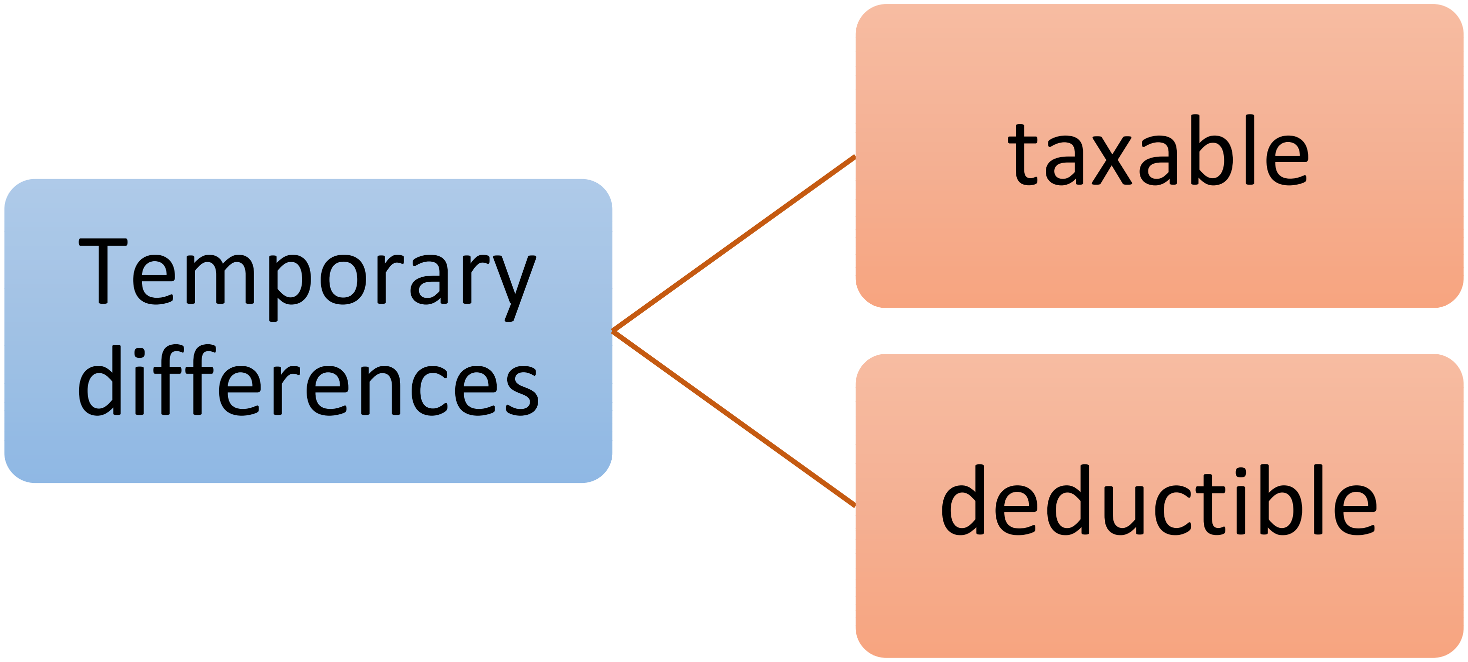
Deferred tax liabilities

amounts of income taxes payable in future periods in respect of taxable temporary differences

Deferred tax assets

amounts of income taxes recoverable in future periods in respect of taxable temporary differences and other items

DEFINITIONS



DEFINITIONS

Tax base of

Assets

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

Liabilities

Is their carrying amount minus any amount that is deductible for tax purposes in respect of that liability in the future

DEFINITIONS

If	For assets	For liabilities
Carrying amount > Tax Base	→ Taxable temporary differences (TTD)	→ Deductible temporary differences (DTD)
Carrying amount < Tax Base	→ Deductible temporary differences (DTD)	→ Taxable temporary differences (TTD)

EXAMPLE 1 continued

How much is accounting and taxable profit in each year in Example 1 above? How much should tax expense be in each year? And how much current tax expense is in each year?

Case a)	year 20x1	year 20x2	year20x3	Total Tax
Accounting profit is	1,000	1,000	1,000	
Tax expense should be	160	160	160	480
Taxable profit is	1,000+200-300 = 900	900	1,000+200 = 1,200	
Current tax expense is	144	144	192	480

EXAMPLE 1 continued

How much is accounting and taxable profit in each year in Example 1 above? How much tax expense should be in each year? And how much current tax expense is in each year?

Case b)	year 20x1	year 20x2	year 20x3	Total tax
Accounting profit is	1,000	1,000	1,000	
Tax expense should be	160	160	160	480
Taxable profit is	1,000+300-200 = 1,100	1,000+300-200 = 1,100	1,000-200 = 800	
Current tax expense is	176	176	128	480

EXAMPLE 1 continued

What are the taxable/deductible temporary differences (TTD/DTD) that result in each case?

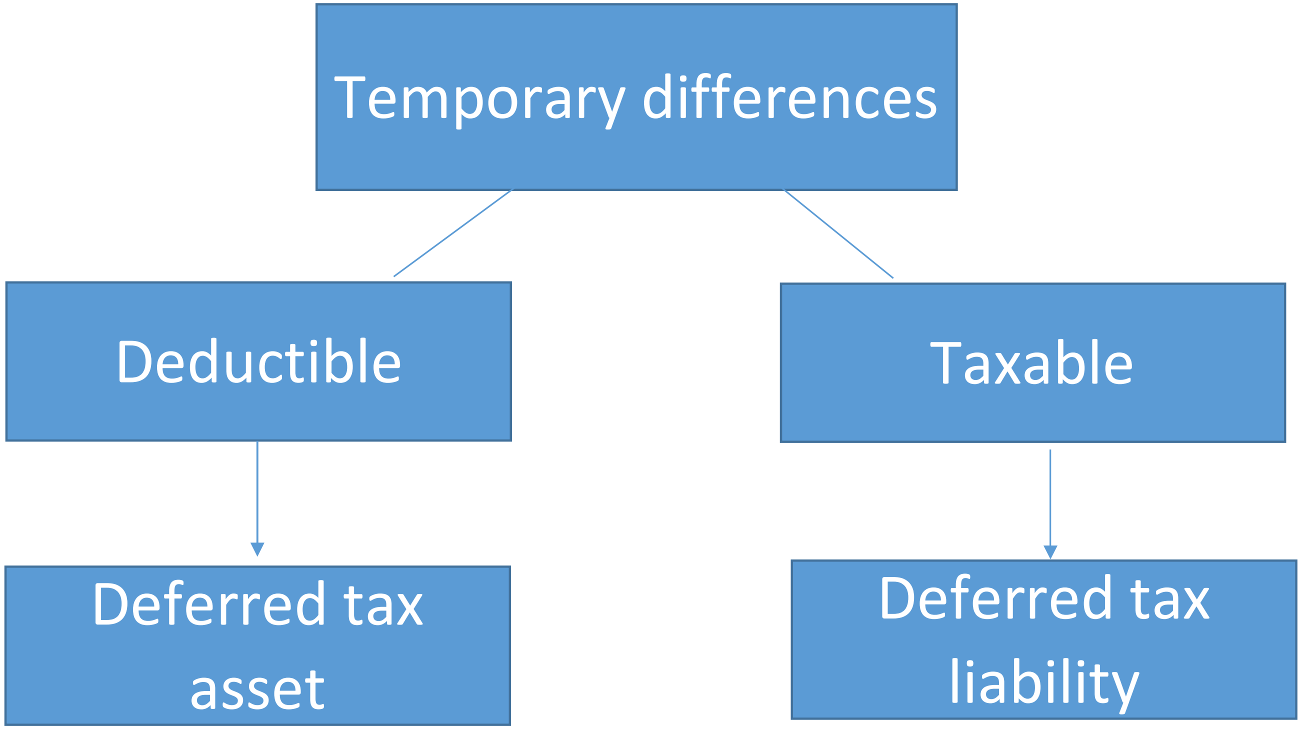
Case a) Date	Carrying amount	Tax base	TTD	DTD
31.12.20x1	400	300	100	-
31.12.20x2	200	0	200	-
31.12.20x3	0	0	0	-

EXAMPLE 1 continued

What are the taxable/deductible temporary differences (TTD/DTD) that result in each case?

Case b) Date	Carrying amount	Tax base	TTD	DTD
31.12.20x1	300	400	-	100
31.12.20x2	0	200	-	200
31.12.20x3	0	0	-	0

FUNDAMENTAL ISSUES



EXAMPLE 1 continued case a

What are the deferred tax implications in Example 1 above and the resulting tax expense?

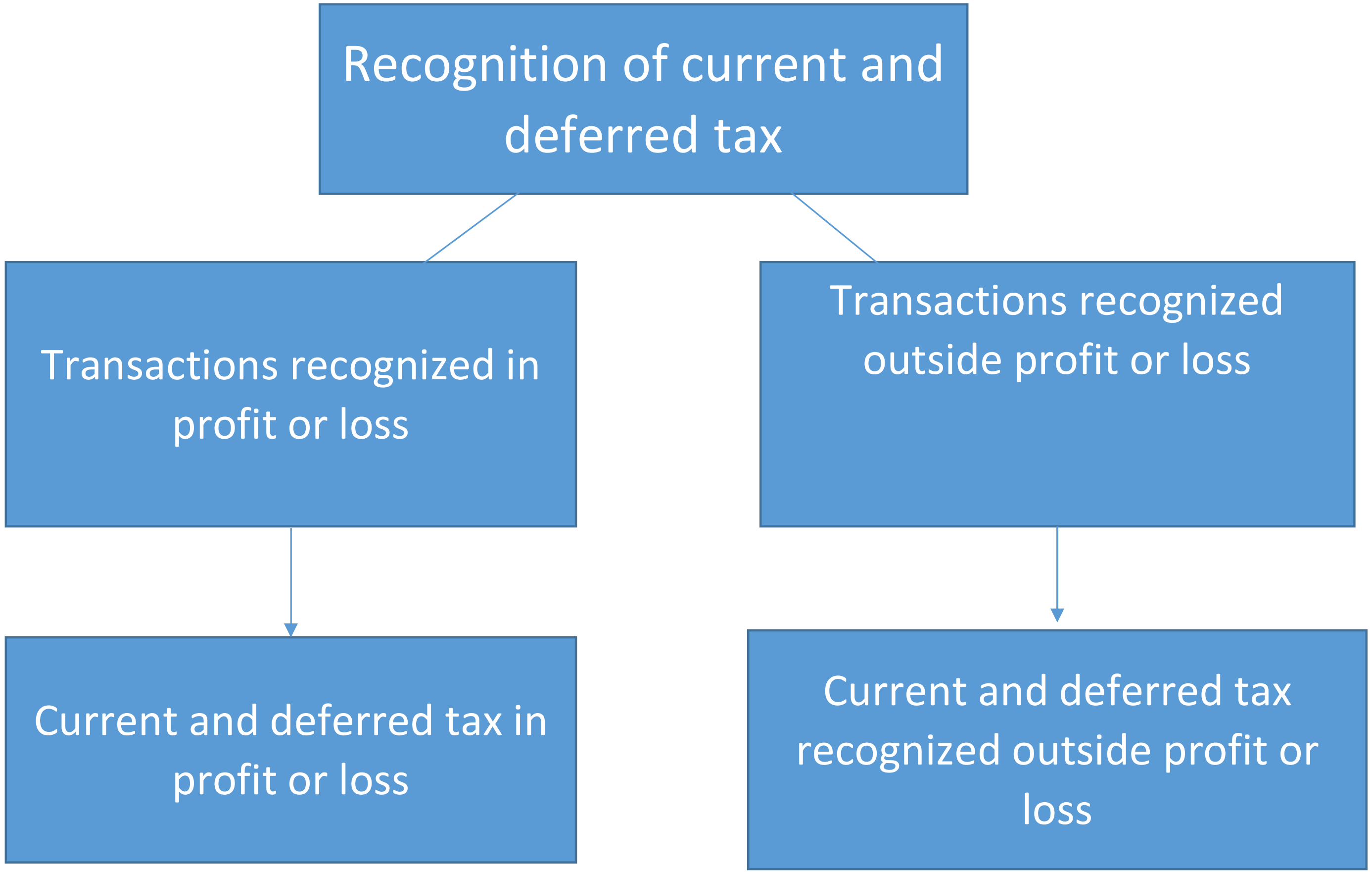
Date	Entry (in CU)
31.12.20x1	Dr. Deferred tax expense 16 Cr. Deferred tax liability 16
31.12.20x2	Dr. Deferred tax expense 16 Cr. Deferred tax liability 16
31.12.20x3	Dr. Deferred tax liability 32 Cr. Deferred tax income 32

EXAMPLE 1 continued case b

What are the deferred tax implications in Example 1 above and the resulting tax expense?

Date	Entry
31.12.20x1	Dr. Deferred tax asset 16 Cr. Deferred tax income 16
31.12.20x2	Dr. Deferred tax asset 16 Cr. Deferred tax income 16
31.12.20x3	Dr. Deferred tax expense 32 Cr. Deferred tax asset 32

FUNDAMENTAL ISSUES



EXAMPLE 2

Let's suppose the following temporary differences were calculated for FR Co.

	End of 20x1	End of 20x2
Taxable temporary difference	CU10,000	CU8,000
Deductible temporary difference	CU6,000	CU9,000

Also, a deferred tax liability of CU1,000 existed at the beginning of year 20x1. The applicable income tax rate is 16%. How does the entity account for the deferred taxes resulting for the two years?

EXAMPLE 2 solution

Date	Calculations (in CU)	Entry
31.12.20x1	TTD 10,000 → DTL 1,600 Op DTL 1,000 → +DTL 600 DTD 6,000 → +DTA 960	Dr. Deferred tax expense 600 Cr. Deferred tax liability 600 Dr. Deferred tax asset 960 Cr. Deferred tax income 960
31.1220x2	TTD 8,000 → DTL 1,280 Op DTL 1,600 → -DTL 320 DTD 9,000 → DTA 1,440 Op DTA 960 → +DTA 480	Dr. Deferred tax liability 320 Cr. Deferred tax income 320 Dr. Deferred tax asset 480 Cr. Deferred tax income 480

EXAMPLE 2 continued

But what would it be different if the entity had revalued its land properties during 20x2, which generated a taxable temporary difference of CU1,500?

EXAMPLE 2 continued solution

Upon revaluation:

Dr. Land 1,500

Cr. Revaluation reserve 1,500

Dr. Deferred tax recognized in equity 240

Cr. Deferred tax liability 240

End of year 20x2:

Dr. Deferred tax liability 560

Cr. Deferred tax income 560

DISCLOSURE

An entity shall disclose separately the components of tax expense (income), such as, for example, current tax expense (income) and deferred tax expense (income). Additionally, entities must disclose aggregate amounts of tax recognised directly in equity or related to each item of other comprehensive income.

An entity shall also disclose separately an explanation of the relationship between tax expense (income) and accounting profit. The average effective tax rate is the tax expense (income) divided by the accounting profit.

ADDITIONAL EXAMPLE

Merchandise is held at the end of the years 20x1 and 20x2 for CU1,000. The net realisable value of this merchandise is CU950 as at December 31 year 20x1, and CU1,050 as at December 31 year 20x2. The value adjustments for inventory write-downs are not tax deductible. The accounting profit of each year is CU500. The applicable income tax rate is 16%.

What is the effect of deferred taxation on the financial statements (i.e., how much is the yearly tax expense)?

ADDITIONAL EXAMPLE solution

Inventories are measured at the lower value between their cost and their net realisable value.

At the end of the year 20x1, inventories are measured at CU950.

Therefore, in terms of deferred taxation, the entity recognizes:

Dr. Deferred tax asset 8

Cr. Deferred tax income 8

Tax expense = CU88-CU8 (deferred tax income) = CU80 (16%*CU500)

ADDITIONAL EXAMPLE solution continued

At the end of the year 20x2, inventories are measured at CU1,000.

Therefore, in terms of deferred taxation, the entity recognizes:

Dr. Deferred tax expense 8

Cr. Deferred tax asset 8

Tax expense = CU72+CU8 (deferred tax expense) = CU80 (16%*CU500)

PASSFR.EU

A Digital Learning Platform for Generation Z:
Passport to IFRS®

Co-funded by the
Erasmus+ Programme
of the European Union