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Educational material

Application of IAS 12 – *Income Taxes* – Substantively Enacted Tax Rates (Also applicable to IFRS for SMEs)

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1. Introduction

This educational material issued by SAICA's Accounting Practices Committee (APC) is prepared for educational purposes, summarising the requirements of IAS 12 Income Taxes (IAS 12) and Financial Reporting Pronouncement 1 (FRP 1) with regards to when changes in tax rates announced by the Minister of Finance in his/her delivery of the national budget speech are regarded as being substantively enacted. It highlights that the announcement by the Minister on 23 February 2022 is substantively enacted and explains the requirements for the change in the tax rate from 28% to 27%.

Entities are reminded to consider the impact of the above when preparing both interim and annual financial statements.

Relevant references to FRP 1 are included below. The full FRP can be accessed here:
https://saicawebprstorage.blob.core.windows.net/uploads/resources/FRP_1.pdf

This guidance does not change, remove nor add to, the requirements in IFRS Standards or FRP 1. It is intended to support the sound, consistent and robust application of the requirements in IFRS Standards and FRP 1. While the APC is a technical accounting body, the APC consultation included tax experts to help ensure completeness of the document and the relevant facts and circumstances.

This education material is also applicable to IFRS for SMEs.

2. Background of the educational material

On 23 February 2022 at the Good Hope Chamber, the Minister of Finance stated as follows:

'*Restructuring the corporate income tax system is an important part of our efforts to create a conducive environment for businesses to grow, increase investment and employ more people. As announced in the 2021 Budget, the corporate income tax rate will be reduced from 28 per cent to 27 per cent, for companies with years of assessment ending on or after 31 March 2023. This will be complemented by base-broadening measures to ensure that there is no negative impact on revenue*.'

The Minister of Finance may announce changes in tax rates and tax laws during the annual Budget Statement. Such tax rate changes may be in force immediately (subject to ratification by Parliament within 12 months) or will only come into force once enacted. Even once enacted, the tax rate may not come into force immediately as its effective date may be a future date that is more than 12 months after announcement or enactment or alternatively the in force effective date may be subject to a public notice after enactment.

3. Guidance from IAS 12 and FRP 1

In terms of paragraphs 46 and 47 of IAS 12, both current and deferred tax assets and liabilities are to be measured using the tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period.

In order to provide context to the requirements of IAS 12, FRP 1 was issued to address, in a South African environment, when changes in tax rates and tax laws that are announced by the Minister of Finance during the annual Budget Statement should be regarded as substantively enacted.

In terms of paragraph 6 of FRP 1, changes in tax rates should be regarded as substantively enacted from the time that they are announced in terms of the Minister of Finance's Budget Statement. However, this only applies where the change in tax rates is not inextricably linked to other changes in the tax laws. To be regarded as substantively enacted, there should be the required degree of certainty that the announced changes would be promulgated in a substantially unchanged manner.

4. Is the tax rate change considered to be substantively enacted?

The Minister of Finance announced the change in the corporate tax rate from 28% to 27% in the Budget speech on 23 February 2022. To be regarded as substantively enacted, there should be the required degree of certainty that the announced changes would be promulgated in a substantially unchanged manner.

In terms of paragraph 6 of FRP 1, changes in tax rates should be regarded as substantively enacted from the time that they are announced in terms of the Minister of Finance's Budget Statement. This criterion has been met. To be regarded as substantively enacted, the principle in paragraph 6 of FRP 1 is there should be the required degree of certainty that the announced changes would be promulgated in a substantially unchanged manner. In this case, there are no substantial changes expected.

The budget speech refers to the effective date of the rate change as for years of assessment ending on or after 31 March 2023. The general process for tax rate changes is that the rate change is announced in the Budget Review documents, incorporated in a draft Bill issued at the same time as the Budget and that later in that same year is approved by Parliament. This announcement of the reduced corporate income tax rate has been considered by Parliament during this year and is incorporated in the 2022 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill.

The rate change announcement made by the Minister of Finance during the 2021 budget speech provided a significant degree of uncertainty due to the reasons as set out in the educational material issued in March 2021. One of the reasons as set out in the previous educational material was that the announcement by the Minister of Finance referred to other changes to tax law, which were not known at the date of the announcement. Thus providing significant uncertainty surrounding whether these changes, tax rate and other tax rules, were inextricably linked affecting the determination of substantive enactment.

These tax rules were enacted into law during January 2022, however would only come into operation and be applicable for years of commencement on or after the date on when the reduction of the tax rate was announced by the Minister of Finance, which is the date of the budget speech announcement of 23 February 2022. Therefore any uncertainty that existed from the previous years budget speech announcement related to the reduction in the corporate tax rate and other changes to tax law was clarified during the 2022 budget speech announcement which is now expected to be promulgated in an unchanged manner.

5. How to apply the tax rate change?

Paragraph 9 of FRP 1 states that the changes in tax rates and tax laws should be applied to the period to which they relate. For example, a change in tax rates could be announced during a tax year as being applicable to the following year, in which case the current tax balances in the balance sheet would be based on the previous tax rate, whereas the deferred tax balance in the balance sheet would be based on the new tax rate.

IAS 12, Paragraph 46 states that current tax liabilities (assets) for the current and prior periods shall be measured at the amounts expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted, by the end of the reporting period.

This means that, in the South African context, companies will still measure their current taxation at 28% for years ending before 31 March 2023. For years ending on or after 31 March 2023, companies will measure their current taxation at 27%.

Paragraph 47 of IAS 12 states that deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

In addition, Paragraph 48 states that current and deferred tax assets and liabilities are usually measured using the tax rates (and tax laws) that have been enacted. However, in some jurisdictions, announcements of tax rates (and tax laws) by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. In these circumstances, tax assets and liabilities are measured using the announced tax rate (and tax laws).

In the South African context, this means that companies with annual reporting periods ending on or after 31 March 2022 will apply a rate of 27% to measure their deferred taxation assuming their subsequent annual reporting period end will be 31 March 2023 and later. If their subsequent annual reporting period end is earlier than 31 March 2023, a mixed rate of 28% or 27% applies depending on when the deferred tax asset is expected to realise, or the liability expected to be settled in accordance with paragraph 47 (above).

For companies with annual reporting periods ending before 31 March 2022 but after 23 February 2022, a mixed rate of 28% or 27% will apply depending on when the deferred tax asset is expected to realise, or the liability expected to be settled in accordance with paragraph 47 (above).

For companies with annual reporting periods ending before 23 February 2022, the announcement by the Minister is a non-adjusting event after the reporting period. For example, a company with a 31 December 2021 reporting period end will measure both current and deferred tax at 28%. Such companies should refer to the disclosure guidance in paragraph 21 of IAS 10 if the effect of the rate change would be material.

Summary:

Year ending on	Rate of Current Tax	Rate of Deferred Tax	Notes
22 February 2022 and before	28%	28%	The rate change in a non-adjusting event after the reporting period.
23 February 2022 to 30 March 2022	28%	Mixed	Depending on when the temporary differences are expected to unwind.
31 March 2022 to 30 March 2023	28%	27%	Assuming their subsequent annual reporting period end is 31 March 2023 or later
31 March 2023 and onwards	27%	27%	

6. Conclusion

The discussion above highlights that the tax rate change is considered to be substantively enacted as of 23 February 2022. Accordingly, companies would need to carefully assess whether a 27% or 28% rate applies to the measurement of their current and deferred taxation.