

Income Taxes
Illustrative Examples

Illustrative examples

These illustrative examples accompany, but are not part of, SB-FRS 12.

Examples of temporary differences

A. Examples of circumstances that give rise to taxable temporary differences

All taxable temporary differences give rise to a deferred tax liability.

Transactions that affect profit or loss

- 1 Interest revenue is received in arrears and is included in accounting profit on a time apportionment basis but is included in taxable profit on a cash basis.
- 2 Revenue from the sale of goods is included in accounting profit when goods are delivered but is included in taxable profit when cash is collected. (*note: as explained in B3 below, there is also a **deductible** temporary difference associated with any related inventory*).
- 3 Depreciation of an asset is accelerated for tax purposes.
- 4 Development costs have been capitalised and will be amortised to the statement of comprehensive income but were deducted in determining taxable profit in the period in which they were incurred.
- 5 Prepaid expenses have already been deducted on a cash basis in determining the taxable profit of the current or previous periods.

Transactions that affect the statement of financial position

- 6 Depreciation of an asset is not deductible for tax purposes and no deduction will be available for tax purposes when the asset is sold or scrapped. (*note: paragraph 15(b) of the Standard prohibits recognition of the resulting deferred tax liability unless the asset was acquired in a business combination, see also paragraph 22 of the Standard.*)
- 7 A borrower records a loan at the proceeds received (which equal the amount due at maturity), less transaction costs. Subsequently, the carrying amount of the loan is increased by amortisation of the transaction costs to accounting profit. The transaction costs were deducted for tax purposes in the period when the loan was first recognised. (*notes: (1) the taxable temporary difference is the amount of transaction costs already deducted in determining the taxable profit of current or prior periods, less the cumulative amount amortised to accounting profit; and (2) as the initial recognition of the loan affects taxable profit, the exception in paragraph 15(b) of the Standard does not apply. Therefore, the borrower recognises the deferred tax liability.*)
- 8 A loan payable was measured on initial recognition at the amount of the net proceeds, net of transaction costs. The transaction costs are amortised to accounting profit over the life of the loan. Those transaction costs are not deductible in determining the taxable profit of future, current or prior periods. (*notes: (1) the taxable temporary difference is the amount of unamortised transaction costs; and (2) paragraph 15(b) of the Standard prohibits recognition of the resulting deferred tax liability.*)
- 9 The liability component of a compound financial instrument (for example a convertible bond) is measured at a discount to the amount repayable on maturity (see SB-FRS 32 *Financial*

Instruments: Presentation). The discount is not deductible in determining taxable profit (tax loss).

Fair value adjustments and revaluations

- 10 Financial assets or investment property are carried at fair value which exceeds cost but no equivalent adjustment is made for tax purposes.
- 11 An entity revalues property, plant and equipment (under the revaluation model treatment in SB-FRS 16 *Property, Plant and Equipment*) but no equivalent adjustment is made for tax purposes. *(note: paragraph 61A of the Standard requires the related deferred tax to be recognised in other comprehensive income.)*

Business combinations and consolidation

- 12 The carrying amount of an asset is increased to fair value in a business combination and no equivalent adjustment is made for tax purposes. *(Note that on initial recognition, the resulting deferred tax liability increases goodwill or decreases the amount of any bargain purchase gain recognised. See paragraph 66 of the Standard.)*
- 13 Reductions in the carrying amount of goodwill are not deductible in determining taxable profit and the cost of the goodwill would not be deductible on disposal of the business. *(Note that paragraph 15(a) of the Standard prohibits recognition of the resulting deferred tax liability.)*
- 14 Unrealised losses resulting from intragroup transactions are eliminated by inclusion in the carrying amount of inventory or property, plant and equipment.
- 15 Retained earnings of subsidiaries, branches, associates and joint ventures are included in consolidated retained earnings, but income taxes will be payable if the profits are distributed to the reporting parent. *(note: paragraph 39 of the Standard prohibits recognition of the resulting deferred tax liability if the parent, investor or 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.)*
- 16 Investments in foreign subsidiaries, branches or associates or interests in foreign joint ventures are affected by changes in foreign exchange rates. *(notes: (1) there may be either a taxable temporary difference or a deductible temporary difference; and (2) paragraph 39 of the Standard prohibits recognition of the resulting deferred tax liability if the parent, investor or 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.)*
- 17 The non-monetary assets and liabilities of an entity are measured in its functional currency but the taxable profit or tax loss is determined in a different currency. *(notes: (1) there may be either a taxable temporary difference or a deductible temporary difference; (2) where there is a taxable temporary difference, the resulting deferred tax liability is recognised (paragraph 41 of the Standard); and (3) the deferred tax is recognised in profit or loss, see paragraph 58 of the Standard.)*

Hyperinflation

- 18 Non-monetary assets are restated in terms of the measuring unit current at the end of the reporting period (see SB-FRS 29 *Financial Reporting in Hyperinflationary Economies*) and no equivalent adjustment is made for tax purposes. *(notes: (1) the deferred tax is recognised in profit or loss; and (2) if, in addition to the restatement, the non-monetary assets are also revalued, the deferred tax relating to the revaluation is recognised in other comprehensive income and the deferred tax relating to the restatement is recognised in profit or loss.)*

B. Examples of circumstances that give rise to deductible temporary differences

All deductible temporary differences give rise to a deferred tax asset. However, some deferred tax assets may not satisfy the recognition criteria in paragraph 24 of the Standard.

Transactions that affect profit or loss

- 1 Retirement benefit costs are deducted in determining accounting profit as service is provided by the employee, but are not deducted in determining taxable profit until the entity pays either retirement benefits or contributions to a fund. *(note: similar deductible temporary differences arise where other expenses, such as product warranty costs or interest, are deductible on a cash basis in determining taxable profit.)*
- 2 Accumulated depreciation of an asset in the financial statements is greater than the cumulative depreciation allowed up to the end of the reporting period for tax purposes.
- 3 The cost of inventories sold before the end of the reporting period is deducted in determining accounting profit when goods or services are delivered but is deducted in determining taxable profit when cash is collected. *(note: as explained in A2 above, there is also a **taxable** temporary difference associated with the related trade receivable.)*
- 4 The net realisable value of an item of inventory, or the recoverable amount of an item of property, plant or equipment, is less than the previous carrying amount and an entity therefore reduces the carrying amount of the asset, but that reduction is ignored for tax purposes until the asset is sold.
- 5 Research costs (or organisation or other start-up costs) are recognised as an expense in determining accounting profit but are not permitted as a deduction in determining taxable profit until a later period.
- 6 Income is deferred in the statement of financial position but has already been included in taxable profit in current or prior periods.
- 7 A government grant which is included in the statement of financial position as deferred income will not be taxable in future periods. *(note: paragraph 24 of the Standard prohibits the recognition of the resulting deferred tax asset, see also paragraph 33 of the Standard.)*

Fair value adjustments and revaluations

- 8 Financial assets or investment property are carried at fair value which is less than cost, but no equivalent adjustment is made for tax purposes.

Business combinations and consolidation

- 9 A liability is recognised at its fair value in a business combination, but none of the related expense is deducted in determining taxable profit until a later period. *(Note that the resulting deferred tax asset decreases goodwill or increases the amount of any bargain purchase gain recognised. See paragraph 66 of the Standard.)*
- 10 [Deleted]
- 11 Unrealised profits resulting from intragroup transactions are eliminated from the carrying amount of assets, such as inventory or property, plant or equipment, but no equivalent adjustment is made for tax purposes.

- 12 Investments in foreign subsidiaries, branches or associates or interests in foreign joint ventures are affected by changes in foreign exchange rates. *(notes: (1) there may be a taxable temporary difference or a deductible temporary difference; and (2) paragraph 44 of the Standard requires recognition of the resulting deferred tax asset to the extent, and 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).*
- 13 The non-monetary assets and liabilities of an entity are measured in its functional currency but the taxable profit or tax loss is determined in a different currency. *(notes: (1) there may be either a taxable temporary difference or a deductible temporary difference; (2) where there is a deductible temporary difference, the resulting deferred tax asset is recognised to the extent that it is probable that sufficient taxable profit will be available (paragraph 41 of the Standard); and (3) the deferred tax is recognised in profit or loss, see paragraph 58 of the Standard.)*

C. Examples of circumstances where the carrying amount of an asset or liability is equal to its tax base

- 1 Accrued expenses have already been deducted in determining an entity's current tax liability for the current or earlier periods.
- 2 A loan payable is measured at the amount originally received and this amount is the same as the amount repayable on final maturity of the loan.
- 3 Accrued expenses will never be deductible for tax purposes.
- 4 Accrued income will never be taxable.

Illustrative computations and presentation

Extracts from statements of financial position and statements of comprehensive income are provided to show the effects on these financial statements of the transactions described below. These extracts do not necessarily conform with all the disclosure and presentation requirements of other Standards.

All the examples below assume that the entities concerned have no transaction other than those described.

Example 1 – Depreciable assets

An entity buys equipment for 10,000 and depreciates it on a straight-line basis over its expected useful life of five years. For tax purposes, the equipment is depreciated at 25% a year on a straight-line basis. Tax losses may be carried back against taxable profit of the previous five years. In year 0, the entity's taxable profit was 5,000. The tax rate is 40%.

The entity will recover the carrying amount of the equipment by using it to manufacture goods for resale. Therefore, the entity's current tax computation is as follows:

	Year				
	1	2	3	4	5
Taxable income	2,000	2,000	2,000	2,000	2,000
Depreciation for tax purposes	2,500	2,500	2,500	2,500	0
Taxable profit (tax loss)	<u>(500)</u>	<u>(500)</u>	<u>(500)</u>	<u>(500)</u>	<u>2,000</u>
Current tax expense (income) at 40%	<u><u>(200)</u></u>	<u><u>(200)</u></u>	<u><u>(200)</u></u>	<u><u>(200)</u></u>	<u><u>800</u></u>

The entity recognises a current tax asset at the end of years 1 to 4 because it recovers the benefit of the tax loss against the taxable profit of year 0.

The temporary differences associated with the equipment and the resulting deferred tax asset and liability and deferred tax expense and income are as follows:

	Year				
	1	2	3	4	5
Carrying amount	8,000	6,000	4,000	2,000	0
Tax base	<u>7,500</u>	<u>5,000</u>	<u>2,500</u>	<u>0</u>	<u>0</u>
Taxable temporary difference	<u><u>500</u></u>	<u><u>1,000</u></u>	<u><u>1,500</u></u>	<u><u>2,000</u></u>	<u><u>0</u></u>
Opening deferred tax liability	0	200	400	600	800
Deferred tax expense (income)	<u>200</u>	<u>200</u>	<u>200</u>	<u>200</u>	<u>(800)</u>
Closing deferred tax liability	<u><u>200</u></u>	<u><u>400</u></u>	<u><u>600</u></u>	<u><u>800</u></u>	<u><u>0</u></u>

The entity recognises the deferred tax liability in years 1 to 4 because the reversal of the taxable temporary difference will create taxable income in subsequent years. The entity's statement of comprehensive income includes the following:

	Year				
	1	2	3	4	5
Income	2,000	2,000	2,000	2,000	2,000
Depreciation	<u>2,000</u>	<u>2,000</u>	<u>2,000</u>	<u>2,000</u>	<u>2,000</u>
Profit before tax	0	0	0	0	0
Current tax expense (income)	(200)	(200)	(200)	(200)	800
Deferred tax expense (income)	<u>200</u>	<u>200</u>	<u>200</u>	<u>200</u>	<u>(800)</u>
Total tax expense (income)	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Profit for the period	<u><u>0</u></u>	<u><u>0</u></u>	<u><u>0</u></u>	<u><u>0</u></u>	<u><u>0</u></u>

Example 2 – Deferred tax assets and liabilities

The example deals with an entity over the two-year period, X5 and X6. In X5 the enacted income tax rate was 40% of taxable profit. In X6 the enacted income tax rate was 35% of taxable profit.

Charitable donations are recognised as an expense when they are paid and are not deductible for tax purposes.

In X5, the entity was notified by the relevant authorities that they intend to pursue an action against the entity with respect to sulphur emissions. Although as at December X6 the action had not yet come to court the entity recognised a liability of 700 in X5 being its best estimate of the fine arising from the action. Fines are not deductible for tax purposes.

In X2, the entity incurred 1,250 of costs in relation to the development of a new product. These costs were deducted for tax purposes in X2. For accounting purposes, the entity capitalised this expenditure and amortised it on the straight-line basis over five years. At 31/12/X4, the unamortised balance of these product development costs was 500.

In X5, the entity entered into an agreement with its existing employees to provide healthcare benefits to retirees. The entity recognises as an expense the cost of this plan as employees provide service. No payments to retirees were made for such benefits in X5 or X6. Healthcare costs are deductible for tax purposes when payments are made to retirees. The entity has determined that it is probable that taxable profit will be available against which any resulting deferred tax asset can be utilised.

Buildings are depreciated for accounting purposes at 5% a year on a straight-line basis and at 10% a year on a straight-line basis for tax purposes. Motor vehicles are depreciated for accounting purposes at 20% a year on a straight-line basis and at 25% a year on a straight-line basis for tax purposes. A full year's depreciation is charged for accounting purposes in the year that an asset is acquired.

At 1/1/X6, the building was revalued to 65,000 and the entity estimated that the remaining useful life of the building was 20 years from the date of the revaluation. The revaluation did not affect taxable profit in X6 and the taxation authorities did not adjust the tax base of the building to reflect the revaluation. In X6, the entity transferred 1,033 from revaluation surplus to retained earnings. This represents the difference of 1,590 between the actual depreciation on the building (3,250) and equivalent depreciation based on the cost of the building (1,660, which is the book value at 1/1/X6 of 33,200 divided by the remaining useful life of 20 years), less the related deferred tax of 557 (see paragraph 64 of the Standard).

Current tax expense

	X5	X6
Accounting profit	8,775	8,740
<i>Add</i>		
Depreciation for accounting purposes	4,800	8,250
Charitable donations	500	350
Fine for environmental pollution	700	–
Product development costs	250	250
Healthcare benefits	<u>2,000</u>	<u>1,000</u>
	17,025	18,590
<i>Deduct</i>		
Depreciation for tax purposes	<u>(8,100)</u>	<u>(11,850)</u>
Taxable profit	<u>8,925</u>	<u>6,740</u>
Current tax expense at 40%	<u>3,570</u>	
Current tax expense at 35%		<u>2,359</u>

Carrying amounts of property, plant and equipment

	<i>Building</i>	<i>Motor vehicles</i>	<i>Total</i>
Balance at 31/12/X4	50,000	10,000	60,000
Additions X5	<u>6,000</u>	<u>–</u>	<u>6,000</u>
Balance at 31/12/X5	56,000	10,000	66,000
Elimination of accumulated depreciation on revaluation at 1/1/X6	(22,800)	–	(22,800)
Revaluation at 1/1/X6	<u>31,800</u>	<u>–</u>	<u>31,800</u>
Balance at 1/1/X6	65,000	10,000	75,000
Additions X6	<u>–</u>	<u>15,000</u>	<u>15,000</u>
	<u>65,000</u>	<u>25,000</u>	<u>90,000</u>
<i>Accumulated depreciation</i>	5%	20%	
Balance at 31/12/X4	20,000	4,000	24,000
Depreciation X5	<u>2,800</u>	<u>2,000</u>	<u>4,800</u>
Balance at 31/12/X5	22,800	6,000	28,800
Revaluation at 1/1/X6	<u>(22,800)</u>	<u>–</u>	<u>(22,800)</u>
Balance at 1/1/X6	–	6,000	6,000
Depreciation X6	<u>3,250</u>	<u>5,000</u>	<u>8,250</u>
Balance at 31/12/X6	<u>3,250</u>	<u>11,000</u>	<u>14,250</u>

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Carrying amounts of property, plant and equipment

Carrying amount

31/12/X4	30,000	6,000	36,000
31/12/X5	<u>33,200</u>	<u>4,000</u>	<u>37,200</u>
31/12/X6	<u>61,750</u>	<u>14,000</u>	<u>75,750</u>

Tax base of property, plant and equipment

<i>Cost</i>	<i>Building</i>	<i>Motor vehicles</i>	<i>Total</i>
Balance at 31/12/X4	50,000	10,000	60,000
Additions X5	<u>6,000</u>	–	<u>6,000</u>
Balance at 31/12/X5	56,000	10,000	66,000
Additions X6	<u>–</u>	<u>15,000</u>	<u>15,000</u>
Balance at 31/12/X6	<u>56,000</u>	<u>25,000</u>	<u>81,000</u>
 <i>Accumulated depreciation</i>	 10%	 25%	
Balance at 31/12/X4	40,000	5,000	45,000
Depreciation X5	<u>5,600</u>	<u>2,500</u>	<u>8,100</u>
Balance at 31/12/X5	45,600	7,500	53,100
Depreciation X6	<u>5,600</u>	<u>6,250</u>	<u>11,850</u>
Balance 31/12/X6	<u>51,200</u>	<u>13,750</u>	<u>64,950</u>
 <i>Tax base</i>			
31/12/X4	<u>10,000</u>	<u>5,000</u>	<u>15,000</u>
31/12/X5	<u>10,400</u>	<u>2,500</u>	<u>12,900</u>
31/12/X6	<u>4,800</u>	<u>11,250</u>	<u>16,050</u>

Deferred tax assets, liabilities and expense at 31/12/X4

	<i>Carrying amount</i>	<i>Tax base</i>	<i>Temporary differences</i>
Accounts receivable	500	500	–
Inventory	2,000	2,000	–
Product development costs	500	–	500
Investments	33,000	33,000	–
Property, plant & equipment	<u>36,000</u>	<u>15,000</u>	<u>21,000</u>
TOTAL ASSETS	<u><u>72,000</u></u>	<u><u>50,500</u></u>	<u><u>21,500</u></u>
Current income taxes payable	3,000	3,000	–
Accounts payable	500	500	–
Fines payable	–	–	–
Liability for healthcare benefits	–	–	–
Long-term debt	20,000	20,000	–
Deferred income taxes	<u>8,600</u>	<u>8,600</u>	–
TOTAL LIABILITIES	<u>32,100</u>	<u>32,100</u>	
Share capital	5,000	5,000	–
Revaluation surplus	–	–	–
Retained earnings	<u>34,900</u>	<u>13,400</u>	
TOTAL LIABILITIES/EQUITY	<u><u>72,000</u></u>	<u><u>50,500</u></u>	
TEMPORARY DIFFERENCES			<u><u>21,500</u></u>
Deferred tax liability	21,500 at 40%		8,600
Deferred tax asset	–	–	–
Net deferred tax liability			<u><u>8,600</u></u>

Deferred tax assets, liabilities and expense at 31/12/X5

	<i>Carrying amount</i>	<i>Tax base</i>	<i>Temporary differences</i>
Accounts receivable	500	500	–
Inventory	2,000	2,000	–
Product development costs	250	–	250
Investments	33,000	33,000	–
Property, plant & equipment	<u>37,200</u>	<u>12,900</u>	<u>24,300</u>
TOTAL ASSETS	<u><u>72,950</u></u>	<u><u>48,400</u></u>	<u><u>24,550</u></u>
Current income taxes payable	3,570	3,570	–
Accounts payable	500	500	–
Fines payable	700	700	–
Liability for healthcare benefits	2,000	–	(2,000)
Long-term debt	12,475	12,475	–
Deferred income taxes	<u>9,020</u>	<u>9,020</u>	
TOTAL LIABILITIES	<u>28,265</u>	<u>26,265</u>	<u>(2,000)</u>
Share capital	5,000	5,000	–
Revaluation surplus	–	–	–
Retained earnings	<u>39,685</u>	<u>17,135</u>	
TOTAL LIABILITIES/EQUITY	<u><u>72,950</u></u>	<u><u>48,400</u></u>	
TEMPORARY DIFFERENCES			<u><u>22,550</u></u>
Deferred tax liability	24,550 at 40%		9,820
Deferred tax asset	2,000 at 40%		<u>(800)</u>
Net deferred tax liability			9,020
Less: Opening deferred tax liability			<u>(8,600)</u>
Deferred tax expense (income) related to the origination and reversal of temporary differences			<u><u>420</u></u>

Deferred tax assets, liabilities and expense at 31/12/X6

	<i>Carrying amount</i>	<i>Tax base</i>	<i>Temporary differences</i>
Accounts receivable	500	500	–
Inventory	2,000	2,000	–
Product development costs	–	–	–
Investments	33,000	33,000	–
Property, plant & equipment	<u>75,750</u>	<u>16,050</u>	<u>59,700</u>
TOTAL ASSETS	<u>111,250</u>	<u>51,550</u>	<u>59,700</u>
Current income taxes payable	2,359	2,359	–
Accounts payable	500	500	–
Fines payable	700	700	–
Liability for healthcare benefits	3,000	–	(3,000)
Long-term debt	12,805	12,805	–
Deferred income taxes	<u>19,845</u>	<u>19,845</u>	–
TOTAL LIABILITIES	39,209	36,209	(3,000)
Share capital	5,000	5,000	–
Revaluation surplus	19,637	–	–
Retained earnings	<u>47,404</u>	<u>10,341</u>	–
TOTAL LIABILITIES/EQUITY	<u>111,250</u>	<u>51,550</u>	–
TEMPORARY DIFFERENCES			<u>56,700</u>
Deferred tax liability	59,700 at 35%		20,895
Deferred tax asset	3,000 at 35%		<u>(1,050)</u>
Net deferred tax liability			19,845
Less: Opening deferred tax liability			(9,020)
Adjustment to opening deferred tax liability resulting from reduction in tax rate	22,550 at 5%		1,127
Deferred tax attributable to revaluation surplus	31,800 at 35%		<u>(11,130)</u>
Deferred tax expense (income) related to the origination and reversal of temporary differences			<u>822</u>

Illustrative disclosure

The amounts to be disclosed in accordance with the Standard are as follows:

Major components of tax expense (income) (paragraph 79)

	X5	X6
Current tax expense	3,570	2,359
Deferred tax expense relating to the origination and reversal of temporary differences:	420	822
Deferred tax expense (income) resulting from reduction in tax rate	<u>–</u>	<u>(1,127)</u>
Tax expense	<u>3,990</u>	<u>2,054</u>

Income tax relating to the components of other comprehensive income (paragraph 81(ab))

Deferred tax relating to revaluation of building	<u>–</u>	<u>(11,130)</u>
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In addition, deferred tax of 557 was transferred in X6 from retained earnings to revaluation surplus. This relates to the difference between the actual depreciation on the building and equivalent depreciation based on the cost of the building.

Explanation of the relationship between tax expense and accounting profit (paragraph 81(c))

The Standard permits two alternative methods of explaining the relationship between tax expense (income) and accounting profit. Both of these formats are illustrated below.

- (i) a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed

	X5	X6
Accounting profit	<u>8,775</u>	<u>8,740</u>
Tax at the applicable tax rate of 35% (X5: 40%)	3,510	3,059
Tax effect of expenses that are not deductible in determining taxable profit:		
Charitable donations	200	122
Fines for environmental pollution	280	–
Reduction in opening deferred taxes resulting from reduction in tax rate	<u>–</u>	<u>(1,127)</u>
Tax expense	<u>3,990</u>	<u>2,054</u>

The applicable tax rate is the aggregate of the national income tax rate of 30% (X5: 35%) and the local income tax rate of 5%.

- (ii) a numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed

	X5	X6
	%	%
	<u> </u>	<u> </u>
Applicable tax rate	40.0	35.0
Tax effect of expenses that are not deductible for tax purposes:		
Charitable donations	2.3	1.4
Fines for environmental pollution	3.2	–
Effect on opening deferred taxes of reduction in tax rate	<u> </u> –	<u> </u> (12.9)
Average effective tax rate (tax expense divided by profit before tax)	<u> </u> 45.5	<u> </u> 23.5

The applicable tax rate is the aggregate of the national income tax rate of 30% (X5: 35%) and the local income tax rate of 5%.

An explanation of changes in the applicable tax rate(s) compared to the previous accounting period (paragraph 81(d))

In X6, the government enacted a change in the national income tax rate from 35% to 30%.

In respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:

- (i) the amount of the deferred tax assets and liabilities recognised in the statement of financial position for each period presented;
- (ii) the amount of the deferred tax income or expense recognised in profit or loss for each period presented, if this is not apparent from the changes in the amounts recognised in the statement of financial position (paragraph 81(g))

	X5	X6
Accelerated depreciation for tax purposes	9,720	10,322
Liabilities for healthcare benefits that are deducted for tax purposes only when paid	(800)	(1,050)
Product development costs deducted from taxable profit in earlier years	100	–
Revaluation, net of related depreciation	<u> </u> –	<u> </u> 10,573
Deferred tax liability	<u> </u> 9,020	<u> </u> 19,845

(note: the amount of the deferred tax income or expense recognised in profit or loss for the current year is apparent from the changes in the amounts recognised in the statement of financial position)

Example 3 – Business combinations

On 1 January X5 entity A acquired 100 per cent of the shares of entity B at a cost of 600. At the acquisition date, the tax base in A's tax jurisdiction of A's investment in B is 600. 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 B were to dispose of its underlying business. The tax rate in A's tax jurisdiction is 30 per cent and the tax rate in B's tax jurisdiction is 40 per cent.

The fair value of the identifiable assets acquired and liabilities assumed (excluding deferred tax assets and liabilities) by A is set out in the following table, together with their tax bases in B's tax jurisdiction and the resulting temporary differences.

	<i>Amount recognised at acquisition</i>	<i>Tax base</i>	<i>Temporary differences</i>
Property, plant and equipment	270	155	115
Accounts receivable	210	210	–
Inventory	174	124	50
Retirement benefit obligations	(30)	–	(30)
Accounts payable	(120)	(120)	–
Identifiable assets acquired and liabilities assumed, excluding deferred tax	<u>504</u>	<u>369</u>	<u>135</u>

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 74 of the Standard).

No deduction is available in B's tax jurisdiction for the cost of the goodwill. Therefore, the tax base of the goodwill in B's jurisdiction is nil. However, in accordance with paragraph 15(a) of the Standard, A recognises no deferred tax liability for the taxable temporary difference associated with the goodwill in B's tax jurisdiction.

The carrying amount, in A's consolidated financial statements, of its investment in B is made up as follows:

Fair value of identifiable assets acquired and liabilities assumed, excluding deferred tax	504
Deferred tax liability (135 at 40%)	<u>(54)</u>
Fair value of identifiable assets acquired and liabilities assumed	450
Goodwill	<u>150</u>
Carrying amount	<u><u>600</u></u>

Because, at the acquisition date, the tax base in A's tax jurisdiction, of A's investment in B is 600, no temporary difference is associated in A's tax jurisdiction with the investment.

During X5, B's equity (incorporating the fair value adjustments made as a result of the business combination) changed as follows:

At 1 January X5	450
Retained profit for X5 (net profit of 150, less dividend payable of 80)	<u>70</u>
At 31 December X5	<u><u>520</u></u>

A recognises a liability for any withholding tax or other taxes that it will incur on the accrued dividend receivable of 80.

At 31 December X5, the carrying amount of A's underlying investment in B, excluding the accrued dividend receivable, is as follows:

Net assets of B	520
Goodwill	<u>150</u>
Carrying amount	<u><u>670</u></u>

The temporary difference associated with A's underlying investment is 70. This amount is equal to the cumulative retained profit since the acquisition date.

If A has determined that it will not sell the investment in the foreseeable future and that B will not distribute its retained profits in the foreseeable future, no deferred tax liability is recognised in relation to A's investment in B (see paragraphs 39 and 40 of the Standard). Note that this exception would apply for an investment in an associate only if there is an agreement requiring that the profits of the associate will not be distributed in the foreseeable future (see paragraph 42 of the Standard). A discloses the amount of the temporary difference for which no deferred tax is recognised, ie 70 (see paragraph 81(f) of the Standard).

If A expects to sell the investment in B, or that B will distribute its retained profits in the foreseeable future, A recognises a deferred tax liability to the extent that the temporary difference is expected to reverse. The tax rate reflects the manner in which A expects to recover the carrying amount of its investment (see paragraph 51 of the Standard). A recognises the deferred tax in other comprehensive income to the extent that the deferred tax results from foreign exchange translation differences that have been recognised in other comprehensive income (paragraph 61A of the Standard). A discloses separately:

- (a) the amount of deferred tax that has been recognised in other comprehensive income (paragraph 81(ab) of the Standard); and
- (b) the amount of any remaining temporary difference which is not expected to reverse in the foreseeable future and for which, therefore, no deferred tax is recognised (see paragraph 81(f) of the Standard).

Example 4 – Compound financial instruments

An entity receives a non-interest-bearing convertible loan of 1,000 on 31 December X4 repayable at par on 1 January X8. In accordance with SB-FRS 32 *Financial Instruments: Presentation* the entity classifies the instrument's liability component as a liability and the equity component as equity. The entity assigns an initial carrying amount of 751 to the liability component of the convertible loan and 249 to the equity component. Subsequently, the entity recognises imputed discount as interest expense at an annual rate of 10% on the carrying amount of the liability component at the beginning of the year. The tax authorities do not allow the entity to claim any deduction for the imputed discount on the liability component of the convertible loan. The tax rate is 40%.

The temporary differences associated with the liability component and the resulting deferred tax liability and deferred tax expense and income are as follows:

	Year			
	X4	X5	X6	X7
Carrying amount of liability component	751	826	909	1,000
Tax base	<u>1,000</u>	<u>1,000</u>	<u>1,000</u>	<u>1,000</u>
Taxable temporary difference	<u>249</u>	<u>174</u>	<u>91</u>	<u>–</u>
Opening deferred tax liability at 40%	0	100	70	37
Deferred tax charged to equity	100	–	–	–
Deferred tax expense (income)	<u>–</u>	<u>(30)</u>	<u>(33)</u>	<u>(37)</u>
Closing deferred tax liability at 40%	<u>100</u>	<u>70</u>	<u>37</u>	<u>–</u>

As explained in paragraph 23 of the Standard, at 31 December X4, the entity recognises the resulting deferred tax liability by adjusting the initial carrying amount of the equity component of the convertible liability. Therefore, the amounts recognised at that date are as follows:

Liability component	751
Deferred tax liability	100
Equity component (249 less 100)	<u>149</u>
	<u>1,000</u>

Subsequent changes in the deferred tax liability are recognised in profit or loss as tax income (see paragraph 23 of the Standard). Therefore, the entity's profit or loss includes the following:

	Year			
	X4	X5	X6	X7
Interest expense (imputed discount)	–	75	83	91
Deferred tax expense (income)	<u>–</u>	<u>(30)</u>	<u>(33)</u>	<u>(37)</u>
	<u>–</u>	<u>45</u>	<u>50</u>	<u>54</u>

Example 5 – Share-based payment transactions

In accordance with SB-FRS 102 *Share-based Payment*, an entity has recognised an expense for the consumption of employee services received as consideration for share options granted. A tax deduction will not arise until the options are exercised, and the deduction is based on the options' intrinsic value at exercise date.

As explained in paragraph 68B of the Standard, the difference between the tax base of the employee services received to date (being the amount the taxation authorities will permit as a deduction in future periods in respect of those services), and the carrying amount of nil, is a deductible temporary difference that results in a deferred tax asset. Paragraph 68B requires that, if the amount the taxation authorities will permit as a deduction in future periods is not known at the end of the period, it should be estimated, based on information available at the end of the period. If the amount that the taxation authorities will permit as a deduction in future periods is dependent upon the entity's share price at a future date, the measurement of the deductible temporary difference should be based on the entity's share price at the end of the period. Therefore, in this example, the estimated future tax deduction (and hence the measurement of the deferred tax asset) should be based on the options' intrinsic value at the end of the period.

As explained in paragraph 68C of the Standard, if the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, paragraph 68C requires that the excess of the associated current or deferred tax should be recognised directly in equity.

The entity's tax rate is 40 per cent. The options were granted at the start of year 1, vested at the end of year 3 and were exercised at the end of year 5. Details of the expense recognised for employee services received and consumed in each accounting period, the number of options outstanding at each year-end, and the intrinsic value of the options at each year-end, are as follows:

	Employee services expense	Number of options at year-end	Intrinsic value per option
Year 1	188,000	50,000	5
Year 2	185,000	45,000	8
Year 3	190,000	40,000	13
Year 4	0	40,000	17
Year 5	0	40,000	20

The entity recognises a deferred tax asset and deferred tax income in years 1–4 and current tax income in year 5 as follows. In years 4 and 5, some of the deferred and current tax income is recognised directly in equity, because the estimated (and actual) tax deduction exceeds the cumulative remuneration expense.

Year 1

Deferred tax asset and deferred tax income:

$(50,000 \times 5 \times \frac{1}{3}^1 \times 0.40) =$	<u>33,333</u>
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The deferred tax income is all recognised in profit or loss, because the estimated future tax deduction of 83,333 ($50,000 \times 5 \times \frac{1}{3}$) is less than the cumulative remuneration expense of 188,000.

Year 2

Deferred tax asset at year-end:

$(45,000 \times 8 \times \frac{2}{3} \times 0.40) =$	96,000
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Less deferred tax asset at start of year	<u>(33,333)</u>
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Deferred tax income for year	<u>62,667*</u>
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* This amount consists of the following:

Deferred tax income for the temporary difference between the tax base of the employee services received during the year and their carrying amount of nil:

$(45,000 \times 8 \times \frac{1}{3} \times 0.40)$	48,000
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Tax income resulting from an adjustment to the tax base of employee services received in previous years:

(a) increase in intrinsic value: $(45,000 \times 3 \times \frac{1}{3} \times 0.40)$	18,000
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(b) decrease in number of options: $(5,000 \times 5 \times \frac{1}{3} \times 0.40)$	<u>(3,333)</u>
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Deferred tax income for year	<u>62,667</u>
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The deferred tax income is all recognised in profit or loss, because the estimated future tax deduction of 240,000 ($45,000 \times 8 \times \frac{2}{3}$) is less than the cumulative remuneration expense of 373,000 (188,000 + 185,000).

Year 3

Deferred tax asset at year-end:

$(40,000 \times 13 \times 0.40) =$	208,000
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Less deferred tax asset at start of year	<u>(96,000)</u>
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Deferred tax income for year	<u>112,000</u>
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The deferred tax income is all recognised in profit or loss, because the estimated future tax deduction of 520,000 ($40,000 \times 13$) is less than the cumulative remuneration expense of 563,000 (188,000 + 185,000 + 190,000).

¹ 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.

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Year 4

Deferred tax asset at year-end:

(40,000 × 17 × 0.40) =	272,000	
Less deferred tax asset at start of year	<u>(208,000)</u>	
Deferred tax income for year		<u>64,000</u>

The deferred tax income is recognised partly in profit or loss and partly directly in equity as follows:

Estimated future tax deduction (40,000 × 17) =	680,000	
Cumulative remuneration expense	<u>563,000</u>	
Excess tax deduction		<u>117,000</u>
Deferred tax income for year	64,000	
Excess recognised directly in equity (117,000 × 0.40) =	<u>46,800</u>	
Recognised in profit or loss		<u>17,200</u>

Year 5

Deferred tax expense (reversal of deferred tax asset)	272,000	
Amount recognised directly in equity (reversal of cumulative deferred tax income recognised directly in equity)	<u>46,800</u>	
Amount recognised in profit or loss		<u>225,200</u>
Current tax income based on intrinsic value of options at exercise date (40,000 × 20 × 0.40) =	320,000	
Amount recognised in profit or loss (563,000 × 0.40) =	<u>225,200</u>	
Amount recognised directly in equity		<u>94,800</u>

Summary

	Statement of comprehensive income				Statement of financial position	
	Employee services expense	Current tax expense (income)	Deferred tax expense (income)	Total tax expense (income)	Equity	Deferred tax asset
Year 1	188,000	0	(33,333)	(33,333)	0	33,333
Year 2	185,000	0	(62,667)	(62,667)	0	96,000
Year 3	190,000	0	(112,000)	(112,000)	0	208,000
Year 4	0	0	(17,200)	(17,200)	(46,800)	272,000
Year 5	0	(225,200)	225,200	0	46,800	0
					(94,800)	
Totals	563,000	(225,200)	0	(225,200)	(94,800)	0

Example 6 – Replacement awards in a business combination

On 1 January 20X1 Entity A acquired 100 per cent of Entity B. Entity A pays cash consideration of CU400 to the former owners of Entity B.

At the acquisition date Entity B had outstanding employee share options with a market-based measure of CU100. The share options were fully vested. As part of the business combination Entity B's outstanding share options are replaced by share options of Entity A (replacement awards) with a market-based measure of CU100 and an intrinsic value of CU80. The replacement awards are fully vested. In accordance with paragraphs B56–B62 of SB-FRS 103 *Business Combinations* (as revised in 2008), the replacement awards are part of the consideration transferred for Entity B. A tax deduction for the replacement awards will not arise until the options are exercised. The tax deduction will be based on the share options' intrinsic value at that date. Entity A's tax rate is 40 per cent. Entity A recognises a deferred tax asset of CU32 (CU80 intrinsic value × 40%) on the replacement awards at the acquisition date.

Entity A measures the identifiable net assets obtained in the business combination (excluding deferred tax assets and liabilities) at CU450. The tax base of the identifiable net assets obtained is CU300. Entity A recognises a deferred tax liability of CU60 ((CU450 – CU300) × 40%) on the identifiable net assets at the acquisition date.

Goodwill is calculated as follows:

	CU
Cash consideration	400
Market-based measure of replacement awards	100
Total consideration transferred	500
Identifiable net assets, excluding deferred tax assets and liabilities	(450)
Deferred tax asset	32
Deferred tax liability	60
Goodwill	78

Reductions in the carrying amount of goodwill are not deductible for tax purposes. In accordance with paragraph 15(a) of the Standard, Entity A recognises no deferred tax liability for the taxable temporary difference associated with the goodwill recognised in the business combination.

The accounting entry for the business combination is as follows:

	CU	CU
Dr Goodwill	78	
Dr Identifiable net assets	450	
Dr Deferred tax asset	32	
Cr Cash		400
Cr Equity (replacement awards)		100
Cr Deferred tax liability		60

On 31 December 20X1 the intrinsic value of the replacement awards is CU120. Entity A recognises a deferred tax asset of CU48 (CU120 × 40%). Entity A recognises deferred tax income of CU16 (CU48 – CU32) from the increase in the intrinsic value of the replacement awards. The accounting entry is as follows:

		CU	CU
Dr	Deferred tax asset	16	
	Cr Deferred tax income		16

If the replacement awards had not been tax-deductible under current tax law, Entity A would not have recognised a deferred tax asset on the acquisition date. Entity A would have accounted for any subsequent events that result in a tax deduction related to the replacement award in the deferred tax income or expense of the period in which the subsequent event occurred.

Paragraphs B56–B62 of SB-FRS 103 provide guidance on determining which portion of a replacement award is part of the consideration transferred in a business combination and which portion is attributable to future service and thus a post-combination remuneration expense. Deferred tax assets and liabilities on replacement awards that are post-combination expenses are accounted for in accordance with the general principles as illustrated in Example 5.