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To: New/Business Editor 5 September 2002
(For IMMEDIATE RELEASE)

HKSA Issues a revised Standard on Income taxes and two related Interpretations

The Hong Kong Society of Accountants (HKSA) has recently issued the following statements on financial reporting for income taxes:

- SSAP 12 (revised), Income Taxes;
- Interpretation 20, Income Taxes – Recovery of revalued Non-Depreciable Assets; and
- Interpretation 21, Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders

These statements, based on the equivalent statements issued by the International Accounting Standards Board (IASB), replace the former SSAP 12, Accounting for Deferred Tax ("former SSAP 12").

As compared to the former SSAP 12, SSAP 12 (revised) is a more comprehensive standard, dealing with current taxes as well as deferred taxes. In respect of current income taxes, SSAP 12 (revised) essentially carries forward existing practice and therefore no significant change in practice is anticipated. The general requirements relating to the accounting for current taxes under SSAP 12 (revised) are set out in the Appendix to this Press Release for information.

In respect of deferred income taxes, SSAP 12 (revised), however, requires changes be made to existing practice as the approach used for the accounting for deferred taxes under SSAP 12 (revised) and that used under the former SSAP 12 are different. The broad principles relating to the accounting for deferred taxes under SSAP 12 (revised) are set out in the Appendix to this Press Release for information. Many enterprises may find that the changes on implementing SSAP 12 (revised) will result in the reporting of a larger amount of deferred taxes due to the following key differences between SSAP 12 (revised) and the former SSAP 12:

- SSAP 12 (revised) requires full provisioning whereby deferred tax is recognised in respect of all deferred tax liabilities and assets, with limited exceptions. No consideration will be given as to whether or not the deferred tax assets and liabilities are likely to be paid or settled in future, as under the former SSAP 12's partial provisioning approach. For example, the difference between the carrying amount of a revalued asset and its tax base would give rise to a deferred tax liability or asset which is required to be recognised under SSAP 12 (revised) even where:

  (i) the enterprise does not intend to dispose of the asset; or

  (ii) the tax liability can be deferred if the proceeds of the disposal of the asset are invested in a similar asset.

- SSAP 12 (revised) adopts a balance sheet approach and is concerned with the tax consequences of the future recovery or settlement of the carrying amount of assets or liabilities recognised in the balance sheet ("temporary differences"), whereas the former SSAP 12 is focused more on the income statement and accounting for the tax consequences of differences between profits or losses as computed for tax purposes and results as stated in the financial statements, which will be reversed in one or more subsequent periods ("timing differences"). All timing differences are temporary differences. Temporary differences also arise in circumstances which do not give rise to timing differences, such as where the cost of a business combination is allocated to the identifiable assets and liabilities acquired by reference to their fair values but no equivalent adjustment is made for tax purposes.

However, the reporting of deferred taxes using the approach under SSAP 12 (revised) ensures such reporting is on par with international best practice.

Mr. Roger Best, Chairman of the HKSA's Financial Accounting Standards Committee said: "Accounting for deferred tax has been identified as one major area of difference between Hong Kong financial accounting standards and IAS. Upon implementation of the revised SSAP on income taxes, we have made a big step forward in achieving our ultimate objective of convergence with IAS."

The HKSA is the only statutory licensing body of accountants in Hong Kong responsible for the regulation of the accounting profession, with a 20,000-plus-strong membership. The HKSA issues on a regular basis Professional Standards on various aspects of accounting practice, and these are required to be observed by professional accountants.

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(Issued by the HKSA. For further information, please contact Ms. Florence Chan or Ms. Cynthia Lee of the public relations section of the HKSA on 2287 7228.)

Appendix – Requirements under SSAP 12 (revised)

Accounting for current taxes

The general requirements relating to the accounting for current taxes under SSAP 12 (revised) are as follows:

- Current tax liabilities (assets) for the current and prior periods are measured at the amount 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 balance sheet date.

- Tax for current and prior periods, to the extent unpaid, is recognised as a liability and, conversely, an overpayment of tax or a tax loss that can be carried back to recover the tax of an earlier period is recognised as an asset.

Accounting for deferred taxes

The broad principles relating to the accounting for deferred taxes under SSAP 12 (revised) are as follows:

- The future tax consequences of the recovery or settlement of the carrying amount of assets or liabilities recognised in an enterprise's balance sheet in the form of an inflow or outflow of economic benefits to and from the enterprise in future periods give rise to deferred tax liabilities or assets, and are calculated on the following basis:

Carrying amount of assets or liabilities	- *The amount attributable to the assets or liabilities for tax purposes ("tax bases")*	= *Taxable or deductible temporary differences*
Taxable or deductible temporary differences	*x Tax rates*	= *Deferred tax assets or liabilities*

e.g. An asset which costs $1,500 has a carrying amount of $1,000 (being cost less accumulated depreciation of $500) and a tax base of $600 (being cost less accumulated tax allowances of $900). The applicable tax rate is 16%.
In recovering the carrying amount of $1,000, the enterprise will derive taxable income in future of $1,000, but will only be able to obtain further tax allowances of $600. Consequently, the enterprise will pay income tax of $64 (($1,000-$600) x 16%) when it recovers the carrying amount of the asset.
The difference between carrying amount of $1,000 and the tax base of $600 is a taxable temporary difference of $400. Therefore, a deferred tax liability of $64 will arise by applying the tax rate of 16% to the taxable temporary difference of $400.

- Deferred tax assets also arise from unused tax losses that tax law allows to be carried forward, and are calculated in accordance with the following formula:

Unused tax losses	*x Tax rates*	= *Deferred tax assets*

- The future tax consequences are measured using the tax rate and the tax base (e.g. income tax basis or capital gains tax basis) that reflect the manner in which the enterprise expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities. (Example: An asset has a carrying amount of $1,000 and a tax base of $600. A tax rate of 20% would apply if the asset were sold and a tax rate of 30% would apply to other income. A deferred tax liability of $80 ($400 x 20%) will arise if the enterprise expects to sell the asset without future use and a deferred tax liability of $120 (400 x 30%) if it expects to retain the asset and recover its carrying amount through use.)

- With limited exceptions, all deferred tax liabilities should be recognised in the balance sheet whereas, again subject to limited exceptions, deferred tax assets are recognised in the balance sheet to the extent that it is probable that there will be sufficient taxable profits in the future to enable the asset to be recovered.