SSAP 12
STATEMENT OF STANDARD ACCOUNTING PRACTICE 12
INCOME TAXES

(Issued August 2002)

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*The standards, which have been set in **bold italic type**, should be read in the context of the background material and implementation guidance and in the context of the Foreword to Statements of Standard Accounting Practice, Interpretations and Accounting Guidelines. Statements of Standard Accounting Practice are not intended to apply to immaterial items (see paragraph 8 of the Foreword).*

The explanatory guidance and illustrative examples set out in the boxes are to illustrate the application of the standards to assist in clarifying their meaning. They are for general guidance only and do not form part of the standards.

Objective

The objective of this Statement is to prescribe the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of:

(a) the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an enterprise's balance sheet; and

(b) transactions and other events of the current period that are recognised in an enterprise's financial statements.

It is inherent in the recognition of an asset or liability that the reporting enterprise expects to recover or settle the carrying amount of that asset or liability. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, this Statement requires an enterprise to recognise a deferred tax liability (deferred tax asset), with certain limited exceptions.

This Statement requires an enterprise to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in the income statement, any related tax effects are also recognised in the income statement. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill or negative goodwill arising in that business combination.

This Statement also deals with the recognition of deferred tax assets arising from unused tax losses or unused tax credits, the presentation of income taxes in the financial statements and the disclosure of information relating to income taxes.

General Principles

- This Statement deals with current taxes and deferred taxes. As its approach to deferred taxes is different from that contained in the superseded SSAP 12 "Accounting for deferred tax", some general principles relating to the treatment of deferred taxes in this Statement are set out below.

- The future tax consequences of transactions and other events recognised in an enterprise's balance sheet give rise to deferred tax liabilities and assets, and are calculated in accordance with the following formulae:

Carrying amounts of assets or liabilities	-	*Tax bases of assets or liabilities*	=	*Taxable or deductible temporary differences*
Taxable or deductible temporary differences	X	*Tax rates*	=	*Deferred tax liabilities or assets*

- 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 notion of temporary differences is central to understanding the requirements of this Statement. A taxable temporary difference gives rise to a deferred tax liability. A deductible temporary difference gives rise to a deferred tax asset. A taxable or deductible temporary difference arises when the carrying amount of an asset or a liability differs from its tax base. The meaning of "tax base" is of key importance to applying the requirements of this Statement. Tax base is defined in paragraph 5 of this Statement and is generally the amount that would be shown as an asset or a liability in a balance sheet prepared for tax purposes. Unlike the practice in some other countries, it is not customary in Hong Kong for enterprises to prepare tax-based balance sheets. However, the notion of a tax-based balance sheet is relevant to this Statement and may be used as a basis for working papers developed for the purpose of implementing this Statement.
- This Statement generally requires an enterprise to recognise the tax consequences of transactions and other events consistently with the way that it recognises the transactions and other events themselves. Thus, for transactions and other events recognised in net profit or loss for the period, any related tax effects are also recognised in net profit or loss for the period. For transactions and other events that are recognised as direct credits to equity (direct debits to equity), any related tax effects are generally recognised as direct debits to equity (direct credits to equity).

Scope

1. ***This Statement should be applied in accounting for income taxes.***

2. For the purposes of this Statement, income taxes include all domestic and foreign taxes which are based on taxable profits. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint venture on distributions to the reporting enterprise.

3. [Not used]

4. This Statement does not deal with the methods of accounting for government grants (see SSAP 35, Accounting for Government Grants and Disclosure of Government Assistance) or investment tax credits. However, this Statement does deal with the accounting for temporary differences that may arise from such grants or investment tax credits.

Definitions

5. ***The following terms are used in this Statement with the meanings specified:***

   <u>Accounting profit</u> is net profit or loss for a period before deducting tax expense.

   <u>Taxable profit (tax loss)</u> 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).

   <u>Tax expense (tax income)</u> is the aggregate amount included in the determination of net profit or loss for the period in respect of current tax and deferred tax.

   <u>Current tax</u> is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

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

   <u>Deferred tax assets</u> are the amounts of income taxes recoverable in future periods in respect of:

   (a) deductible temporary differences;

   (b) the carryforward of unused tax losses; and

   (c) the carryforward of unused tax credits.

   <u>Temporary differences</u> are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:

   (a) <u>taxable temporary differences</u>, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or

   (b) <u>deductible temporary differences</u>, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

   The <u>tax base</u> of an asset or liability is the amount attributed to that asset or liability for tax purposes.

6. Tax expense (tax income) comprises current tax expense (current tax income) and deferred tax expense (deferred tax income).

Tax Base

This section provides guidance for the calculation of tax base in different circumstances. The concept of tax base is of key importance in implementing the principles in this Statement. A difference between the carrying amount of an asset or a liability and the tax base of the asset or liability is a taxable temporary difference or a deductible temporary difference that gives rise to a deferred tax liability or asset, respectively.

7. 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 enterprise 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.

The tax base of an asset may be calculated as the asset's carrying amount, less any future taxable amounts plus any future deductible amounts that are expected to arise from recovering the asset's carrying amount as at the balance sheet date. For example, in the case of plant and equipment, the tax base is the tax written down value.

EXAMPLES

Examples of the calculation of the tax base of assets

1. A machine cost $100 and is expected to be ultimately disposed of for an amount that is equal to or less than cost. For tax purposes, depreciation of $30 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the machine (that is, revenue generated from recovering the carrying amount of the machine) is taxable, any gain or loss on disposal will be subject to a balancing adjustment (such as for recouped depreciation) for tax purposes. The machine has been depreciated for accounting purposes by $20.

   The tax base of the machine is:

Carrying Amount		*Taxable Amounts*		*Deductible Amounts*		*Tax Base*
$80	-	*$80*	+	*$70*	=	*$70*

2. Leasehold land with a cost of $100 and a carrying amount of $90 is revalued to $150. For tax purposes, depreciation of $20 has been deducted in the current and prior periods and the remaining cost will be deductible in future periods through depreciation. Revenue generated from the use of the leasehold land is taxable and any gain or loss on disposal will be subject to a balancing adjustment for tax purposes.

   The tax base of the leasehold land is:

Carrying Amount		*Taxable Amounts*		*Deductible Amounts*		*Tax Base*
$150	-	*$150*	+	*$80*	=	*$80*

3. Freehold land with a cost of $100 is revalued to $150. For tax purposes, there is no depreciation. Revenue generated from the use of the freehold land is taxable. However, any gain on disposal of the land at the revalued amount will not be taxable.

   The tax base of the freehold land is:

Carrying Amount		*Taxable Amounts*		*Deductible Amounts*		*Tax Base*
$150	-	*$150*	+	*$100*	=	*$100*

4. Trade receivables has a carrying amount of $100 and is expected to be recovered through payments from debtors. There are no doubtful debts. The related revenue of $100 has already been included in the calculation of taxable profit (tax loss).

   The tax base of the trade receivables is:

Carrying Amount		*Taxable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	*Nil*	+	*Nil*	=	*$100*

5. Trade receivables has a carrying amount of $100, for which specific bad debt provisions amounting to $20 have been made. These provisions have already been deducted for tax purposes.

   The tax base of the trade receivables is:

Carrying Amount		*Taxable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	*Nil*	+	*Nil*	=	*$100*

6. Trade receivables has a carrying amount of $100, for which general bad debt provisions amounting to $20 have been made. These provisions have not yet been deducted for tax purposes but are expected to give rise to future deductible amounts.

   The tax base of the trade receivables is:

Carrying Amount		*Taxable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	*Nil*	+	*$20*	=	*$120*

7. A loan receivable has a carrying amount of $100 and is expected to be recovered through payments from the borrower. The repayment of the carrying amount of the loan as at the reporting date will have no tax consequences.

   The tax base of the loan is:

Carrying Amount		*Taxable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	*Nil*	+	*Nil*	=	*$100*

8. Dividends receivable from a subsidiary have a carrying amount of $100. The dividends are not taxable.

   The tax base of the dividends receivable is:

Carrying Amount		*Taxable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	Nil	+	Nil	=	$100

9. An interest receivable has a carrying amount of $100. The related interest revenue will be taxed only when received.

   The tax base of the interest receivable is:

Carrying Amount		*Taxable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	$100	+	Nil	=	Nil

8. 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 which 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.

   The tax base of a liability may be calculated as the liability's carrying amount as at the balance sheet date less any future deductible amounts, plus any future taxable amounts, that are expected to arise from settling the liability's carrying amount as at the balance sheet date. The tax base of a liability that is in the nature of "revenue received in advance", however, is calculated as the liability's carrying amount less any amount of the "revenue received in advance" that has been included in taxable amounts in the current or a previous reporting period.

EXAMPLES

Calculation of the tax base of liabilities

1. Current liabilities include accrued wages with a carrying amount of $100. The related expense has already been deducted for tax purposes on an accrued basis (that is, the wages were deducted for tax purposes in the same year in which they were recognised as an expense for accounting purposes).

   The tax base of the accrued expenses is:

Carrying Amount		*Deductible Amounts*		*Taxable Amounts*		*Tax Base*
$100	-	Nil	+	NIL	=	$100

2. Current liabilities include accrued fines and penalties with a carrying amount of $100. Fines and penalties are not deductible for tax purposes.

   The tax base of the accrued fines and penalties is:

Carrying Amount		*Deductible Amounts*		*Taxable Amounts*		*Tax Base*
$100	-	Nil	+	Nil	=	$100

3. A loan payable has a carrying amount of $100. The repayment of the carrying amount of the loan as at the reporting date will not give rise to taxable or deductible amounts.

   The tax base of the loan is:

Carrying Amount		*Deductible Amounts*		*Taxable Amounts*		*Tax Base*
$100	-	Nil	+	Nil	=	$100

4. Current liabilities include interest revenue received in advance, with a carrying amount of $100. The related interest revenue was taxed on a cash basis.

   The tax base of the interest received in advance is:

Carrying Amount		*Amount of revenue received in advance that has increased taxable amount (or decreased tax loss)*		*Tax Base*
$100	-	$100	=	Nil

5. A foreign currency loan payable has a carrying amount on initial recognition of $100. Subsequently, the carrying amount is reduced to $90 to reflect the change in exchange rates (an unrealised foreign exchange gain). Exchange gains are only taxable when they are realised. The repayment of the $90 carrying amount of the loan will give rise to taxable amounts of $10.

   The tax base of the loan is:

Carrying Amount		*Deductible Amounts*		*Taxable Amounts*		*Tax Base*
$90	-	Nil	+	$10	=	$100

6. An interest payable has a carrying amount of $100. The related interest will be deductible for tax purposes only when it is paid.

   The tax base of the interest payable is:

Carrying Amount		*Deductible Amounts*		*Taxable Amounts*		*Tax Base*
$100	-	$100	+	Nil	=	Nil

9. Some items have a tax base but are not recognised as assets and liabilities in the balance sheet. For example, research costs are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period. The difference between the tax base of the research costs, being the amount the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset.

10. Where the tax base of an asset or liability is not immediately apparent, it is helpful to consider the fundamental principle upon which this Statement is based: that an enterprise should, with certain limited exceptions, recognise a deferred tax liability (asset) whenever recovery or settlement of the carrying amount of an asset or liability would make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences. Example C following paragraph 52 illustrates circumstances when it may be helpful to consider this fundamental principle, for example, when the tax base of an asset or liability depends on the expected manner of recovery or settlement.

11. In consolidated financial statements, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. The tax base is determined by reference to a consolidated tax return in those jurisdictions in which such a return is filed. In other jurisdictions, the tax base is determined by reference to the tax returns of each enterprise in the group.

Recognition of Current Tax Liabilities and Current Tax Assets

12. Current tax for current and prior periods should, to the extent unpaid, be recognised as a liability. If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess should be recognised as an asset.

13. The benefit relating to a tax loss that can be carried back to recover current tax of a previous period should be recognised as an asset.

14. When a tax loss is used to recover current tax of a previous period, an enterprise recognises the benefit as an asset in the period in which the tax loss occurs because it is probable that the benefit will flow to the enterprise and the benefit can be reliably measured.

Recognition of Deferred Tax Liabilities and Deferred Tax Assets

Taxable Temporary Differences

15. A deferred tax liability should be recognised for all taxable temporary differences, unless the deferred tax liability arises from:

(a) goodwill for which amortisation is not deductible for tax purposes; or

(b) the initial recognition of an asset or liability in a transaction which:

(i) is not a business combination; and

(ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax liability should be recognised in accordance with paragraph 39.

16. It is inherent in the recognition of an asset that its carrying amount will be recovered in the form of economic benefits that flow to the enterprise in future periods. When the carrying amount of the asset exceeds its tax base, the amount of taxable economic benefits will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability. As the enterprise recovers the carrying amount of the asset, the taxable temporary difference will reverse and the enterprise will have taxable profit. This makes it probable that economic benefits will flow from the enterprise in the form of tax payments. Therefore, this Statement requires the recognition of all deferred tax liabilities, except in certain circumstances described in paragraphs 15 and 39.

The recovery of the carrying amount of many assets gives rise to taxable and deductible amounts. For example, an item of equipment may be used to produce goods that are in turn used to generate revenue, and therefore taxable amounts, and give rise to depreciation that is a deductible amount. When the carrying amount of the asset (equipment) exceeds its tax base, the amount of taxable economic benefits (taxable amounts) will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to settle the resulting income taxes in future periods is a deferred tax liability. The example below illustrates a circumstance in which a deferred tax liability arises that is required to be recognised by this Statement.

EXAMPLE

An example of circumstances that give rise to a deferred tax liability that is required to be recognised

An asset that costs $150 has a carrying amount of $100. Cumulative depreciation for tax purposes is $90 and the tax rate is 30%.

	Carrying Amount	**Tax Base**	**Temporary Difference**
	$	$	$
At acquisition	150	150	
Accumulated Depreciation	50	90	
Net amount	100	60	40
Tax rate			30%
Deferred Tax Liability			12

The tax base of the asset is $60 (cost of $150 less cumulative tax depreciation of $90). In recovering the carrying amount of $100, the enterprise will derive taxable amounts of $100, but will only be able to deduct tax depreciation of $60. Consequently, the enterprise will pay income taxes of $12 (calculated as $40 x 30%) as a result of recovering the carrying amount of the asset. The difference between the carrying amount of $100 and the tax base of $60 is a taxable temporary difference of $40. Therefore, the enterprise recognises a deferred tax liability of $12 (calculated as $40 x 30%) representing the effect on income tax payable as a consequence of recovering the carrying amount of the asset.

17. Some temporary differences arise when income or expense is included in accounting profit in one period but is included in taxable profit in a different period. Such temporary differences are often described as timing differences. The following are examples of temporary differences of this kind which are taxable temporary differences and which therefore result in deferred tax liabilities:

    (a) interest revenue is included in accounting profit on a time proportion basis but may, in some jurisdictions, be included in taxable profit when cash is collected. The tax base of any receivable recognised in the balance sheet with respect to such revenues is nil because the revenues do not affect taxable profit until cash is collected;

    (b) depreciation used in determining taxable profit (tax loss) may differ from that used in determining accounting profit. The temporary difference is the difference between the carrying amount of the asset and its tax base which is the original cost of the asset less all deductions in respect of that asset permitted by the taxation authorities in determining taxable profit of the current and prior periods. A taxable temporary difference arises, and results in a deferred tax liability, when tax depreciation is accelerated (if tax depreciation is less rapid than accounting depreciation, a deductible temporary difference arises and results in a deferred tax asset); and

    (c) development costs may be capitalised and amortised over future periods in determining accounting profit but deducted in determining taxable profit in the period in which they are incurred. Such development costs have a tax base of nil as they have already been deducted from taxable profit. The temporary difference is the difference between the carrying amount of the development costs and their tax base of nil.

18. Temporary differences also arise when:

    (a) the cost of a business combination that is an acquisition is allocated to the identifiable assets and liabilities acquired by reference to their fair values but no equivalent adjustment is made for tax purposes (see paragraph 19);

    (b) assets are revalued and no equivalent adjustment is made for tax purposes (see paragraph 20);

    (c) goodwill or negative goodwill arises on consolidation (see paragraphs 21 and 32);

    (d) the tax base of an asset or liability on initial recognition differs from its initial carrying amount, for example when an enterprise benefits from non-taxable government grants related to assets (see paragraphs 22 and 33); or

    (e) the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures becomes different from the tax base of the investment or interest (see paragraphs 38 - 45).

Business Combinations

19. In a business combination that is an acquisition, the cost of the acquisition is allocated to the identifiable assets and liabilities acquired by reference to their fair values at the date of the exchange transaction. Temporary differences arise when the tax bases of the identifiable assets and liabilities acquired are not affected by the business combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 66).

Assets Carried at Fair Value

20. Statements of Standard Accounting Practice permit certain assets to be carried at fair value or to be revalued (see, for example, SSAP 13, Accounting for investment properties, SSAP 17, Property, plant and equipment, SSAP 29, Intangible Assets and SSAP 24, Accounting for investments in securities.) In some jurisdictions, the revaluation or other restatement of an asset to fair value affects taxable profit (tax loss) for the current period. As a result, the tax base of the asset is adjusted and no temporary difference arises. In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the enterprise and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:

    (a) the enterprise does not intend to dispose of the asset. In such cases, the revalued carrying amount of the asset will be recovered through use and this will generate taxable income which exceeds the depreciation that will be allowable for tax purposes in future periods; or

    (b) tax on capital gains is deferred if the proceeds of the disposal of the asset are invested in similar assets. In such cases, the tax will ultimately become payable on sale or use of the similar assets.

Goodwill

21. Goodwill is the excess of the cost of an acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired. Many taxation authorities do not allow the amortisation of goodwill as a deductible expense in determining taxable profit. Moreover, in such jurisdictions, the cost of goodwill is often not deductible when a subsidiary disposes of its underlying business. In such jurisdictions, goodwill has a tax base of nil. Any difference between the carrying amount of goodwill and its tax base of nil is a taxable temporary difference. However, this Statement does not permit the recognition of the resulting deferred tax liability because goodwill is a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill.

Initial Recognition of an Asset or Liability[1]

22. A temporary difference may arise on initial recognition of an asset or liability, for example if part or all of the cost of an asset will not be deductible for tax purposes. The method of accounting for such a temporary difference depends on the nature of the transaction which led to the initial recognition of the asset:

[1] In accordance with SSAP 1 paragraph 23, management could consider IAS 32, Financial Instruments: Disclosure and Presentation, when accounting for a compound financial instrument. Under IAS 32, the issuer of a compound financial instrument (for example, a convertible bond) classifies the instrument's liability component as a liability and the equity component as equity. In some jurisdictions, the tax base of the liability component on initial recognition is equal to the initial carrying amount of the sum of the liability and equity components. The resulting taxable temporary difference arises from the initial recognition of the equity component separately from the liability component. Therefore, the exception set out in paragraph 15(b) of this Statement does not apply. Consequently, an enterprise recognises the resulting deferred tax liability. In accordance with paragraph 61 of this Statement, the deferred tax is charged directly to the carrying amount of the equity component. In accordance with paragraph 58 of this Statement, subsequent changes in the deferred tax liability are recognised in the income statement as deferred tax expense (income).

(a) in a business combination, an enterprise recognises any deferred tax liability or asset and this affects the amount of goodwill or negative goodwill (see paragraph 19);

(b) if the transaction affects either accounting profit or taxable profit, an enterprise recognises any deferred tax liability or asset and recognises the resulting deferred tax expense or income in the income statement (see paragraph 59);

(c) if the transaction is not a business combination, and affects neither accounting profit nor taxable profit, an enterprise would, in the absence of the exemption provided by paragraphs 15 and 24, recognise the resulting deferred tax liability or asset and adjust the carrying amount of the asset or liability by the same amount. Such adjustments would make the financial statements less transparent. Therefore, this Statement does not permit an enterprise to recognise the resulting deferred tax liability or asset, either on initial recognition or subsequently (see example below). Furthermore, an enterprise does not recognise subsequent changes in the unrecognised deferred tax liability or asset as the asset is depreciated.

Example illustrating paragraph 22(c)

An enterprise intends to use an asset which cost $1,000 throughout its useful life of five years and then dispose of it for a residual value of nil. The tax rate is 40%. Depreciation of the asset is not deductible for tax purposes. On disposal, any capital gain would not be taxable and any capital loss would not be deductible.

As it recovers the carrying amount of the asset, the enterprise will earn taxable income of $1,000 and pay tax of $400. The enterprise does not recognise the resulting deferred tax liability of $400 because it results from the initial recognition of the asset.

In the following year, the carrying amount of the asset is $800. In earning taxable income of $800, the enterprise will pay tax of $320. The enterprise does not recognise the deferred tax liability of $320 because it results from the initial recognition of the asset.

23. [Not used]

Deductible Temporary Differences

24. A deferred tax asset should be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from:

(a) negative goodwill which is treated as deferred income in accordance with SSAP 30, Business combinations; or

(b) the initial recognition of an asset or liability in a transaction which:

(i) is not a business combination; and

(ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax asset should be recognised in accordance with paragraph 44.

25. It is inherent in the recognition of a liability that the carrying amount will be settled in future periods through an outflow from the enterprise of resources embodying economic benefits. When resources flow from the enterprise, part or all of their amounts may be deductible in determining taxable profit of a period later than the period in which the liability is recognised. In such cases, a temporary difference exists between the carrying amount of the liability and its tax base. Accordingly, a deferred tax asset arises in respect of the income taxes that will be recoverable in the future periods when that part of the liability is allowed as a deduction in determining taxable profit. Similarly, if the carrying amount of an asset is less than its tax base, the difference gives rise to a deferred tax asset in respect of the income taxes that will be recoverable in future periods.

Provisions such as guarantees, product warranties or employee entitlements (including long service payments) made for accounting purposes on an estimated basis may be deducted in determining accounting profit in the reporting period in which the liability for such items arises, but deducted in determining taxable profit when paid. The example below illustrates a circumstance in which a deferred tax asset arises.

EXAMPLE

An example of circumstances that give rise to a deferred tax asset

An enterprise recognises a liability of $100 for accrued product warranty costs. For tax purposes, the product warranty costs will not be deductible until the enterprise meets claims. The tax rate is 30%.

	Carrying Amount	**Tax Base**	**Temporary Difference**
	$	$	$
Accrued Warranty Costs	100	Nil	100
Tax rate			30%
Deferred Tax Asset			30

The tax base of the liability is nil (carrying amount of $100, less the deductible amount of $100 in respect of that liability in future periods). In settling the liability for its carrying amount, the enterprise will reduce its future taxable amount by $100 and, consequently, reduce its future tax payments by $30 (calculated as $100 x 30%). The difference between the carrying amount of $100 and the tax base of nil is a deductible temporary difference of $100. Therefore, the enterprise recognises a deferred tax asset of $30 (calculated as $100 x 30%), provided that it is probable that the entity will earn sufficient taxable amounts in future periods to benefit from a reduction in tax payments.

26. The following are examples of deductible temporary differences which result in deferred tax assets:

    (a) retirement benefit costs may be deducted in determining accounting profit as service is provided by the employee, but deducted in determining taxable profit either when contributions are paid to a fund by the enterprise or when retirement benefits are paid by the enterprise. A temporary difference exists between the carrying amount of the liability and its tax base; the tax base of the liability is usually nil. Such a deductible temporary difference results in a deferred tax asset as economic benefits will flow to the enterprise in the form of a deduction from taxable profits when contributions or retirement benefits are paid;

    (b) research costs are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period. The difference between the tax base of the research costs, being the amount the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset;

    (c) in a business combination that is an acquisition, the cost of the acquisition is allocated to the assets and liabilities recognised, by reference to their fair values at the date of the exchange transaction. When a liability is recognised on the acquisition but the related costs are not deducted in determining taxable profits until a later period, a deductible temporary difference arises which results in a deferred tax asset. A deferred tax asset also arises where the fair value of an identifiable asset acquired is less than its tax base. In both cases, the resulting deferred tax asset affects goodwill (see paragraph 66); and

    (d) certain assets may be carried at fair value, or may be revalued, without an equivalent adjustment being made for tax purposes (see paragraph 20). A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.

27. The reversal of deductible temporary differences results in deductions in determining taxable profits of future periods. However, economic benefits in the form of reductions in tax payments will flow to the enterprise only if it earns sufficient taxable profits against which the deductions can be offset. Therefore, an enterprise recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised.

28. 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 same taxation authority and the same taxable entity which are expected to reverse:

    (a) in the same period 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 carried back or forward.

    In such circumstances, the deferred tax asset is recognised in the period in which the deductible temporary differences arise.

29. 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 enterprise 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). In evaluating whether it will have sufficient taxable profit in future periods, an enterprise ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from these deductible temporary differences will itself require future taxable profit in order to be utilised; or

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

> **Example illustrating paragraph 29(a)**
>
> An enterprise has a tax loss of $1000 which can be carried forward for 5 years. The estimated cumulative taxable profits for the next five years are $600. It is estimated that $400 of the tax loss will expire unused. The tax rate is 30%.
>
> *The enterprise recognises a deferred tax asset of $180 ($600 x 30%)*
>
> Suppose the enterprise expects to buy a machine that costs $300 with a useful life for accounting purposes of 2 years, and a useful life for the purpose of calculating tax depreciation of 3 years. In year 1, a deductible temporary difference of $50 (representing the tax base of $200 less the carrying amount of $150) will arise corresponding to taxable income of $50 and a further deductible amount (and taxable income) of $50 will arise in year 2. These differences will reverse (with a reduction of $100 in taxable profit) in year 3.
>
> *The enterprise ignores the taxable income of $50 in years 1 and 2 when evaluating whether there is sufficient taxable profit to utilise the tax loss carried forward. This is because it merely creates another deductible temporary difference, which itself needs to be tested for recoverability.*

30. Tax planning opportunities are actions that the enterprise would take in order to create or increase taxable income in a particular period before the expiry of a tax loss or tax credit carryforward. For example, in some jurisdictions, taxable profit may be created or increased by:

    (a) electing to have interest income taxed on either a received or receivable basis;

    (b) deferring the claim for certain deductions from taxable profit;

    (c) selling, and perhaps leasing back, assets that have appreciated but for which the tax base has not been adjusted to reflect such appreciation; and

    (d) selling an asset that generates non-taxable income (such as, in some jurisdictions, a government bond) in order to purchase another investment that generates taxable income.

    Where tax planning opportunities advance taxable profit from a later period to an earlier period, the utilisation of a tax loss or tax credit carryforward still depends on the existence of future taxable profit from sources other than future originating temporary differences.

31. When an enterprise has a history of recent losses, the enterprise considers the guidance in paragraphs 35 and 36.

Negative Goodwill

32. This Statement does not permit the recognition of a deferred tax asset arising from deductible temporary differences associated with negative goodwill which is treated as deferred income in accordance with SSAP 30, Business Combinations, because negative goodwill is a residual and the recognition of the deferred tax asset would increase the carrying amount of negative goodwill.

Initial Recognition of an Asset or Liability

33. One case when a deferred tax asset arises on initial recognition of an asset is when a non-taxable government grant related to an asset is deducted in arriving at the carrying amount of the asset but, for tax purposes, is not deducted from the asset's depreciable amount (in other words its tax base); the carrying amount of the asset is less than its tax base and this gives rise to a deductible temporary difference. Government grants may also be set up as deferred income in which case the difference between the deferred income and its tax base of nil is a deductible temporary difference. Whichever method of presentation an enterprise adopts, the enterprise does not recognise the resulting deferred tax asset, for the reason given in paragraph 22.

Unused Tax Losses and Unused Tax Credits

34. A deferred tax asset should be recognised for the carryforward 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.

35. The criteria for recognising deferred tax assets arising from the carryforward of unused tax losses and tax credits are the same as the criteria for recognising deferred tax assets arising from deductible temporary differences. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an enterprise has a history of recent losses, the enterprise recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the enterprise has sufficient taxable temporary differences or 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 enterprise. In such circumstances, paragraph 82 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.

36. An enterprise considers the following criteria in assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised:

    (a) whether the enterprise 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 enterprise 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 (see paragraph 30) are available to the enterprise 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.

Re-assessment of Unrecognised Deferred Tax Assets

37. At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets. The enterprise recognises a previously unrecognised deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered. For example, an improvement in trading conditions may make it more probable that the enterprise will be able to generate sufficient taxable profit in the future for the deferred tax asset to meet the recognition criteria set out in paragraphs 24 or 34. Another example is when an enterprise re-assesses deferred tax assets at the date of a business combination or subsequently (see paragraphs 67 and 68).

Investments in Subsidiaries, Branches and Associates and Interests in Joint Ventures

38. Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures (namely the parent or investor's share of the net assets of the subsidiary, branch, associate or investee, including the carrying amount of goodwill) becomes different from the tax base (which is often cost) of the investment or interest. Such differences may arise in a number of different circumstances, for example:

    (a) the existence of undistributed profits of subsidiaries, branches, associates and joint ventures;

    (b) changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and

    (c) a reduction in the carrying amount of an investment in an associate to its recoverable amount.

    In consolidated financial statements, the temporary difference may be different from the temporary difference associated with that investment in the parent's separate financial statements if the parent carries the investment in its separate financial statements at cost or revalued amount.

39. An enterprise should recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied:

    (a) the parent, investor or venturer is able to control the timing of the reversal of the temporary difference; and

    (b) it is probable that the temporary difference will not reverse in the foreseeable future.

40. As a parent controls the dividend policy of its subsidiary, it is able to control the timing of the reversal of temporary differences associated with that investment (including the temporary differences arising not only from undistributed profits but also from any foreign exchange translation differences). Furthermore, it would often be impracticable to determine the amount of income taxes that would be payable when the temporary difference reverses. Therefore, when the parent has determined that those profits will not be distributed in the foreseeable future the parent does not recognise a deferred tax liability. The same considerations apply to investments in branches.

41. An enterprise accounts in its own currency for the non-monetary assets and liabilities of a foreign operation that is integral to the enterprise's operations. Where the foreign operation's taxable profit or tax loss (and, hence, the tax base of its non-monetary assets and liabilities) is determined in the foreign currency, changes in the exchange rate give rise to temporary differences. Because such temporary differences relate to the foreign operation's own assets and liabilities, rather than to the reporting enterprise's investment in that foreign operation, the reporting enterprise recognises the resulting deferred tax liability or (subject to paragraph 24) asset. The resulting deferred tax is charged or credited in the income statement (see paragraph 58).

42. An investor in an associate does not control that enterprise and is usually not in a position to determine its dividend policy. Therefore, in the absence of an agreement requiring that the profits of the associate will not be distributed in the foreseeable future, an investor recognises a deferred tax liability arising from taxable temporary differences associated with its investment in the associate. In some cases, an investor may not be able to determine the amount of tax that would be payable if it recovers the cost of its investment in an associate, but can determine that it will equal or exceed a minimum amount. In such cases, the deferred tax liability is measured at this amount.

43. The arrangement between the parties to a joint venture usually deals with the sharing of the profits and identifies whether decisions on such matters require the consent of all the venturers or a specified majority of the venturers. When the venturer can control the sharing of profits and it is probable that the profits will not be distributed in the foreseeable future, a deferred tax liability is not recognised.

44. An enterprise should recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint ventures, to the extent that, and only to the extent that, it is probable that:

(a) the temporary difference will reverse in the foreseeable future; and

(b) taxable profit will be available against which the temporary difference can be utilised.

45. In deciding whether a deferred tax asset is recognised for deductible temporary differences associated with its investments in subsidiaries, branches and associates, and its interests in joint ventures, an enterprise considers the guidance set out in paragraphs 28 to 31.

Measurement

46. Current tax liabilities (assets) for the current and prior periods should be 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.

47. Deferred tax assets and liabilities should 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 tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

48. 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).

49. When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using the average rates that are expected to apply to the taxable profit (tax loss) of the periods in which the temporary differences are expected to reverse.

50. [Not used]

51. The measurement of deferred tax liabilities and deferred tax assets should reflect the tax consequences that would follow from the manner in which the enterprise expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities.

52. In some jurisdictions, the manner in which an enterprise recovers (settles) the carrying amount of an asset (liability) may affect either or both of:

(a) the tax rate applicable when the enterprise recovers (settles) the carrying amount of the asset (liability); and

(b) the tax base of the asset (liability).

In such cases, an enterprise measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.

Example A

An asset has a carrying amount of $100 and a tax base of $60. A tax rate of 20% would apply if the asset were sold and a tax rate of 30% would apply to other income.

The enterprise recognises a deferred tax liability of $8 ($40 at 20%) if it expects to sell the asset without further use and a deferred tax liability of $12 ($40 at 30%) if it expects to retain the asset and recover its carrying amount through use.

Example B

An asset with a cost of $100 and a carrying amount of $80 is revalued to $150 (that is, an asset revaluation reserve is credited with an amount of $70) and has an expected residual value of zero. No equivalent or other adjustment is made for tax purposes. Cumulative depreciation for tax purposes is $30 and the tax rate is 30%. If the asset were to be sold for an amount greater than or equal to cost, the cumulative tax depreciation of $30 would be included in the taxable amount, but sales proceeds in excess of cost would not be taxable (the asset is not subject to capital gains tax).

Assuming the carrying amount of the asset will be recovered through use:

	Carrying Amount	Tax Base	Temporary Difference
	$	$	$
Cost	100	100	
Accumulated Depreciation	20	30	
Net Amount	80	70	
Revaluation	70	-	
Net Amount	150	70	80
Tax rate			30%
Deferred Tax Liability			24

If the enterprise's management expects to recover the carrying amount of the asset through use, it will generate an assessable amount of $150, but will only be able to deduct depreciation of $70. On this basis, there is a deferred tax liability of $24 (calculated as $80 x 30%).

Assuming the carrying amount of the asset will be recovered through sale, the tax base is:

Carrying amount	$150
Less taxable amount (recouped depreciation)	30
Add deductible amount	-
Tax Base	120

The deferred tax liability is therefore $150 - $120 = $30@ 30% = $9

(*Note: In accordance with paragraph 61, the additional deferred tax that arises on the revaluation is recognised as a debit to the asset revaluation reserve. Thus, if the carrying amount of the asset will be recovered through use, $21 [$24 less the opening balance of the deferred tax liability of $3] is recognised as a debit to the asset revaluation reserve. If the carrying amount of the asset will be recovered through sale, $6 [$9 less the opening balance of deferred tax liability of $3] is recognised as a debit to the asset revaluation reserve.*)

Example C

The facts are as in Example B, except that if the asset were to be sold for more than cost, the sales proceeds in excess of cost would be included in the taxable amount (taxed at 40% - the asset is subject to capital gains tax).

	Carrying Amount	Tax Base		Temporary Difference	
		Recovery Through Use	Recovery Through Sale	Recovery Through Use	Recovery Through Sale
	$	$	$	$	$
Cost	100	100	100		
Accumulated Depreciation	20	30	30		
Net Amount	80	70	70		
Revaluation	70	-	-		
Net Amount	150	70	70	80	80
Tax Rate				30%	30%/40% (see calculation below)
Deferred Tax Liability				24	29

If the enterprise's management expects to recover the carrying amount by using the asset, it will generate an taxable amount of $150, but will only be able to deduct depreciation of $70. On this basis, the tax base is $70, there is a taxable temporary difference of $80 and there is a deferred tax liability of $24 (calculated as $80 x 30%), as in Example B.

If the enterprise's management expects to recover the carrying amount by selling the asset immediately for proceeds of $150, the entity will be able to deduct the cost of $100. The net proceeds of $50 will be taxed at 40%. In addition, the cumulative tax depreciation of $30 will be included in the taxable amount and taxed at 30%. On this basis, the tax base is $70 (calculated as $100 - $30), there is a taxable temporary difference of $80 and there is a deferred tax liability of $29 (calculated as [$50 x 40%] + [$30 x 30%]).

If the tax base is not immediately apparent in this example, it may be helpful to consider the fundamental principle set out in paragraph 10.

(Note: In accordance with paragraph 61, the additional deferred tax that arises on the revaluation is recognised as a debit to the asset revaluation reserve. Thus, if the carrying amount of the asset will be recovered through use, $21 [$24 less the opening balance of deferred tax liability of $3] is recognised as a debit to the asset revaluation reserve. If the carrying amount of the asset will be recovered through sale, $26 [$29 less the opening balance of deferred tax liability of $3] is recognised as a debit to the asset revaluation reserve.)

52A. In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the enterprise. In some other jurisdictions, income taxes may be refundable or payable if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the enterprise. In these circumstances, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits.

52B. In the circumstances described in paragraph 52A, the income tax consequences of dividends are recognised when a liability to pay the dividend is recognised. The income tax consequences of dividends are more directly linked to past transactions or events than to distributions to owners. Therefore, the income tax consequences of dividends are recognised in net profit or loss for the period as required by paragraph 58 except to the extent that the income tax consequences of dividends arise from the circumstances described in paragraph 58(a) and (b).

Example Illustrating Paragraphs 52A and 52B

The following example deals with the measurement of current and deferred tax assets and liabilities for an enterprise in a jurisdiction where income taxes are payable at a higher rate on undistributed profits (50%) with an amount being refundable when profits are distributed. The tax rate on distributed profits is 35%. At the balance sheet date, 31 December 20X1, the enterprise does not recognise a liability for dividends proposed or declared after the balance sheet date. As a result, no dividends are recognised in the year 20X1. Taxable income for 20X1 is $100,000. The net taxable temporary difference for the year 20X1 is $40,000.

The enterprise recognises a current tax liability and a current income tax expense of $50,000 ($100,000 at 50%). No asset is recognised for the amount potentially recoverable as a result of future dividends. The enterprise also recognises a deferred tax liability and deferred tax expense of $20,000 ($40,000 at 50%) representing the income taxes that the enterprise will pay when it recovers or settles the carrying amounts of its assets and liabilities based on the tax rate applicable to undistributed profits.

Subsequently, on 15 March 20X2 the enterprise recognises dividends of $10,000 from previous operating profits as a liability.

On 15 March 20X2, the enterprise recognises the recovery of income taxes of $1,500 (15% of the dividends recognised as a liability) as a current tax asset and as a reduction of current income tax expense for 20X2.

53. Deferred tax assets and liabilities should not be discounted.

54. The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each temporary difference. In many cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between enterprises. Therefore, this Statement does not require or permit the discounting of deferred tax assets and liabilities.

55. Temporary differences are determined by reference to the carrying amount of an asset or liability. This applies even where that carrying amount is itself determined on a discounted basis, for example in the case of retirement benefit obligations (see SSAP 34, Employee Benefits).

56. The carrying amount of a deferred tax asset should be reviewed at each balance sheet date. An enterprise should reduce the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilised. Any such reduction should be reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Recognition of Current and Deferred Tax

57. Accounting for the current and deferred tax effects of a transaction or other event is consistent with the accounting for the transaction or event itself. Paragraphs 58 to 68 implement this principle.

Income Statement

58. Current and deferred tax should be recognised as income or an expense and included in the net profit or loss for the period, except to the extent that the tax arises from:

- ***(a) a transaction or event which is recognised, in the same or a different period, directly in equity (see paragraphs 61 to 65); or***
- ***(b) a business combination that is an acquisition (see paragraphs 66 to 68).***

59. Most deferred tax liabilities and deferred tax assets arise where income or expense is included in accounting profit in one period, but is included in taxable profit (tax loss) in a different period. The resulting deferred tax is recognised in the income statement. Examples are when:

- (a) interest, royalty or dividend revenue is received in arrears and is included in accounting profit on a time apportionment basis in accordance with SSAP 18, Revenue, but is included in taxable profit (tax loss) on a cash basis; and
- (b) costs of intangible assets have been capitalised in accordance with SSAP 29, Intangible Assets, and are being amortised in the income statement, but were deducted for tax purposes when they were incurred.

60. The carrying amount of deferred tax assets and liabilities may change even though there is no change in the amount of the related temporary differences. This can result, for example, from:

- (a) a change in tax rates or tax laws;
- (b) a re-assessment of the recoverability of deferred tax assets; or
- (c) a change in the expected manner of recovery of an asset.

The resulting deferred tax is recognised in the income statement, except to the extent that it relates to items previously charged or credited to equity (see paragraph 63).

Items Credited or Charged Directly to Equity

61. Current tax and deferred tax should be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.

62. Statements of Standard Accounting Practice require or permit certain items to be credited or charged directly to equity. Examples of such items are:

- (a) a change in carrying amount arising from the revaluation of property, plant and equipment (see SSAP 17, Property, Plant and Equipment);
- (b) an adjustment to the opening balance of retained earnings resulting from either a change in accounting policy or the correction of a fundamental error (see SSAP 2, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies); and
- (c) exchange differences arising on the translation of the financial statements of a foreign entity (see SSAP 11, Foreign Currency Translation).

63. In exceptional circumstances it may be difficult to determine the amount of current and deferred tax that relates to items credited or charged to equity. This may be the case, for example, when:

(a) there are graduated rates of income tax and it is impossible to determine the rate at which a specific component of taxable profit (tax loss) has been taxed;

(b) a change in the tax rate or other tax rules affects a deferred tax asset or liability relating (in whole or in part) to an item that was previously charged or credited to equity; or

(c) an enterprise determines that a deferred tax asset should be recognised, or should no longer be recognised in full, and the deferred tax asset relates (in whole or in part) to an item that was previously charged or credited to equity.

In such cases, the current and deferred tax related to items that are credited or charged to equity is based on a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction concerned, or other method that achieves a more appropriate allocation in the circumstances.

64. SSAP 17, Property, Plant and Equipment, does not specify whether an enterprise should transfer each year from revaluation surplus to retained earnings an amount equal to the difference between the depreciation or amortisation on a revalued asset and the depreciation or amortisation based on the cost of that asset. If an enterprise makes such a transfer, the amount transferred is net of any related deferred tax. Similar considerations apply to transfers made on disposal of an item of property, plant or equipment.

65. When an asset is revalued for tax purposes and that revaluation is related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects of both the asset revaluation and the adjustment of the tax base are credited or charged to equity in the periods in which they occur. However, if the revaluation for tax purposes is not related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects of the adjustment of the tax base are recognised in the income statement.

65A. When an enterprise pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. In many jurisdictions, this amount is referred to as a withholding tax. Such an amount paid or payable to taxation authorities is charged to equity as a part of the dividends.

Deferred Tax Arising from a Business Combination

66. As explained in paragraphs 19 and 26(c), temporary differences may arise in a business combination that is an acquisition. In accordance with SSAP 30, Business Combinations, an enterprise recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 24) or deferred tax liabilities as identifiable assets and liabilities at the date of the acquisition. Consequently, those deferred tax assets and liabilities affect goodwill or negative goodwill. However, in accordance with paragraphs 15(a) and 24(a), an enterprise does not recognise deferred tax liabilities arising from goodwill itself (if amortisation of the goodwill is not deductible for tax purposes) and deferred tax assets arising from non-taxable negative goodwill which is treated as deferred income.

67. As a result of a business combination, an acquirer may consider it probable that it will recover its own deferred tax asset that was not recognised prior to the business combination. For example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree. In such cases, the acquirer recognises a deferred tax asset and takes this into account in determining the goodwill or negative goodwill arising on the acquisition.

68. When an acquirer did not recognise a deferred tax asset of the acquiree as an identifiable asset at the date of a business combination and that deferred tax asset is subsequently recognised in the acquirer's consolidated financial statements, the resulting deferred tax income is recognised in the income statement. In addition, the acquirer:

(a) adjusts the gross carrying amount of the goodwill and the related accumulated amortisation to the amounts that would have been recorded if the deferred tax asset had been recognised as an identifiable asset at the date of the business combination; and

(b) recognises the reduction in the net carrying amount of the goodwill as an expense.

However, the acquirer does not recognise negative goodwill, nor does it increase the carrying amount of negative goodwill.

Example illustrating the application of paragraph 68

An enterprise acquired a subsidiary which had deductible temporary differences of $300. The tax rate at the time of the business combination was 30%. The resulting deferred tax asset of $90 was not recognised as an identifiable asset in measuring the goodwill of $500 resulting from the acquisition, because it was assessed as not meeting the "probable" recognition criterion at the date of acquisition. The goodwill is amortised over 20 years. Two years after the acquisition, the enterprise assessed that future taxable amounts would probably be sufficient for the enterprise to recover the benefit of all the deductible temporary differences.

The enterprise recognises a deferred tax asset of $90 (calculated as $300 x 30%) and, in net profit or loss, deferred tax revenue of $90. It also reduces the cost of the goodwill by $90 and the accumulated amortisation by $9 (representing 2 years' amortisation). The net adjustment of $81 to the amortised cost of the goodwill is recognised as an expense in net profit or loss. Consequently, the cost of the goodwill, and the related accumulated amortisation, are reduced to the amounts ($410 and $41) that would have been recorded if a deferred tax asset of $90 had been recognised as an identifiable asset at the date of the acquisition.

If the tax rate has increased to 40%, the enterprise recognises a deferred tax asset of $120 (calculated as $300 x 40%) and, in net profit or loss, deferred tax revenue of $120. If the tax rate has decreased to 20%, the enterprise recognises a deferred tax asset of $60 (calculated as $300 x 20%) and deferred tax revenue of $60. In both cases, the enterprise also reduces the cost of the goodwill by $90 and the accumulated amortisation by $9 and recognises the net adjustment of $81 as an expense in net profit or loss based on the 30% tax rate at the time of business combination.

Presentation

Tax Assets and Tax Liabilities

69. Tax assets and tax liabilities should be presented separately from other assets and liabilities in the balance sheet. Deferred tax assets and liabilities should be distinguished from current tax assets and liabilities.

70. When an enterprise makes a distinction between current and non-current assets and liabilities in its financial statements, it should not classify deferred tax assets (liabilities) as current assets (liabilities).

Offset

71. An enterprise should offset current tax assets and current tax liabilities if, and only if, the enterprise:

(a) has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

72. Although current tax assets and liabilities are separately recognised and measured, they are offset in the balance sheet when an enterprise has a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income taxes levied by the same taxation authority and the taxation authority permits the enterprise to make or receive a single net payment.

73. In consolidated financial statements, a current tax asset of one enterprise in a group is offset against a current tax liability of another enterprise in the group if, and only if, the enterprises concerned have a legally enforceable right to make or receive a single net payment and the enterprises intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously.

74. An enterprise should offset deferred tax assets and deferred tax liabilities if, and only if:

(a) the enterprise has a legally enforceable right to set off current tax assets against current tax liabilities; and

(b) the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:

(i) the same taxable entity; or

(ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

75. To avoid the need for detailed scheduling of the timing of the reversal of each temporary difference, this Statement requires an enterprise to set off a deferred tax asset against a deferred tax liability of the same taxable entity if, and only if, they relate to income taxes levied by the same taxation authority and the enterprise has a legally enforceable right to set off current tax assets against current tax liabilities.

76. In rare circumstances, an enterprise may have a legally enforceable right of set-off, and an intention to settle net, for some periods but not for others. In such rare circumstances, detailed scheduling may be required to establish reliably whether the deferred tax liability of one taxable entity will result in increased tax payments in the same period in which a deferred tax asset of another taxable entity will result in decreased payments by that second taxable entity.

Tax Expense

Tax Expense (Income) related to Profit or Loss from Ordinary Activities

77. The tax expense (income) related to profit or loss from ordinary activities should be presented on the face of the income statement.

Exchange Differences on Deferred Foreign Tax Liabilities or Assets

78. SSAP 11, Foreign Currency Translation, requires certain exchange differences to be recognised as income or expense but does not specify where such differences should be presented in the income statement. Accordingly, where exchange differences on deferred foreign tax liabilities or assets are recognised in the income statement, such differences may be classified as deferred tax expense (income) if that presentation is considered to be the most useful to financial statement users.

Disclosure

79. The major components of tax expense (income) should be disclosed separately.

80. 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 current tax expense;

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

    (g) deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 56.

81. The following should also be disclosed separately:

(a) the aggregate current and deferred tax relating to items that are charged or credited to equity;

(b) tax expense (income) relating to extraordinary items recognised during the period;

(c) an explanation of the relationship between tax expense (income) and accounting profit in either or both of the following forms:

(i) a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed; or

(ii) 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;

(d) ***an explanation of changes in the applicable tax rate(s) compared to the previous accounting period;***

(e) ***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 balance sheet;***

(f) ***the aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, for which deferred tax liabilities have not been recognised (see paragraph 39);***

(g) ***in respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:***

(i) ***the amount of the deferred tax assets and liabilities recognised in the balance sheet for each period presented;***

(ii) ***the amount of the deferred tax income or expense recognised in the income statement, if this is not apparent from the changes in the amounts recognised in the balance sheet; and***

(h) ***in respect of discontinued operations, the tax expense relating to:***

(i) ***the gain or loss on discontinuance; and***

(ii) ***the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented; and***

(i) ***the amount of income tax consequences of dividends to shareholders of the enterprise that were proposed or declared before the financial statements were authorised for issue, but are not recognised as a liability in the financial statements.***

82. ***An enterprise should disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:***

(a) ***the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and***

(b) ***the enterprise has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.***

82A. ***In the circumstances described in paragraph 52A, an enterprise should disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. In addition, the enterprise should disclose the amounts of the potential income tax consequences practicably determinable and whether there are any potential income tax consequences not practicably determinable.***

83. An enterprise discloses the nature and amount of each extraordinary item either on the face of the income statement or in the notes to the financial statements. When this disclosure is made in the notes to the financial statements, the total amount of all extraordinary items is disclosed on the face of the income statement, net of the aggregate related tax expense (income). Although financial statement users may find the disclosure of the tax expense (income) related to each extraordinary item useful, it is sometimes difficult to allocate tax expense (income) between such items. Under these circumstances tax expense (income) relating to extraordinary items may be disclosed in the aggregate.

84. The disclosures required by paragraph 81(c) enable users of financial statements to understand whether the relationship between tax expense (income) and accounting profit is unusual and to understand the significant factors that could affect that relationship in the future. The relationship between tax expense (income) and accounting profit may be affected by such factors as revenue that is exempt from taxation, expenses that are not deductible in determining taxable profit (tax loss), the effect of tax losses and the effect of foreign tax rates.

85. In explaining the relationship between tax expense (income) and accounting profit, an enterprise uses an applicable tax rate that provides the most meaningful information to the users of its financial statements. Often, the most meaningful rate is the domestic rate of tax in the country in which the enterprise is domiciled, aggregating the tax rate applied for national taxes with the rates applied for any local taxes which are computed on a substantially similar level of taxable profit (tax loss). However, for an enterprise operating in several jurisdictions, it may be more meaningful to aggregate separate reconciliations prepared using the domestic rate in each individual jurisdiction. The following example illustrates how the selection of the applicable tax rate affects the presentation of the numerical reconciliation.

Whilst in most cases, the applicable rate of tax that provides the most meaningful information to users will be the domestic rate of tax in the country in which the enterprise is domiciled, there will be exceptions. For example, it is common in Hong Kong for groups to have a parent enterprise domiciled in Bermuda with operating subsidiaries in Hong Kong. In these circumstances, the most meaningful rate of tax will be Hong Kong tax where the majority of the operations are carried out.

Example Illustrating Paragraph 85

In 20X2, an enterprise has accounting profit in its own jurisdiction (country A) of $1,500 (20X1: $2,000) and in country B of $1,500 (20X1: $500). The tax rate is 30% in country A and 20% in country B. In country A, expenses of $100 (20X1: $200) are not deductible for tax purposes.

The following is an example of a reconciliation to the domestic tax rate.

	20X1	*20X2*
	$	*$*
Accounting profit	*2,500*	*3,000*
Tax at the domestic rate of 30%	*750*	*900*
Tax effect of expenses that are not deductible for tax purposes	*60*	*30*
Effect of lower tax rates in country B	*(50)*	*(150)*
Tax expense	*760*	*780*

The following is an example of a reconciliation prepared by aggregating separate reconciliations for each national jurisdiction. Under this method, the effect of differences between the reporting enterprise's own domestic tax rate and the domestic tax rate in other jurisdictions does not appear as a separate item in the reconciliation. An enterprise may need to discuss the effect of significant changes in either tax rates, or the mix of profits earned in different jurisdictions, in order to explain changes in the applicable tax rate(s), as required by paragraph 81(d).

	$	*$*
Accounting profit	*2,500*	*3,000*
Tax at the domestic rates applicable to profits in the country concerned	*700*	*750*
Tax effect of expenses that are not deductible for tax purposes	*60*	*30*
Tax expense	*760*	*780*

86. The average effective tax rate is the tax expense (income) divided by the accounting profit.

87. It would often be impracticable to compute the amount of unrecognised deferred tax liabilities arising from investments in subsidiaries, branches and associates and interests in joint ventures (see paragraph 39). Therefore, this Statement requires an enterprise to disclose the aggregate amount of the underlying temporary differences but does not require disclosure of the deferred tax liabilities. Nevertheless, where practicable, enterprises are encouraged to disclose the amounts of the unrecognised deferred tax liabilities because financial statement users may find such information useful.

87A. Paragraph 82A requires an enterprise to disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. An enterprise discloses the important features of the income tax systems and the factors that will affect the amount of the potential income tax consequences of dividends.

87B. It would sometimes not be practicable to compute the total amount of the potential income tax consequences that would result from the payment of dividends to shareholders. This may be the case, for example, where an enterprise has a large number of foreign subsidiaries. However, even in such circumstances, some portions of the total amount may be easily determinable. For example, in a consolidated group, a parent and some of its subsidiaries may have paid income taxes at a higher rate on undistributed profits and be aware of the amount that would be refunded on the payment of future dividends to shareholders from consolidated retained earnings. In this case, that refundable amount is disclosed. If applicable, the enterprise also discloses that there are additional potential income tax consequences not practicably determinable. In the parent's separate financial statements, if any, the disclosure of the potential income tax consequences relates to the parent's retained earnings.

87C. An enterprise required to provide the disclosures in paragraph 82A may also be required to provide disclosures related to temporary differences associated with investments in subsidiaries, branches and associates or interests in joint ventures. In such cases, an enterprise considers this in determining the information to be disclosed under paragraph 82A. For example, an enterprise may be required to disclose the aggregate amount of temporary differences associated with investments in subsidiaries for which no deferred tax liabilities have been recognised (see paragraph 81(f)). If it is impracticable to compute the amounts of unrecognised deferred tax liabilities (see paragraph 87) there may be amounts of potential income tax consequences of dividends not practicably determinable related to these subsidiaries.

88. An enterprise discloses any tax-related contingent liabilities and contingent assets in accordance with SSAP 28, Provisions, Contingent Liabilities and Contingent Assets. Contingent liabilities and contingent assets may arise, for example, from unresolved disputes with the taxation authorities. Similarly, where changes in tax rates or tax laws are enacted or announced after the balance sheet date, an enterprise discloses any significant effect of those changes on its current and deferred tax assets and liabilities (see SSAP 9, Events After the Balance Sheet Date).

Effective Date

89. The accounting practices set out in this Statement should be regarded as standard in respect of financial statements relating to periods beginning on or after 1 January 2003. Earlier adoption is encouraged but not required. If an enterprise applies this Statement for periods beginning before 1 January 2003, it should disclose that fact.

90. This Statement supersedes SSAP 12 "Accounting for deferred tax".

Notes on Legal Requirements in Hong Kong

91. The references to "the Schedule" below are to the Tenth Schedule to the Companies Ordinance.

92. Paragraph 8 of the Schedule requires that if an amount is set aside for the purpose of its being used to prevent undue fluctuations in charges for taxation, it shall be stated. If such amount has been used during the financial year for another purpose, the amount thereof and the fact that it has been so used shall be stated (paragraph 12(12) of the Schedule).

93. Paragraph 12(15) of the Schedule requires disclosure of the basis on which the amount, if any, set aside for Hong Kong profits tax is computed.

94. Paragraph 13(1)(c) of the Schedule requires disclosure of the amount of the charge to revenue for taxes imposed by the Inland Revenue Ordinance and, if that amount would have been greater but for relief from double taxation, the amount which it would have been but for such relief, and the amount of the charge for taxation imposed outside Hong Kong of profits, income and (so far as charged to revenue) capital gains.

95. The basis on which the charge for Hong Kong profit tax is computed shall be stated (paragraph 17(3) of the Schedule). Particulars are required of any special circumstances affecting the tax liability for the financial year or succeeding financial years (paragraph 17(4) of the Schedule).

96. The requirements of paragraphs 92, 94 and 95 do not apply to licensed banks to the extent that these companies take advantage of the disclosure exemptions permitted under Part III of the Schedule.

Acknowledgement

The Hong Kong Society of Accountants is indebted to the Australian Accounting Research Foundation for granting permission to use material from its Standard AASB 1020 "Income taxes" as some of the explanatory guidance and illustrative examples in this Statement.

Appendix A

Examples of Temporary Differences

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

A. EXAMPLES OF CIRCUMSTANCES THAT GIVE RISE TO TAXABLE TEMPORARY DIFFERENCES

All taxable temporary differences give rise to a deferred tax liability.

Transactions that affect the income statement

1. Interest revenue is received in arrears and is included in accounting profit on a time apportionment basis but is included in taxable profit on a cash basis.
2. Revenue from the sale of goods is included in accounting profit when goods are delivered but is included in taxable profit when cash is collected. (*note: as explained in B3 below, there is also a deductible temporary difference associated with any related inventory*).
3. Depreciation of an asset is accelerated for tax purposes.
4. Development costs have been capitalised and will be amortised to the income statement but were deducted in determining taxable profit in the period in which they were incurred.
5. Prepaid expenses have already been deducted on a cash basis in determining the taxable profit of the current or previous periods.

Transactions that affect the balance sheet

6. Depreciation of an asset is not deductible for tax purposes and no deduction will be available for tax purposes when the asset is sold or scrapped. (*note: paragraph 15(b) of the Statement prohibits recognition of the resulting deferred tax liability unless the asset was acquired in a business combination, see also paragraph 22 of the Statement*).
7. A borrower records a loan at the proceeds received (which equal the amount due at maturity), less transaction costs. Subsequently, the carrying amount of the loan is increased by amortisation of the transaction costs to accounting profit. The transaction costs were deducted for tax purposes in the period when the loan was first recognised. (*notes: (1) the taxable temporary difference is the amount of transaction costs already deducted in determining the taxable profit of current or prior periods, less the cumulative amount amortised to accounting profit; and (2) as the initial recognition of the loan affects taxable profit, the exception in paragraph 15(b) of the Statement does not apply. Therefore, the borrower recognises the deferred tax liability*).
8. A loan payable was measured on initial recognition at the amount of the net proceeds, net of transaction costs. The transaction costs are amortised to accounting profit over the life of the loan. Those transaction costs are not deductible in determining the taxable profit of future, current or prior periods. (*notes: (1) the taxable temporary difference is the amount of unamortised transaction costs; and (2) paragraph 15(b) of the Statement prohibits recognition of the resulting deferred tax liability*)
9. [Not used]

Fair value adjustments and revaluations

10. Financial assets or investment property are carried at fair value which exceeds cost but no equivalent adjustment is made for tax purposes.

11. An enterprise revalues property, plant and equipment (under SSAP 17, Property, Plant and Equipment) but no equivalent adjustment is made for tax purposes. (*note: paragraph 61 of the Statement requires the related deferred tax to be charged directly to equity*).

Business combinations and consolidation

12. The carrying amount of an asset is increased to fair value in a business combination that is an acquisition and no equivalent adjustment is made for tax purposes. (*note: on initial recognition, the resulting deferred tax liability increases goodwill or decreases negative goodwill, see paragraph 66 of the Statement*).

13. Amortisation of goodwill is not deductible in determining taxable profit and the cost of the goodwill would not be deductible on disposal of the business (*note: paragraph 15(a) of the Statement prohibits recognition of the resulting deferred tax liability*).

14. Unrealised losses resulting from intragroup transactions are eliminated by inclusion in the carrying amount of inventory or property, plant and equipment.

15. Retained earnings of subsidiaries, branches, associates and joint ventures are included in consolidated retained earnings, but income taxes will be payable if the profits are distributed to the reporting parent. (*note: paragraph 39 of the Statement prohibits recognition of the resulting deferred tax liability if the parent, investor or venturer is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future*).

16. Investments in foreign subsidiaries, branches or associates or interests in foreign joint ventures are affected by changes in foreign exchange rates. (*notes: (1) there may be either a taxable temporary difference or a deductible temporary difference; and (2) paragraph 39 of the Statement prohibits recognition of the resulting deferred tax liability if the parent, investor or venturer is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future*).

17. An enterprise accounts in its own currency for the cost of the non-monetary assets of a foreign operation that is integral to the reporting enterprise's operations but the taxable profit or tax loss of the foreign operation is determined in the foreign currency. (*notes: (1) there may be either a taxable temporary difference or a deductible temporary difference; (2) where there is a taxable temporary difference, the resulting deferred tax liability is recognised, because it relates to the foreign operation's own assets and liabilities, rather than to the reporting enterprise's investment in that foreign operation (paragraph 41 of the Statement); and (3) the deferred tax is charged in the income statement, see paragraph 58 of the Statement*).

18. [Not used]

B. EXAMPLES OF CIRCUMSTANCES THAT GIVE RISE TO DEDUCTIBLE TEMPORARY DIFFERENCES

All deductible temporary differences give rise to a deferred tax asset. However, some deferred tax assets may not satisfy the recognition criteria in paragraph 24 of the Statement.

Transactions that affect the Income Statement

1. Retirement benefit costs are deducted in determining accounting profit as service is provided by the employee, but are not deducted in determining taxable profit until the enterprise pays either retirement benefits or contributions to a fund. (*note: similar deductible temporary differences arise where other expenses, such as product warranty costs or interest, are deductible on a cash basis in determining taxable profit*).

2. Accumulated depreciation of an asset in the financial statements is greater than the cumulative depreciation allowed up to the balance sheet date for tax purposes.

3. The cost of inventories sold before the balance sheet date is deducted in determining accounting profit when goods or services are delivered but is deducted in determining taxable profit when cash is collected. (*note: as explained in A2 above, there is also a taxable temporary difference associated with the related trade receivable*).

4. The net realisable value of an item of inventory, or the recoverable amount of an item of property, plant or equipment, is less than the previous carrying amount and an enterprise therefore reduces the carrying amount of the asset, but that reduction is ignored for tax purposes until the asset is sold.

5. Research costs (or organisation or other start up costs) are recognised as an expense in determining accounting profit but are not permitted as a deduction in determining taxable profit until a later period.

6. Income is deferred in the balance sheet but has already been included in taxable profit in current or prior periods.

7. A government grant which is included in the balance sheet as deferred income will not be taxable in future periods. (*note: paragraph 24 of the Statement prohibits the recognition of the resulting deferred tax asset, see also paragraph 33 of the Statement*).

Fair value adjustments and revaluations

8. Financial assets or investment property are carried at fair value which is less than cost, but no equivalent adjustment is made for tax purposes.

Business combinations and consolidation

9. A liability is recognised at its fair value in a business combination that is an acquisition, but none of the related expense is deducted in determining taxable profit until a later period. (*note: the resulting deferred tax asset decreases goodwill or increases negative goodwill, see paragraph 66 of the Statement*).

10. Negative goodwill is included in the balance sheet as deferred income and the income will not be included in the determination of taxable profit. (*note: paragraph 24 of the Statement prohibits recognition of the resulting deferred tax asset*).

11. Unrealised profits resulting from intragroup transactions are eliminated from the carrying amount of assets, such as inventory or property, plant or equipment, but no equivalent adjustment is made for tax purposes.

12. Investments in foreign subsidiaries, branches or associates or interests in foreign joint ventures are affected by changes in foreign exchange rates. (*notes: (1) there may be a taxable temporary difference or a deductible temporary difference; and (2) paragraph 44 of the Statement requires recognition of the resulting deferred tax asset to the extent, and only to the extent, that it is probable that: (a) the temporary difference will reverse in the foreseeable future; and (b) taxable profit will be available against which the temporary difference can be utilised*).

13. An enterprise accounts in its own currency for the cost of the non-monetary assets of a foreign operation that is integral to the reporting enterprise's operations but the taxable profit or tax loss of the foreign operation is determined in the foreign currency. (*notes: (1) there may be either a taxable temporary difference or a deductible temporary difference; (2) where there is a deductible temporary difference, the resulting deferred tax asset is recognised to the extent that it is probable that sufficient taxable profit will be available, because the deferred tax asset relates to the foreign operation's own assets and liabilities, rather than to the reporting enterprise's investment in that foreign operation (paragraph 41 of the Statement); and (3) the deferred tax is recognised in the income statement, see paragraph 58 of the Statement*).

C. EXAMPLES OF CIRCUMSTANCES WHERE THE CARRYING AMOUNT OF AN ASSET OR LIABILITY IS EQUAL TO ITS TAX BASE

1. Accrued expenses have already been deducted in determining an enterprise's current tax liability for the current or earlier periods.

2. A loan payable is measured at the amount originally received and this amount is the same as the amount repayable on final maturity of the loan.

3. Accrued expenses will never be deductible for tax purposes.

4. Accrued income will never be taxable.

Appendix B

Illustrative Computations and Presentation

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning. Extracts from income statements and balance sheets are provided to show the effects on these financial statements of the transactions described below. These extracts do not necessarily conform with all the disclosure and presentation requirements of other Statements of Standard Accounting Practice.

All the examples in this appendix assume that the enterprises concerned have no transaction other than those described.

Example 1 - Depreciable Assets

An enterprise buys equipment for $10,000 and depreciates it on a straight line basis over its expected useful life of five years. For tax purposes, the equipment is depreciated at 25% per annum on a straight line basis. Tax losses may be carried back against taxable profit of the previous five years. In year 0, the enterprise's taxable profit was $5,000. The tax rate is 40%.

The enterprise will recover the carrying amount of the equipment by using it to manufacture goods for resale. Therefore, the enterprise's current tax computation is as follows:

	Year				
	1	*2*	*3*	*4*	*5*
	$	$	$	$	$
Taxable income	2,000	2,000	2,000	2,000	2,000
Depreciation for tax purposes	2,500	2,500	2,500	2,500	0
Taxable profit (tax loss)	(500)	(500)	(500)	(500)	2,000
Current tax expense (income) at 40%	(200)	(200)	(200)	(200)	800

The enterprise recognises a current tax asset at the end of years 1 to 4 because it recovers the benefit of the tax loss against the taxable profit of year 0.

The temporary differences associated with the equipment and the resulting deferred tax asset and liability and deferred tax expense and income are as follows:

	Year 1	*2*	*3*	*4*	*5*
	$	$	$	$	$
Carrying Amount	8,000	6,000	4,000	2,000	0
Tax base	7,500	5,000	2,500	0	0
Taxable temporary difference	500	1,000	1,500	2,000	0
Opening deferred tax liability	0	200	400	600	800
Deferred tax expense (income)	200	200	200	200	(800)
Closing deferred tax liability	200	400	600	800	0

The enterprise recognises the deferred tax liability in years 1 to 4 because the reversal of the taxable temporary difference will create taxable income in subsequent years. The enterprise's income statement is as follows:

	Year 1	*2*	*3*	*4*	*5*
	$	$	$	$	$
Income	2,000	2,000	2,000	2,000	2,000
Depreciation	2,000	2,000	2,000	2,000	2,000
Profit before tax	0	0	0	0	0
Current tax expense (income)	(200)	(200)	(200)	(200)	800
Deferred tax expense (income)	200	200	200	200	(800)
Total tax expense (income)	0	0	0	0	0
Net profit for the period	0	0	0	0	0

Example 2 - Deferred Tax Assets and Liabilities

The example deals with an enterprise over the two year period, X5 and X6. In X5 the enacted income tax rate was 40% of taxable profit. In X6 the enacted income tax rate was 35% of taxable profit.

Charitable donations are recognised as an expense when they are paid and are not deductible for tax purposes.

In X5, the enterprise was notified by the relevant authorities that they intend to pursue an action against the enterprise with respect to sulphur emissions. Although as at December X6 the action had not yet come to court the enterprise recognised a liability of $700 in X5 being its best estimate of the fine arising from the action. Fines are not deductible for tax purposes.

In X2, the enterprise incurred $1,250 of costs in relation to the development of a new product. These costs were deducted for tax purposes in X2. For accounting purposes, the enterprise capitalised this expenditure and amortised it on the straight line basis over five years. At 31/12/X4, the unamortised balance of these product development costs was $500.

In X5, the enterprise entered into an agreement with its existing employees to provide health care benefits to retirees. The enterprise recognises as an expense the cost of this plan as employees provide service. No payments to retirees were made for such benefits in X5 or X6. Health care costs are deductible for tax purposes when payments are made to retirees. The enterprise has determined that it is probable that taxable profit will be available against which any resulting deferred tax asset can be utilised.

Buildings are depreciated for accounting purposes at 5% a year on a straight line basis and at 10% a year on a straight line basis for tax purposes. Motor vehicles are depreciated for accounting purposes at 20% a year on a straight line basis and at 25% a year on a straight line basis for tax purposes. A full year's depreciation is charged for accounting purposes in the year that an asset is acquired.

At 1/1/X6, the building was revalued to $65,000 and the enterprise estimated that the remaining useful life of the building was 20 years from the date of the revaluation. The revaluation did not affect taxable profit in X6 and the taxation authorities did not adjust the tax base of the building to reflect the revaluation. In X6, the enterprise transferred $1,033 from revaluation reserve to retained earnings. This represents the difference of $1,590 between the actual depreciation on the building ($3,250) and equivalent depreciation based on the cost of the building ($1,660, which is the book value at 1/1/X6 of $33,200 divided by the remaining useful life of 20 years), less the related deferred tax of $557 (see paragraph 64 of the Statement).

Current Tax Expense

	X5	*X6*
	$	$
Accounting profit	8,775	8,740
Add		
Depreciation for accounting purposes	4,800	8,250
Charitable donations	500	350
Fine for environmental pollution	700	-
Product development costs	250	250

Provision for health care benefits	2,000	1,000
	17,025	18,590
Deduct		
Depreciation for tax purposes	(8,100)	(11,850)
Taxable Profit	8,925	6,740
Current tax expense at 40%	3,570	
Current tax expense at 35%		2,359

Carrying Amounts of Property, Plant and Equipment

	Building	*Motor Vehicles*	*Total*
	$	*$*	*$*
Cost			
Balance at 31/12/X4	50,000	10,000	60,000
Additions X5	6,000	-	6,000
Balance at 31/12/X5	56,000	10,000	66,000
Elimination of accumulated depreciation on revaluation at 1/1/X6	(22,800)	-	(22,800)
Revaluation at 1/1/X6	31,800	-	31,800
Balance at 1/1/X6	65,500	10,000	75,000
Additions X6	-	15,000	15,000
Balance at 31/12/X6	65,000	25,000	90,000
Accumulated Depreciation	5%	20%	
Balance at 31/12/X4	20,000	4,000	24,000
Depreciation X5	2,800	2,000	4,800
Balance at 31/12/X5	22,800	6,000	28,800
Revaluation at 1/1/X6	(22,800)	-	(22,800)
Balance at 1/1/X6	-	6,000	6,000

Depreciation X6	3,250	5,000	8,250
Balance at 31/12/X6	3,250	11,000	14,250
Carrying Amount			
31/12/X4	30,000	6,000	36,000
31/12/X5	33,200	4,000	37,200
31/12/X6	61,750	14,000	75,750

Tax Base of Property, Plant and Equipment

	Building	*Motor Vehicles*	*Total*
	$	*$*	*$*
Cost			
Balance at 31/12/X4	50,000	10,000	60,000
Additions X5	6,000	-	6,000
Balance at 31/12/X5	56,000	10,000	66,000
Additions X6	-	15,000	15,000
Balance at 31/12/X6	56,000	25,000	81,000
Accumulated Depreciation	10%	25%	
Balance at 31/12/X4	40,000	5,000	45,000
Depreciation X5	5,600	2,500	8,100
Balance at 31/12/X5	45,600	7,500	53,100
Depreciation X6	5,600	6,250	11,850
Balance 31/12/X6	51,200	13,750	64,950
Tax Base			
31/12/X4	10,000	5,000	15,000
31/12/X5	10,400	2,500	12,900
31/12/X6	4,800	11,250	16,050

Deferred Tax Assets, Liabilities and Expense at 31/12/X4

	Carrying Amount	*Tax Base*	*Temporary Differences*
	$	$	$
Accounts receivable	500	500	-
Inventory	2,000	2,000	-
Product development costs	500	-	500
Investments	33,000	33,000	-
Property, plant & equipment	36,000	15,000	21,000
TOTAL ASSETS	72,000	50,500	21,500
Current income taxes payable	3,000	3,000	-
Accounts payable	500	500	-
Fines payable	-	-	-
Liability for health care benefits	-	-	-
Long term debt	20,000	20,000	-
Deferred income taxes	8,600	8,600	-
TOTAL LIABILITIES	32,100	32,100	
Share capital	5,000	5,000	-
Revaluation surplus	-	-	-
Retained earnings	34,900	13,400	
TOTAL LIABILITIES / EQUITY	72,000	50,500	
TEMPORARY DIFFERENCES			21,500
Deferred tax liability	21,500 at 40%		8,600
Deferred tax asset	-		-
Net deferred tax liability			8,600

Deferred Tax Assets, Liabilities and Expense at 31/12/X5

	Carrying Amount	*Tax Base*	*Temporary Differences*
	$	$	$
Accounts receivable	500	500	-
Inventory	2,000	2,000	-
Product development costs	250	-	250
Investments	33,000	33,000	-
Property, plant & equipment	37,200	12,900	24,300
TOTAL ASSETS	72,950	48,400	24,550
Current income taxes payable	3,570	3,570	-
Accounts payable	500	500	-
Fines payable	700	700	-
Liability for health care benefits	2,000	-	(2,000)
Long term debt	12,475	12,475	-
Deferred income taxes	9,020	9,020	-
TOTAL LIABILITIES	28,265	26,265	(2,000)
Share capital	5,000	5,000	-
Revaluation surplus	-	-	-
Retained earnings	39,685	17,135	
TOTAL LIABILITIES / EQUITY	72,950	48,400	
TEMPORARY DIFFERENCES			22,550

Deferred tax liability	24,550 at 40%	9,820
Deferred tax asset	(2,000) at 40%	(800)
Net deferred tax liability		9,020
Less: Opening deferred tax liability		(8,600)
Deferred tax expense (income) related to the origination and reversal of temporary differences		420

Deferred Tax Assets, Liabilities and Expense at 31/12/X6

	Carrying Amount	*Tax Base*	*Temporary Differences*
	$	$	$
Accounts receivable	500	500	-
Inventory	2,000	2,000	-
Product development costs	-	-	-
Investments	33,000	33,000	-
Property, plant & equipment	75,750	16,050	59,700
TOTAL ASSETS	111,250	51,550	59,700
Current income taxes payable	2,359	2,359	-
Accounts payable	500	500	-
Fines payable	700	700	
Liability for health care benefits	3,000	-	(3,000)
Long term debt	12,805	12,805	-
Deferred income taxes	19,845	19,845	-
TOTAL LIABILITIES	39,209	36,209	(3,000)
Share capital	5,000	5,000	-
Revaluation surplus	19,637	-	-
Retained earnings	47,404	10,341	
TOTAL LIABILITIES / EQUITY	111,250	51,550	
TEMPORARY DIFFERENCES			56,700

Deferred tax liability	59,700 at 35%	20,895
Deferred tax asset	(3,000) at 35%	(1,050)
Net deferred tax liability		19,845
Less: Opening deferred tax liability		(9,020)
Adjustment to opening deferred tax liability resulting from reduction in tax rate	22,550 at 5%	1,127
Deferred tax attributable to revaluation surplus	31,800 at 35%	(11,130)
Deferred tax expense (income) related to the origination and reversal of temporary differences		822

Illustrative Disclosure

The amounts to be disclosed in accordance with the Statement are as follows:

Major components of tax expense (income) (paragraph 79)

	X5	*X6*
	$	$
Current tax expense	3,570	2,359
Deferred tax expense relating to the origination and reversal of temporary differences:	420	822
Deferred tax expense (income) resulting from reduction in tax rate	-	(1,127)
Tax expense	3,990	2,054

Aggregate current and deferred tax relating to items charged or credited to equity (paragraph 81(a))

Deferred tax relating to revaluation of building	-	(11,130)

In addition, deferred tax of $557 was transferred in X6 from retained earnings to revaluation reserve. This relates to the difference between the actual depreciation on the building and equivalent depreciation based on the cost of the building.

Explanation of the relationship between tax expense and accounting profit (paragraph 81(c))

The Statement permits two alternative methods of explaining the relationship between tax expense (income) and accounting profit. Both of these formats are illustrated on the next page.

(i) a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed

	X5	*X6*
	$	$
Accounting profit	8,775	8,740
Tax at the applicable tax rate of 35% (X5: 40%)	3,510	3,059

Tax effect of expenses that are not deductible in determining taxable profit:		
Charitable donations	200	122
Fines for environmental pollution	280	-
Reduction in opening deferred taxes resulting from reduction in tax rate	-	(1,127)
Tax expense	3,990	2,054

The applicable tax rate is the aggregate of the national income tax rate of 30% (X5: 35%) and the local income tax rate of 5%.

(ii) 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

	X5	*X6*
	%	%
Applicable tax rate	40.0	35.0
Tax effect of expenses that are not deductible for tax purposes:		
Charitable donations	2.3	1.4
Fines for environmental pollution	3.2	-
Effect on opening deferred taxes of reduction in tax rate	-	(12.9)
Average effective tax rate (tax expense divided by profit before tax)	45.5	23.5

The applicable tax rate is the aggregate of the national income tax rate of 30% (X5: 35%) and the local income tax rate of 5%.

An explanation of changes in the applicable tax rate(s) compared to the previous accounting period (paragraph 81(d))

In X6, the government enacted a change in the national income tax rate from 35% to 30%.

In respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:

(i) the amount of the deferred tax assets and liabilities recognised in the balance sheet for each period presented;

(ii) the amount of the deferred tax income or expense recognised in the income statement for each period presented, if this is not apparent from the changes in the amounts recognised in the balance sheet (paragraph 81(g))

	X5	X6
	$	$
Accelerated depreciation for tax purposes	9,720	10,322
Liabilities for health care benefits that are deducted for tax purposes only when paid	(800)	(1,050)
Product development costs deducted from taxable profit in earlier years	100	-
Revaluation, net of related depreciation	-	10,573
Deferred tax liability	9,020	19,845

(note: the amount of the deferred tax income or expense recognised in the income statement for the current year is apparent from the changes in the amounts recognised in the balance sheet.)

Example 3 - Business Combinations

On 1 January X5 enterprise A acquired 100% of the shares of enterprise B at a cost of $600. A amortises goodwill over 5 years. Goodwill amortisation is not deductible for tax purposes. The tax rate in A's tax jurisdiction is 30% and the tax rate in B's tax jurisdiction is 40%.

The fair value of the identifiable assets and liabilities (excluding deferred tax assets and liabilities) acquired by A is set out in the following table, together with their tax base in B's tax jurisdiction and the resulting temporary differences.

	Cost of Acquisition	*Tax Base*	*Temporary Differences*
	$	$	$
Property, plant and equipment	270	155	115
Accounts receivable	210	210	-
Inventory	174	124	50
Retirement benefit obligations	(30)	-	(30)
Accounts payable	(120)	(120)	-
Fair value of the identifiable assets and liabilities acquired, excluding deferred tax	504	369	135

The deferred tax asset arising from the retirement benefit obligations is offset against the deferred tax liabilities arising from the property, plant and equipment and inventory (see paragraph 74 of the Statement).

No deduction is available in B's tax jurisdiction for the cost of the goodwill. Therefore, the tax base of the goodwill (in B's jurisdiction) is nil. However, in accordance with paragraph 15(a) of the Statement, A recognises no deferred tax liability for the taxable temporary difference associated, in B's tax jurisdiction, with the goodwill.

The carrying amount, in A's consolidated financial statements, of its investment in B is made up as follows:

	$
Fair value of identifiable assets and liabilities acquired, excluding deferred tax	504
Deferred tax liability (135 at 40%)	(54)
Fair value of identifiable assets and liabilities acquired	450
Goodwill (net of amortisation of nil)	150
Carrying amount	600

At the date of acquisition, the tax base, in A's tax jurisdiction, of A's investment in B is $600. Therefore, no temporary difference is associated, in A's jurisdiction, with the investment.

During X5, B's equity (incorporating the fair value adjustments made on acquisition) changed as follows:

	$
At 1 January X5	450
Retained profit for X5 (net profit of $150, less dividend payable of $80)	70
At 31 December X5	520

A recognises a liability for any withholding tax or other taxes that it will suffer on the accrued dividend receivable of $80.

At 31 December X5, the carrying amount of A's underlying investment in B, excluding the accrued dividend receivable, is as follows:

	$
Net assets of B	520
Goodwill (net of amortisation of $30)	120
Carrying amount	640

The temporary difference associated with A's underlying investment is $40 as follows:

	$
Cumulative retained profit since acquisition	70
Cumulative amortisation of goodwill	(30)
	40

If A has determined that it will not sell the investment in the foreseeable future and that B will not distribute its retained profits in the foreseeable future, no deferred tax liability is recognised in relation to A's investment in B (see paragraphs 39 and 40 of the Statement). Note that this exception would apply for an investment in an associate only if there is an agreement requiring that the profits of the associate will not be distributed in the foreseeable future (see paragraph 42 of the Statement). A discloses the amount ($40) of the temporary difference for which no deferred tax is recognised (see paragraph 81(f) of the Statement).

If A expects to sell the investment in B, or that B will distribute its retained profits in the foreseeable future, A recognises a deferred tax liability to the extent that the temporary difference is expected to reverse. The tax rate reflects the manner in which A expects to recover the carrying amount of its investment (see paragraph 51 of the Statement). A credits or charges the deferred tax to equity to the extent that the deferred tax results from foreign exchange translation differences which have been charged or credited directly to equity (paragraph 61 of the Statement). A discloses separately:

(a) the amount of deferred tax which has been charged or credited directly to equity (paragraph 81(a) of the Statement); and

(b) the amount of any remaining temporary difference which is not expected to reverse in the foreseeable future and for which, therefore, no deferred tax is recognised (see paragraph 81(f) of the Statement).

APPENDIX C

Comparison of SSAP 12 with International Accounting Standards

This comparison appendix, which was prepared as at 31 May 2002 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in SSAP 12.

The International Accounting Standard comparable with SSAP 12 is IAS 12 (revised 2000), Income Taxes.

The following sets out the major textual differences between SSAP 12 and IAS 12 and the reasons for such differences.

Differences	Reasons for the differences
1. **IAS 12 Paras 23, 62(d), Appendix A Para 9 and Appendix B Example 4** IAS 12 contains certain guidance on calculating deferred tax on a compound financial instrument that is accounted for in accordance with IAS 32, Financial nstruments: Disclosure and Presentation. SSAP 12 does not contain such guidance.	There is currently no SSAP equivalent to IAS 32 which specifies the accounting treatment for a compound financial instrument.
2. **IAS 12 Para 72 SSAP 12 Para 72** IAS 12 paragraph 72 contains a reference to the offsetting criteria in IAS 32. The corresponding paragraph in SSAP 12 does not contain such a reference.	There is currently no SSAP equivalent to IAS 32.
3. **IAS 12 Paras 62(b) and 80(h) SSAP 12 Para 62(b)** IAS 12 contains certain guidance and a disclosure requirement that concerns the fact that IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies, has an allowed alternative treatment for the correction of fundamental errors and change in accounting policies. SSAP 12 does not contain such guidance and disclosure requirement.	SSAP 2, which is the Hong Kong equivalent of IAS 8, does not permit the use of the allowed alternative treatment in IAS 8.

(Note: The explanatory guidance and illustrative examples set out in the boxes within the body of SSAP 12 contain material that may not be based on the examples in IAS 12 but based on those in Australian Standard AASB 1020, Income Taxes.)