IAS 12
Income taxes

1. Objective

This Standard prescribes the accounting treatment of income taxes, both payable and deferred, so as to take into account the full tax impact of transactions recognized during the reporting period.

2. Scope

IAS 12 sets down the principles applicable to accounting for income taxes and **how to account for the current and future tax consequences of:**

- the future recovery (or settlement) of the carrying amount of assets (or liabilities) that are recognized in an entity's Statement of financial position;
- and transactions and other events of the current period that are recognized in an entity's financial statements.

According to IAS 12:

- accounting profit is profit or loss for a period before deducting tax expense;
- taxable profit or tax loss is the profit or loss for a period, determined in accordance with the rules established by the taxation authorities applicable to the entity, used to compute income taxes which are payable or recoverable;
- current tax is the amount of income taxes payable in respect of the taxable profit for a period.

IAS 12 defines temporary differences as differences between the carrying amount of an asset or liability in the Statement of financial position and its tax base. These temporary differences constitute a basis (either credit or loss) for deferred taxes giving rise to deferred tax liabilities and deferred tax assets.

Deferred tax assets may relate to:

- the amounts of income taxes recoverable in future periods in respect of non-deductible temporary differences at the end of the period;
- the carry forwards of unused tax losses and tax credits which should be re-

cognized as deferred tax assets when it is probable that the entity will record future taxable profits within a reasonable amount of time leading to the allocation of such unused tax losses or credits.

Example 1: Company X booked an expense of 30,000 as a provision for future retirement benefit obligations. Under the rules of the entity's country, this expense is not deductible from taxable profit until paid. Company X records a deferred tax liability of 30,000 which will be recovered at the time the retirement payments are effectively made. The deferred tax is equal to the amount of the provision multiplied by the tax rate in force, which on the basis of a 30% tax rate, would amount to 9,000 (i.e., 30% on 30,000). The other side of the double entry would be booked as non-taxable tax income.

Example 2: Company Y carried forward a 40,000 loss at the end of the year N. The tax rate in force at the end of the year N was 40%. The tax rate announced for future years, after the date the accounts were finalized, is 30%. Company Y has the right to record a deferred tax asset of 12,000 (i.e., 30% on 40,000) on the condition it is sufficiently probable this loss will be recovered in the future.

Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Example 3: Company Z recognized land with a value of 500 in connection with a business combination. This fixed asset was valued at 300 in the books of the acquiree company. This transaction leads to a temporary difference of 200 (carrying amount of 500 less tax base of 300). This will generate taxes that must be paid when the land is sold if the sales price exceeds 300. If the tax rate is 50% in this case, the deferred tax liability would be 100, to be offset in the accounts by an entry of a tax expense equal to the amount booked through profit or loss.

3. Accounting impact

Taxes payable for the current and previous periods must be recognized as a liability if they have not been paid. At the same time, the benefit of tax losses that can be carried back to recover tax of previous periods must be recognized as an asset.

Deferred tax liabilities due to taxable temporary differences must be recognized,

except in special cases (such as for example, deferred tax liabilities generated through initial recognition of goodwill).

Deferred tax assets due to deductible temporary differences must be recognized when it is likely that taxable profits will be subsequently generated.

In the income or profit and loss statement, current tax and deferred tax must be recognized as an expense or as income and included in the profit or loss for the period, except where the tax arises from a transaction or event which is recognized directly in equity or from a business combination (IFRS 3).
Deferred tax assets and liabilities may not be discounted. The carrying amount of a deferred tax asset must be reviewed at the end of each reporting period, and must be reduced to the extent that new information makes it probable that sufficient taxable profit will **not** be available to allow the benefit of part or all of that deferred tax asset to be utilized.

Deferred tax assets and liabilities must only be offset on the condition that the tax relates to the same entity's obligation to the same taxation authority and that such authority allows such a set off.

4. Disclosure

The following information must be disclosed:

- the major components of tax expense (or income) must be presented separately, including disclosure of the following:
  - ✓ current tax expense or income,
  - ✓ any adjustments recognized in the period for current tax of prior periods,
  - ✓ the tax rates applicable to the computation of the tax income or expense,
  - ✓ the effects of changes in tax rates,
  - ✓ the amount of the potential tax savings arising from tax credits or losses that may be carried forward,
  - ✓ the amount of deferred tax expenses relating to changes in the basis for temporary differences,
  - ✓ the amount of tax expense relating to changes in accounting policies and errors;

- the aggregate current and deferred tax relating to items that are charged or credited directly to equity, presented separately;

- an explanation of the relationship between tax expenses (or deferred tax

income) and accounting profits multiplied by the applicable tax rate(s) and if necessary, 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 (effectively a tax reconciliation statement giving "proof of tax");

- the nature of evidence used to recognize a deferred tax asset when its utilization is unsure at the time of recognition.

- the amount of deductible temporary differences, unused tax losses and tax credits, for which no deferred tax asset has been recognized.

Example 4: In year N, Company X reported its taxable profit at 100,000, with corporate income tax at 40%. The taxable profit took into account expenses of 12,000 relating to non-deductible fines and penalties. In addition, the Company had previously recognized revaluation gains on non-depreciable assets of 30,000 recorded as a result of a business combination, which are subject to a deferred tax system until disposal.

On 31 December year N, Company X made the following accounting entries:

	Debit	Credit
Income tax expense (P&L)	40,000	
Corporate Income tax provision (B/S)		40,000

There is no temporary difference arising from the fines and penalties expense (this expense was never deductible for tax purposes).

On the other hand, the revaluation adjustment resulting from the business combination relating to the non-depreciable assets will be taxable when these assets are disposed of. There is therefore a temporary difference generating a deferred tax liability which should be recorded as follows:

	Debit	Credit
Equity (B/S)	12,000	
Income tax provision (30,000 × 40%) (B/S)		12,000

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Example 5: Throughout the year N–1, company Y recorded a tax loss of 70,000. It determined that the future utilization of this tax loss was highly likely, and so made the following accounting entries:

Income tax provision (B/S)	28,000	
Deferred tax income (70,000 × 40%) (P&L)		28,000

At the end of the reporting period N, an unused tax loss of 40,000 remained on Y's books. During the course of year N+1, the corporate income tax rate was reduced from 40% to 30%.

At the end of reporting period N, company Y had to measure the deferred tax assets and liabilities based on the change in the tax rate according to the liability method, i.e., by computing unrealized tax positions at the future 30% rate. The company thus booked the following entries at the end of reporting period N:

Deferred tax liabilities (reduction in losses carried forward N–1) (P&L)	12,000	
Deferred tax assets [(70,000 – 40,000) × 40%] (B/S)		12,000
Deferred tax liabilities (reduction tax rate in N+1) (P&L)	4,000	
Deferred tax assets [40,000 × (40% – 30%)] (B/S)		4,000

The final position on December 31 of year N would be 12,000, i.e., 30% of the balance of the losses carried forward of 40,000.

Example 6: During the course of the year N, company Z performed a revaluation of its property, plant and equipment for the amount of 150,000. The following entries were made:

Tangible fixed assets (B/S)	150,000	
Revaluation reserve (equity) (B/S)		150,000

At the end of reporting period N, with a tax rate in N+1 equal to 40%, Company Z must post the following entry to deferred tax liabilities:

Revaluation reserve (equity) (B/S)	60,000	
Deferred tax liabilities (150,000 × 40%) (B/S)		60,000

As stated previously, "proof of tax" is also information that must be provided, in the notes to the financial statements. This means determining the income tax expense for the period using the taxable bases and the tax rates in force.

Example 7: In example 4 given above, the tax proof relating to 31 December N would be as follows:

Accounting profit	88,000
Taxes at the rate applicable in year N (88,000 × 40%)	35,200
Tax impact of expenses which are non-deductible for tax purposes	
Fines and penalties (12,000 × 40%)	4,800
Deferred income tax expense on acquisition (30,000 × 40%)	12,000
Income tax expense	**52,000**

The components of this tax expense must be detailed:

Current income tax expense	40,000
Deferred income tax expense	12,000
Deferred tax expense (or income) arising from the reduction of tax rate	0
Income tax expense	**52,000**

Example 8:

Group G generated a consolidated net profit of	1,700,000
After taking into account a current income tax expense of	700,000
i.e., pre-tax profit of	**2,400,000**
The profit reported is composed of the net accounting profits broken down as follows:	
Parent and French subsidiaries taxable at the rate of 33.1/3%	1,220,000
Foreign subsidiary taxable at the rate of 20%	480,000
The taxable profits in France include temporarily non-deductible expenses for the amount of 30,000 and tax-exempt dividends for 90,000.	

Proof of tax would be computed as follows:

A)

Pre-tax profit taxable at 33.1/3%	1,800,000
Add-back non-deductible expenses	30,000
Deduction of tax-exempt dividends	- 90,000
Taxable base at 33.1/3%	1,740,000
Thus a tax expense at 33.1/3% amounting to	**580,000**

B)

Pre-tax profit taxable at 20%	600,000
Thus a tax expense at 20% amounting to	**120,000**
Resulting in a consolidated tax expense of	**700,000**