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**8. Income tax**

|  |  |
| --- | --- |
| **OVERVIEW** | * The total income tax expense recognized in the income statement is the sum of current tax expense (or recovery) plus the change in deferred tax liabilities and assets during the period.
* Current tax represents the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.
* The measurement of current tax is based on rates that are enacted or substantively enacted at the balance sheet date.
* Deferred tax liabilities and assets should be recognized for the estimated future tax effects of temporary differences and tax loss carry‑forwards
* A temporary difference is the difference between the tax base of an asset and liability and its carrying amount in the financial statements.
* Deferred tax should not be discounted.
* Deferred tax is based on enacted or substantively enacted tax rates.
* Deferred tax assets and liabilities should be classified as non‑current in the balance sheet.
* Income tax relating to items charged or credited directly to equity is itself charged or credited directly to equity.
 |

8.1 Purpose and scope (IAS 12.1-4)

This policy provides guidance and rules on accounting for **Current and Deferred Income Taxes** for the purpose of preparing the financial statements of the Group according to International Financial Reporting Standard IAS 12.

Income taxes are any foreign and domestic taxes based on taxable profits, including withholding taxes payable by a subsidiary, joint venture or associate on distributions to the reporting entity. (IAS 12.2)

This policy does not provide guidance on taxes that are not based on taxable profits such as social taxes payable by an employer based on a percentage of an employee’s wages, value added tax (VAT), and taxes payable on capital and reserves. It also does not provide guidance on compliance with local GAAP or statutory tax requirements.

* 1. Definitions (IAS 12.5-11)

The following terms are used in this policy and throughout IAS 12 Income taxes.

**Accounting profit:** is the amount of profit or loss before deducting tax expense.

**Taxable profit (tax loss)**: is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

**Tax expense (tax income)**: is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

**Current tax liability:**  is the amount of income taxes payable in respect of the taxable profit for a period.

**Current tax asset:**  is the amount of income taxes recoverable in respect of the taxable loss for a period.

**Deferred tax liabilities**: the amount of income taxes payable in future periods in respect of taxable temporary differences.

**Deferred tax assets**: the amount of income taxes recoverable in future periods in respect of deductible temporary differences; carry forward of unused tax losses; and the carry forward of unused tax credits.

**Tax base**: the amount attributed to an asset or a liability for tax purposes.

**Taxable temporary difference**: temporary differences that result in taxable amounts in determining taxable profit / loss of future periods when the carrying amount of the asset or liability is recovered or settled

**Deductible temporary difference**: temporary differences that result in amounts that are deductible from taxable profit / loss of future periods when the carrying amount of the asset or liability is recovered or settled

* 1. Tax Base (IAS 12.7-11, SIC 21)

8.3.1 Tax base of an asset

The tax base of an asset is the amount that will be deductible for tax purposes against the taxable benefits to be received by a company when it recovers the carrying amount of the asset. (IAS 12.7) Those taxable benefits could take the form of proceeds on disposal of the asset, or income earned through the use of the asset. Where the economic benefits that flow from an asset are not taxable, the tax base of the asset is equal to its carrying amount.

The tax base of an asset should be determined using the following formula:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Tax base** | **=** | **Carrying amount** | **‑** | **Future taxable amounts** | **+** | **Future deductible amounts** |

As an illustration of the determination of the tax base of an asset, please consider the following:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Tax base** | **=** | **Carrying amount** | **‑** | **Future taxable amounts** | **+** | **Future deductible amounts** |
|  |  |  |  |  |  |  |  |
| Interest receivable of 100 that will be taxed when it is received  | Nil | **=** | 100 | **‑** | 100 | **+** | Nil |
|  |  |  |  |  |  |  |  |
| Loan receivable of 200  | 200 | **=** | 200 | **‑** | Nil | **+** | Nil |
|  |  |  |  |  |  |  |  |
| Trade receivable of 500 with general bad debts allowance of 50 not deductible for tax purposes  | 500 | **=** | 450 | **‑** | Nil | **+** | 50 |
|  |  |  |  |  |  |  |  |
| Development expenditure of 250 deductible for tax purposes when paid, amortized over 5 years for accounting purposes  | 500 | **=** | 250 | **‑** | Nil | **+** | 250 |

8.3.2 Tax base of a liability

The tax base of a liability is the carrying amount less any amount that is going to be deducted in respect of the liability in future periods. (IAS 12.8)

The tax base of a liability should be determined using the following formula:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Tax base** | **=** | **Carrying amount** | **‑** | **Future deductible amounts**  | **+** | **Future taxable amounts** |

As an illustration of the determination of the tax base of a liability, please consider the following:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Tax base** | **=** | **Carrying amount** | **‑** | **Future deductible amounts** | **+** | **Future taxable amounts** |
|  |  |  |  |  |  |  |  |
| Loan payable of 300 | 300 | **=** | 300 | **‑** | Nil | **+** | Nil |
|  |  |  |  |  |  |  |  |
| Foreign currency loan payable of 450, originally recognized at 500. Exchange gains are taxable when realized. | 500 | **=** | 450 | **‑** | Nil | **+** | 50 |
|  |  |  |  |  |  |  |  |
| Provision for pension of 200 (tax deductible when paid) | Nil | **=** | 200 | **‑** | 200 | **+** | Nil |

8.3.3 Tax base of a non-depreciable asset

The deferred tax liability or asset that arises from the revaluation of a non-depreciable asset in accordance with IAS 16.31 shall be measured on the basis of the tax consequences that would follow from recovery of the carrying amount of that asset through sale. Accordingly, if the tax law specifies a tax rate applicable to the taxable amount derived from the sale of an asset that differs from the tax rate applicable to the taxable amount derived from using an asset, the former rate is applied in measuring the deferred tax liability or asset related to a non-depreciable asset. (SIC 21.5)

8.4 Current Income Taxes

8.4.1 Recognition (IAS 12.15-45, IAS 12.57-68C)

Current tax for current and prior periods to the extent unpaid must be recognized as a liability. (IAS 12.12) The amount paid in respect of current and prior period taxes which exceeds the amount due must be recognized as an asset. (IAS 12.13) Tax loss that can be carried back or recovered current tax of a previous period must also be recognized as an asset. (IAS 12.14)

8.4.2 Measurement (IAS 12.46-56)

Current tax liabilities and assets are the amounts expected to be paid or recovered from the tax authorities using enacted or substantively enacted tax rates that are in effect by the end of the reporting period. (IAS 12.46) Tax rates also consider the manner in which the entity is going to settle or recover the carrying value of the asset or liability. (IAS 12.52)

Income tax rates in certain tax jurisdictions can also be affected if part of the income or retained earnings is paid out as dividends to shareholders. In such circumstances the Income tax of dividends is recognized when the liability to pay the dividend is recognized. (IAS 12.52a-b)

8.4.3 Presentation (IAS 12.71-78)

Tax assets and tax liabilities should be presented separately from other assets and liabilities in the balance sheet. In addition, current tax assets and current tax liabilities should be distinguished from deferred tax assets and deferred tax liabilities on the balance sheet.

Current tax assets and current tax liabilities should be classified as current assets and current liabilities to the extent that they are payable/receivable within 12 months. If the current tax assets or liabilities are payable/receivable after 12 months from the balance sheet date, these amounts should be classified as non‑current. (IAS 1.69)

Current tax assets and current tax liabilities should be offset only when:

* the Group has a legally enforceable right to set off current tax assets against current tax liabilities. This will normally be the case when the tax payable/receivable relates to income taxes levied by the same taxation authority and the taxation authority permits the company to make or receive a single net payment; (IAS 12.71a)

the Group intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously. (IAS 12.71b)

Thus, within the Group, current tax assets and current tax liabilities from different entities should be offset only if the entities concerned have a legally enforceable right to make or receive a single net payment and the entities intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously. (IAS 12.73)

8.5 Deferred Income Tax

8.5.1 Recognition (IAS 12.15-45, IAS 12.57-68C)

Under IFRS a deferred tax is based on the balance sheet liability method. Under this method temporary differences between the carrying amount of an asset or a liability (as reported in the balance sheet) and its tax base multiplied by the tax rate gives you the deferred tax liability or asset.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Deferred tax asset or liability** | **=** | **Temporary difference** | **X** | **Tax rate** |

The principal steps in arriving at deferred tax assets and liabilities under IFRS can be summarized as follows:

|  |
| --- |
| Calculation Steps:Step 1 Calculate the tax base of each asset and liability in the balance sheet.Step 2 Calculate the temporary difference (if any) for each asset and liability in the balance sheet.Step 3 Identify those temporary differences that will give rise to deferred tax assets or liabilities using the recognition criteria.Step 4 Calculate the deferred tax attributable to those temporary differences by multiplying each temporary difference by the tax rate that is expected to apply when the temporary difference reverses.Step 5 Recognize in the income statement, equity, or as an adjustment to goodwill, the movement between the deferred tax balances in the opening and closing balance sheets.  |

There are two types of temporary differences: taxable temporary differences and deductible temporary differences.

* A taxable temporary difference will result in an increase in income tax payable in future reporting periods, and gives rise to a deferred tax liability. Taxable temporary differences arise when the carrying amount of an asset is greater than its tax base, or the carrying amount of a liability is less than its tax base.
* A deductible temporary difference will result in a decrease in income tax payable in future reporting periods, and gives rise to a deferred tax asset. Deductible temporary differences arise when the carrying amount of an asset is less than its tax base, or the carrying amount of a liability is greater than its tax base.

8.5.1.1 Deferred Tax Liability

A deferred tax liability is recognized when the carrying amount of an asset exceeds its tax base. The amount of taxable economic benefit exceeds the amount that is allowed as a deduction for tax purposes. This difference is known as a taxable temporary difference and results in income taxes being paid in future periods. As the entity recovers the carrying amount, the taxable temporary difference reverses and the entity shows taxable profit. (IAS 12.16)

A deferred tax liability should be recognized for all taxable temporary differences, unless they arise from: (IAS 12.15a-b, IAS 12.24a-b)

* The initial recognition of goodwill (unless goodwill is tax deductible); or
* The initial recognition of an asset or liability in a transaction that:
* is not a business combination; and

the timing of the transaction, affects neither accounting profit nor taxable profit.

However, for taxable temporary differences associated with investments or interests in subsidiaries, branches and joint ventures a deferred tax liability shall be recognized except to the extent that the following conditions exist: (IAS 12.15, IAS 12.39)

* the parent or investor is able to control the timing of reversing the temporary difference
* it is probable the temporary difference will not reverse in the foreseeable future

8.5.1.2 Deferred Tax Asset

A deferred tax asset is recognized when the carrying amount of asset is less than its tax base. Accordingly this deferred tax asset arises in respect of the income taxes that will be recovered in future periods when that part of the liability is allowed as a deduction in determining taxable profit. This difference is recognized as a deductible temporary difference that results in income taxes being recovered in future periods. (IAS 12.25)

A deferred tax asset should be recognized for all deductible temporary differences to the probable extent that taxable profit will be available against which deductible temporary differences can be utilized, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that: (IAS 12.24a-b, IAS 12.24a-b)

* is not a business combination; and

at the time of the transaction, affects neither accounting profit nor taxable profit.

However, for deductible temporary differences associated with investments or interests in subsidiaries, branches and joint ventures a deferred tax asset shall be recognized to the extent that it is probable that the following conditions exist: (IAS 12.24, IAS 12.44)

* it is probable the temporary difference will reverse in the foreseeable future
* Taxable profit will be available against which temporary differences can be utilized

The carrying amount of deferred tax assets should be reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or the entire deferred tax asset to be utilized. Any such reduction should be subsequently reversed to the extent that it becomes probable that sufficient taxable profit will be available. (IAS 12.37)

A deferred tax asset should be recognized for an unused tax loss carry forward or unused tax credit if, and only if, it is considered probable that there will be sufficient future taxable profit against which the loss or credit carry forwards can be utilized. (IAS 12.34)

8.5.1.3 Deferred Initial Recognition

The following chart illustrates the assessment that is required when recognizing an asset or liability to determine if there is a deferred tax impact:



8.5.2 Measurement (IAS 12.46-56)

Deferred tax assets and liabilities are measured at the rate of tax expected to apply when the asset or liability is realized, based on rates that are enacted or substantively enacted at the end of reporting period. (IAS 12.47) When and where there are different tax rates that must be applied to the different levels of taxable income, deferred tax asset and liabilities are measured using the expected average rate applicable to the taxable profit of the period in which temporary differences will be reversed. (IAS 12.49)

The measurement of the deferred liability or asset must reflect the tax consequence from the manner in which the entity expects at the end of the reporting period to settle or recover its carrying amount. (IAS 12.51) In addition this deferred tax liability or asset cannot be discounted and must be reviewed at the end of each reporting period. The deferred tax asset must be reduced to the extent that taxable profit is no longer available to allow the benefit of the deferred tax asset to be utilized. (IAS 12.56)

The tax rates used to determine taxable income in some jurisdictions can consider the manner in which the entity is going to settle or recover the carrying value of the asset or liability. (IAS 12.52) Income tax rates in certain tax jurisdictions can also be affected if part of the income or retained earnings is paid out as dividends to shareholders. In such circumstances the income tax of dividends is recognized when the liability to pay the dividend is recognized. (IAS 12.52a-b)

8.5.3 Presentation (IAS 12.71-78, IAS 12.19-33

Deferred tax assets and liabilities should be presented separately from current tax assets and liabilities and classified as non‑current on the face of the balance sheet.

The movement between the deferred tax in the opening and closing balance sheets should be recognized as tax expense in the income statement, except for tax arising from:

* a transaction or event which is recognized in an accounting period directly in equity. In this case the deferred tax should be accounted for directly in equity.

a business combination that is accounted for as an acquisition. In this case the movement in deferred tax is reflected as an adjustment to the goodwill or negative goodwill arising from the acquisition.

Deferred tax liabilities and assets can be offset against current tax liabilities and assets but only if the Group has a legally enforceable right and the deferred tax liabilities and assets relate to income taxes levied by the same tax authority on either:

* the same taxable company

different taxable entities, but the entities intend to settle current tax liabilities and assets on a net basis

tax assets and liabilities will be realized simultaneously for each future period in which these differences reverse.

8.6 Disclosure (IAS 12.79-88)

The total income tax expense recorded in the income statement should include as required by IAS 12.80(a)-(h):

* current tax expense (income)
* any adjustments recognized in the period for current tax and prior periods
* amount of deferred tax expense relating to origination and reversal of temporary differences
* amount of deferred tax expense related to the imposition of new tax rates
* amount of benefit arising from a previously unrecognized tax loss or credit of a prior period used to reduce current or deferred taxes
* the amount of tax expense or income that is attributed to changes in accounting policies or errors in accordance with IAS 8
* deferred tax expense arising from a write-down or previous write-down of a deferred tax asset in accordance with IAS 12.56

The following major components of tax expense / income should be disclosed separately:

* reporting of current tax assets, current tax liabilities, deferred tax assets and deferred tax liabilities separately on the statement of financial position
* amount of income tax related to each component of other comprehensive income
* reconciliation between the effective rate and the applicable rate
* adjustments to prior period taxes
* amount of tax expense / income related to accounting policy changes or corrections of errors
* aggregate current and deferred taxes hitting equity
* effects of rate changes
* tax relating to discontinued operations
* amounts and deductible temporary differences, unused tax losses, and unused tax credits
* changes to unrecognized balances
* tax consequences of such dividends as well as disclosure of the nature and amounts of the potential income tax consequences of dividends
* temporary differences associated with investments in subsidiaries, associates, branches, and joint ventures

The following shall not be included in the total income tax expense:

* current / deferred tax relating to items that are charged or credited directly to equity
* amounts arising from a business combination that is an acquisition

**8.6 Example**

Illustrative example of deferred initial recognition:

Subsidiary A has purchased equipment for 1,000 which will be depreciated over 5 years. For tax purposes 20% of the cost are not deductible, and will never enter into the calculation of taxable profit (loss). 80% of the costs are deductible over 4 years. The tax rate is 40%.

As only part of the cost of the equipment is tax deductible, the cost of the asset should be divided into two components: a non‑deductible component (200) and a deductible component (800). The tax base of the non‑deductible component (200) is zero.

Additionally, there is no difference between tax base and accounting base of the deductible component (800) therefore no deferred tax results at initial recognition. However due to different useful lives for accounting and tax purposes a difference emerges subsequent to initial recognition in respect of the deductible component and a deferred tax liability should be recognized as illustrated below:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Accounting Carrying amount** | **Tax Carrying amount** | **Difference** | **Deferred tax DTA/(DTL)** |
| Cost | 200 | 800 | 800 | 0 |  |
| Depreciation – year 1 | 40 | 160 | 200 |  | (16) |
| End year 1 | 160 | 640 | 600 | 40 | (16) |
| Depreciation – year 2 | 40 | 160 | 200 |  | (16) |
| End year 2 | 120 | 480 | 400 | 80 | (32) |
| Depreciation – year 3 | 40 | 160 | 200 |  | (16) |
| End year 3 | 80 | 320 | 200 | 120 | (48) |
| Depreciation – year 4 | 40 | 160 | 200 |  | (16) |
| End year 4 | 40 | 160 | 0 | 160 | (64) |
| Depreciation – year 5 | 40 | 160 | 0 |  | 64 |
| End year 5 | 0 | 0 | 0 | 0 | 0 |