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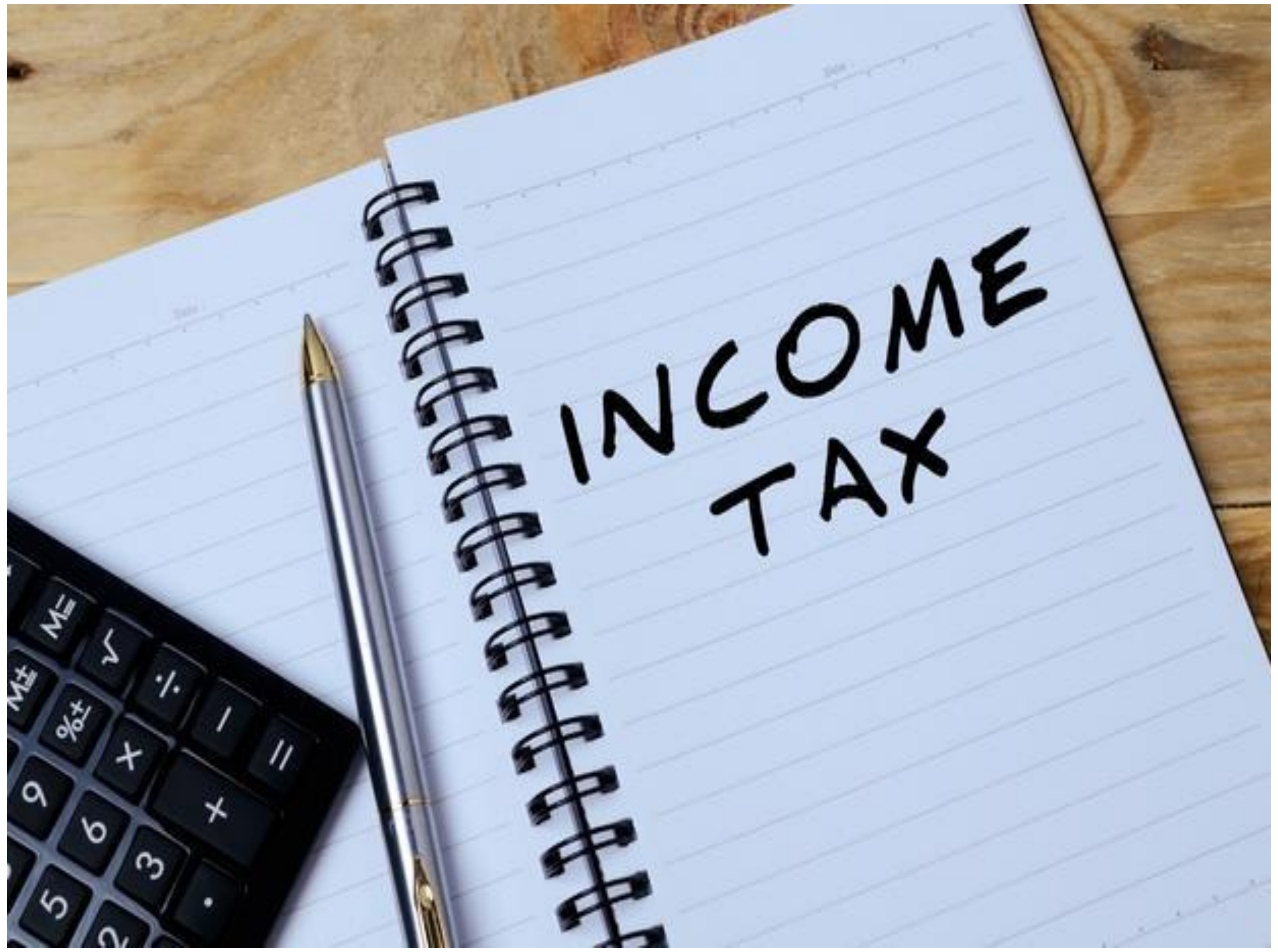
IFRS for SMEs
Section 29 *Income Tax*

Presenter:
Anton van Wyk M. Com CA (SA)



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Presenter

Anton van Wyk M. Com CA (SA)

Anton van Wyk is a **chartered accountant** and independent consultant in International Financial Reporting Standards (IFRS and IFRS for SMEs). As former subject head of Financial Accounting at various higher education providers (including the University of Johannesburg and Monash University South Africa), he has gained valuable insights into and understanding of the important principles underlying the International Financial Reporting Standards (IFRS). Anton is a well-known and popular presenter who has presented numerous IFRS updates for several accounting bodies across South Africa. He is known for his ability to simplify and highlight the most important principles contained in IFRS, whilst keeping the learning process enjoyable for attendees.

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Welcome to the Webinar

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Welcome to this webinar dealing with **Section 29 *Income Tax*** in the **IFRS for SMEs**

Agenda – points to cover in the webinar

1. Introduction to Section 29 *Income Tax*
2. The tax base of an asset and the tax base of a liability
3. Application of the tax bases
4. Exceptions to the calculation of a tax base for an asset/liability
5. Presentation and disclosure of taxes

IFRS for SMEs
Section 29 *Income Tax*
Introduction to Section 29 *Income Tax*

The starting point

	2020	2019
Non-current assets	**R**	**R**
Property, plant and equipment	250m	220m
Non-current liabilities		
Financial liabilities	100m	80m

What does this really mean?

The Basic Approach

- Section 29 requires an entity to calculate the CURRENT and FUTURE tax consequences of transactions and other events that **have been recognised** in the financial statements

Current tax	Deferred (future) tax
SA Revenue Service	Accounting entry only
Dr Income tax (P/L)	Dr Income tax (P/L or OCI)
Cr Tax payable (SARS) (SoFP)	Cr Deferred tax (SoFP)

Current Tax (1)

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- Calculated according to the Income Tax Act and any other legislation applicable to the entity *(e.g. capital gains tax, Value-Added Tax, foreign income tax, withholding tax, dividend tax, etc.)*
- An entity shall measure a current tax liability (asset) at the amount it expects to pay (recover) using the tax rates and laws that have been enacted (or substantively enacted) by the reporting date – *current tax assets/liabilities are not discounted*
    - *An entity shall regard tax rates and tax laws as "substantively enacted" when the remaining steps in the enactment process have not affected the outcome in the past and are unlikely to do so*

Current Tax (2)

- The entity can recognise a *current tax asset* in respect of the benefit of a tax loss that can be carried back to recover tax paid in a previous period
  - Current tax overpayment i.r.o. prior year(s) caused by assessment of tax return differing from the actual tax calculation/return
  - Dr Current tax asset/SARS (SoFP)
  - Cr Income tax (P/L)
- Becomes a reconciling item in the tax rate reconciliation

Deferred Tax (1)

- **Why recognise deferred (future) tax?**
  - Assets are recovered in future, and may impact future taxable profit
  - Liabilities are settled in future, and may impact future taxable profit
  - If it is probable that future tax payments will increase/decrease due to such recovery or settlement, a *deferred tax liability* or *deferred tax asset* should be recognised. If not, no deferred tax is recognised
- How do we calculate deferred (future) tax?
  - On differences between the CAs of assets and liabilities, and their tax bases, and the carry-forward of currently unused tax losses and tax credits

Deferred Tax (2)

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HENCE:

DT arises from

Differences between CA and TB of A&L

If the differences are **temporary** in nature

Currently unused tax losses/tax credits

If future tax **benefit** is expected

Deferred Tax (3)

Old income tax calculation (approach)

Income Statement Focus

Profit before tax	R1 000 000
<u>Permanent differences</u>	
• Dividends received (SA company)	(R200 000)
<u>Temporary differences</u>	(R100 000)
• Plus: Depreciation	R500 000
• Less: Wear-and-tear	(R600 000)
Taxable income	R700 000
Current tax (R700k x 28%)	R196 000 (19,6%)
Deferred tax (R100k x 28%)	R28 000 (2,8%)

Deferred Tax (4)

2020 y/e

A&L (CA v TB)

DT (SoFP)

2019 y/e

A&L (CA v TB)

DT (SoFP)

Movement:

@ OCI/Equity

@ Profit/Loss

The focus is absolutely on Assets and Liabilities

Income tax calculation

Profit before tax

Permanent differences

Movement in TD's

Taxable income

IFRS for SMEs
Section 29 *Income Tax*
The Tax Bases of Assets and Liabilities

Tax Bases (1)

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

Important question: How are assets recovered?

USE

why important?

SALE

Examples: TB of Asset

	CA	TB	TD	DT
Plant	R100m	?	?	?
(unclaimed W&T = R80m, used, no residual value)				
Inventory	R20m	?	?	?
(at cost, no obscolesense)				
Trade Receivables	R1m	?	?	?
(no credit loss allowance)				

Tax bases (2)

The tax base of a **liability** is its carrying amount less any amount that will be deductible for tax purposes in respect of that liability in future periods.

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

Examples: TB of Liability

	CA	TB	TD	DT
LTL	R100m	?	?	?
(measured at amortised cost)				
Provision for audit fee	R20m	?	?	?
(deductible for tax when paid)				
(deductible for tax when accrued)				
Deferred income	R1m	?	?	?
(received in cash, in advance)				
Dividend Payable	R500k	?	?	?
(not deductible for income tax purposes)				

Quick recap…

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ASSETS

CA > TB = DTL

CA < TB = DTA

LIABILITIES

CA > TB = DTA

CA < TB = DTL

WHY?

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Section 29 *Income Tax*

The Exceptions to the Calculation of Tax Bases of Assets and Liabilities

Why do exceptions arise?

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The **correct application** of the definitions of tax bases of assets and liabilities, **leads to an answer that does not make sense**…
Exceptions exempt invalid temporary differences from DT

It is therefore very important to THINK about the outcome of your calculation of deferred tax and whether it makes sense, i.e.:

- Is there a difference in treatment for Accounting and Taxation of that asset and liability? (usually evidenced in accrual versus cash basis for tax authority)
- Is the identified difference temporary or permanent in nature?

Exception 1

If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount (Section 29.9)

Example:	CA		TB	TD	DTL
Dividend receivable (local company, not taxable)	R1m	=	R1m	R0	R0
Trade receivable (taxed upon accrual)	R1m	=	R1m	R0	R0

Exception 2

If, at the initial recognition of an asset or liability, there is a difference between its carrying amount and tax base, such a difference could be exempt, if:

- The transaction is not a business combination;
- The initial recognition of the A/L does not affect profit or loss; and
- The initial recognition of the A/L does not affect taxable income

Exception 2: Examples

Initial recognition of:	CA	TB	TD	DT	Exempt?
Land	R5m	R0	?	?	Yes
Research (capital)	R0m	R3m	?	?	No
Development (revenue)	R3m	R0m	?	?	No
R-o-U Asset	R1m	R0 m	?	?	Yes
Lease liability	R1,15m	R0,15m	?	?	Yes

Exception 3 – guidance (1)

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The reversal of deductible temporary differences results in deductions when taxable profits of future periods are determined.

It is probable that taxable profit will be available against which a deductible temporary difference can be utilised when there are sufficient taxable temporary differences relating to the <u>same taxation authority</u> and the <u>same taxable entity</u>, that are expected to <u>reverse</u>:

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

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

Recognise DTA in the period when deductible TDs arise

Exception 3 – guidance (2)

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

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

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

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

Exception 3 – example

Limitation on the recognition of deductible temporary differences, due to limited future economic benefit expectation

Example:	Year 1	Year 2
Profit before tax	R100 000	R100 000
Temporary differences **(deductible)**	R20 000	R20 000
Taxable profit	R120 000	R120 000
Current tax	R33 600	R33 600
Deferred tax (Yr1) (**80%** x R20k x 28%)	(R4 480)	
Deferred tax (Yr2) (100% x R20k x 28%)		(R5 600)
Deferred tax (Yr2) (**20%** x R20k x 28%)		(R1 120)
Total tax	R29 120	R26 880
Effective tax percentage	29,12%	26,88%

Exception 4 – guidance (1)

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A **deferred tax asset** shall be recognised for the carry-forward of unused tax losses and unused tax credits to the extent that it is **probable** that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.

When assessing such probability, an entity considers the following criteria:

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

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

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

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

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

Exception 4 – guidance (2)

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The existence of **unused tax losses** is strong evidence that future taxable profit may not be available…

Consequently, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences **or** to the extent that there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity.

Exception 4

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Current unused tax losses and unused tax credits that can be used in future

	Year 1	Year 2
Profit before tax	R100 000	R120 000
Temporary differences – taxable	(R110 000)	(R115 000)
(Assessed loss)	(R10 000)	R5 000
Assessed loss brought forward	N/A	(R10 000)
(Assessed loss)		(R5 000)
Current tax (assessed loss)	-	-
Deferred tax △ (R110 000 – R10 000) x 28%	R28 000	
Deferred tax △ (R115 000 + R10 000 – R5 000) x 28%		R33 600

The question is:
To what extent is the DTA raised?

Hence there could be a combination between Exceptions 3 and 4!!

Exception 4 – journal entries

Year 1:

	Dr	Cr
Dr Income tax expense (P/L) (R110 000 x 28%)	R30 800	
Cr Deferred tax (SoFP)		R30 800
Dr Deferred tax (SoFP) (R10 000 x 28%)	R2 800	
Cr Income tax expense (P/L)		R2 800

Year 2:

	Dr	Cr
Dr Income tax expense (P/L) (R115 000 x 28%)	R32 200	
Cr Deferred tax (SoFP)		R32 200
Dr Income tax expense (P/L) ((R10 000 – R5 000) x 28%)	R1 400	
Cr Deferred tax (SoFP)		R1 400

Exception 5

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No deferred tax shall be recognised if it relates to the initial recognition of goodwill (Section 29.14)

	CA	TB	TD	DTL
Goodwill	R100m	R0	R100m	R28m
Goodwill	R100m	R100m	R0	R0

PROBLEM

Exception 6 (1)

Temporary differences may arise due to the consolidation process. Investments in subsidiaries, associates and joint ventures, may be included in the parent's own financial statements at a different amount than in the parent's consolidated financial statements

Examples:

- The investment in the subsidiary is measured at **cost** in the parent's own financial statements, but consolidated at **NAV**
- The investment in a foreign subsidiary is measured at **cost** in the parent's own financial statements, but translated to latest **spot rate** for consolidation (i.e. an FCTR arises upon consolidation)
- The investment in an associate may be measured at **cost** in the parent's own financial statements, but **equity accounted** in the consolidated financial statements

Exception 6 (2)

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Should deferred tax be recognised on the difference between the CA of the investment, and its tax base?

- *Remember: the tax base of the investment will usually be its base cost for CGT purposes, as the investment is recovered through sale*

Such temporary differences are EXEMPT from deferred tax IF:

- The parent **controls the timing of the reversal** of the temporary difference (e.g. sale of investment, declaration of dividends etc.) and
- The parent **has no intention** to reverse the temporary difference in the foreseeable future

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Section 29 *Income Tax*
Presentation and Disclosure
of Income Tax

Presentation of Income Tax

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Allocation in comprehensive income and equity

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

Current/non-current distinction

When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position, it shall not classify any deferred tax assets (liabilities) as current assets (liabilities).

Offsetting

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

Disclosure of Income Tax (1)

An entity shall disclose separately the major components of tax expense (income). Such components of tax expense (income) may include:

(a) current tax expense (income);

(b) any adjustments recognised in the period for current tax of prior periods;

(c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;

(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;

(e) the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce tax expense;

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

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

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

Disclosure of Income Tax (2)

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An entity shall disclose the following separately:

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

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

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

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

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

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

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

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

(g) For variable tax rates dependent on how much profit is declared as a dividend, an explanation of the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders.

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

Tax rate reconciliation

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PBT x 28% (expectation)	XXX
<u>Adjustments:</u>	
• Permanent differences (e.g. exempt income, non-deductible expenses)	(X)/X
• Different foreign income tax rates	(X)/X
• Deferred tax not (fully) recognised on temporary differences	(X)
• Deferred tax recognised on TD's i.r.o. prior periods	X
• Overpayment or underpayment of prior period current taxes	(X)/X
• Impairment/reversal of impairment of DTAs	(X)/X
• Etc.	
Actual income tax expense per profit or loss	XXX

Q&A

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Thank you for your participation

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