FINANCIAL
REPORTING STANDARD

FRS 12

Income Taxes

This version of FRS 12 does **not** include amendments
that are effective for annual periods beginning **after** 1 January 2016.

CONTENTS

Financial Reporting Standard 12 *Income Taxes* (FRS 12) is set out in paragraphs 1–99. All the paragraphs have equal authority. FRS 12 should be read in the context of its objective, the *Preface to Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 This Standard ('FRS 12 (revised)') replaces FRS 12 *Accounting for Taxes on Income* ('the original FRS 12'). FRS 12 (revised) is effective for accounting periods beginning on or after 1 April 2001. The major changes from the original FRS 12 are as follows.

IN2 The original FRS 12 required an entity to account for deferred tax using either the deferral method or a liability method which is sometimes known as the income statement liability method. FRS 12 (revised) prohibits the deferral method and requires another liability method which is sometimes known as the balance sheet liability method.

The income statement liability method focuses on timing differences, whereas the balance sheet liability method focuses on temporary differences. Timing differences are differences between taxable profit and accounting profit that originate in one period and reverse in one or more subsequent periods. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the statement of financial position. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

All timing differences are temporary differences. Temporary differences also arise in the following circumstances, which do not give rise to timing differences, although the original FRS 12 treated them in the same way as transactions that do give rise to timing differences:

(a) subsidiaries, associates or joint arrangements have not distributed their entire profits to the parent, investor, joint venturer or joint operator;

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

(c) the identifiable assets acquired and liabilities assumed in a business combination are generally recognised at their fair values in accordance with FRS 103 *Business Combinations*, but no equivalent adjustment is made for tax purposes.

Furthermore, there are some temporary differences which are not timing differences, for example those temporary differences that arise when:

(a) the non-monetary assets and liabilities of an entity are measured in its functional currency but the taxable profit or tax loss (and, hence, the tax base of its non-monetary assets and liabilities) is determined in a different currency;

(b) non-monetary assets and liabilities are restated under FRS 29 *Financial Reporting in Hyperinflationary Economies*; or

(c) the carrying amount of an asset or liability on initial recognition differs from its initial tax base.

IN3 The original FRS 12 permitted an entity not to recognise deferred tax assets and liabilities where there was reasonable evidence that timing differences would not reverse for some considerable period ahead. FRS 12 (revised) requires an entity to recognise a deferred tax liability or (subject to certain conditions) asset for all temporary differences, with certain exceptions noted below.

IN4 The original FRS 12 required that:

(a) deferred tax assets arising from timing differences should be recognised when there was a reasonable expectation of realisation; and

(b) deferred tax assets arising from tax losses should be recognised as an asset only where there was assurance beyond any reasonable doubt that future taxable income would be sufficient to allow the benefit of the loss to be realised. The original FRS 12 permitted (but did not require) an entity to defer recognition of the benefit of tax losses until the period of realisation.

FRS 12 (revised) requires that deferred tax assets should be recognised when it is probable that taxable profits will be available against which the deferred tax asset can be utilised. Where an entity has a history of tax losses, the entity recognises a deferred tax asset only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available.

IN5 As an exception to the general requirement set out in paragraph IN3 above, FRS 12 (revised) prohibits the recognition of deferred tax liabilities and deferred tax assets arising from certain assets or liabilities whose carrying amount differs on initial recognition from their initial tax base. Because such circumstances do not give rise to timing differences, they did not result in deferred tax assets or liabilities under the original FRS 12.

IN6 The original FRS 12 required that taxes payable on undistributed profits of subsidiaries and associates should be recognised unless it was reasonable to assume that those profits will not be distributed or that a distribution would not give rise to a tax liability. However, FRS 12 (revised) prohibits the recognition of such deferred tax liabilities (and those arising from any related cumulative translation adjustment) to the extent that:

(a) the parent, investor, joint venturer or joint operator 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.

Where this prohibition has the result that no deferred tax liabilities have been recognised, FRS 12 (revised) requires an entity to disclose the aggregate amount of the temporary differences concerned.

IN7 The original FRS 12 did not refer explicitly to fair value adjustments made on a business combination. Such adjustments give rise to temporary differences and FRS 12 (revised) requires an entity to recognise the resulting deferred tax liability or (subject to the probability criterion for recognition) deferred tax asset with a corresponding effect on the determination of the amount of goodwill or bargain purchase gain recognised. However, FRS 12 (revised) prohibits the recognition of deferred tax liabilities arising from the initial recognition of goodwill.

IN8 The original FRS 12 permitted, but did not require, an entity to recognise a deferred tax liability in respect of asset revaluations. FRS 12 (revised) requires an entity to recognise a deferred tax liability in respect of asset revaluations.

IN9 The tax consequences of recovering the carrying amount of certain assets or liabilities may depend on the manner of recovery or settlement, for example:

(a) in certain countries, capital gains are not taxed at the same rate as other taxable income; and

(b) in some countries, the amount that is deducted for tax purposes on sale of an asset is greater than the amount that may be deducted as depreciation.

The original FRS 12 gave no guidance on the measurement of deferred tax assets and liabilities in such cases. FRS 12 (revised) requires that the measurement of deferred tax liabilities and deferred tax assets should be based on the tax consequences that would follow from the manner in which the entity expects to recover or settle the carrying amount of its assets and liabilities.

IN10 The original FRS 12 did not state explicitly whether deferred tax assets and liabilities may be discounted. FRS 12 (revised) prohibits discounting of deferred tax assets and liabilities.

IN11 The original FRS 12 did not specify whether an entity should classify deferred tax balances as current assets and liabilities or as non-current assets and liabilities. FRS 12 (revised) requires that an entity which makes the current/non-current distinction should not classify deferred tax assets and liabilities as current assets and liabilities.[1]

IN12 The original FRS 12 stated that debit and credit balances representing deferred taxes may be offset. FRS 12 (revised) establishes more restrictive conditions on offsetting, based largely on those for financial assets and liabilities in FRS 32 *Financial Instruments: Disclosure and Presentation*.[2]

IN13 The original FRS 12 required disclosure of an explanation of the relationship between tax expense and accounting profit if not explained by the tax rates effective in the reporting entity's country. FRS 12 (revised) requires this explanation to take either or both of the following forms:

(a) a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s); or

(b) a numerical reconciliation between the average effective tax rate and the applicable tax rate.

FRS 12 (revised) also requires an explanation of changes in the applicable tax rate(s) compared to the previous accounting period.

IN14 New disclosures required by FRS 12 (revised) include:

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

  (i) the amount of deferred tax assets and liabilities recognised; and

  (ii) the amount of the deferred tax income or expense recognised in profit or loss, if this is not apparent from the changes in the amounts recognised in the statement of financial position;

(b) 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; and

(c) the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:

  (i) 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

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

1 This requirement has been moved to paragraph 56 of FRS 1 *Presentation of Financial Statements* (as revised in 2008).

2 In 2006, FRS 32 was amended to *Financial Instruments: Presentation*.

Financial Reporting Standard 12
Income Taxes

Objective

The objective of this Standard 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 entity's statement of financial position; and

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

It is inherent in the recognition of an asset or liability that the reporting entity 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 Standard requires an entity to recognise a deferred tax liability (deferred tax asset), with certain limited exceptions.

This Standard requires an entity 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 profit or loss, any related tax effects are also recognised in profit or loss. For transactions and other events recognised outside profit or loss (either in other comprehensive income or directly in equity), any related tax effects are also recognised outside profit or loss (either in other comprehensive income or directly in equity, respectively). Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill arising in that business combination or the amount of the bargain purchase gain recognised.

This Standard 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.

Scope

1 This Standard shall be applied in accounting for income taxes.

2 For the purposes of this Standard, 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 arrangement on distributions to the reporting entity.

3 [Deleted]

4 This Standard does not deal with the methods of accounting for government grants (see FRS 20 *Accounting for Government Grants and Disclosure of Government Assistance*) or investment tax credits. However, this Standard 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 Standard with the meanings specified:**

***Accounting profit* is profit or loss for a period before deducting tax expense.**

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

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

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

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

***Deferred tax assets* 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.

***Temporary differences* are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. Temporary differences may be either:**

(a) t*axable temporary differences*, 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) *deductible temporary differences*, 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 *tax base* 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

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 entity 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.

Examples	
1	A machine cost 100. 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 is taxable, any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes. *The tax base of the machine is 70*.
2	Interest receivable has a carrying amount of 100. The related interest revenue will be taxed on a cash basis. *The tax base of the interest receivable is nil*.
3	Trade receivables have a carrying amount of 100. The related revenue has already been included in taxable profit (tax loss). *The tax base of the trade receivables is 100*.
4	Dividends receivable from a subsidiary have a carrying amount of 100. The dividends are not taxable. *In substance, the entire carrying amount of the asset is deductible against the economic benefits. Consequently, the tax base of the dividends receivable is 100.*[3]
5	A loan receivable has a carrying amount of 100. The repayment of the loan will have no tax consequences. *The tax base of the loan is 100*.

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.

Examples	
1	Current liabilities include accrued expenses with a carrying amount of 100. The related expense will be deducted for tax purposes on a cash basis. *The tax base of the accrued expenses is nil*.
2	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 nil*.
3	Current liabilities include accrued expenses with a carrying amount of 100. The related expense has already been deducted for tax purposes. *The tax base of the accrued expenses is 100*.
4	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 100.*[4]
5	A loan payable has a carrying amount of 100. The repayment of the loan will have no tax consequences. *The tax base of the loan is 100.*

[3] Under this analysis, there is no taxable temporary difference. An alternative analysis is that the accrued dividends receivable have a tax base of nil and that a tax rate of nil is applied to the resulting taxable temporary difference of 100. Under both analyses, there is no deferred tax liability.

[4] Under this analysis, there is no deductible temporary difference. An alternative analysis is that the accrued fines and penalties payable have a tax base of nil and that a tax rate of nil is applied to the resulting deductible temporary difference of 100. Under both analyses, there is no deferred tax asset.

9 Some items have a tax base but are not recognised as assets and liabilities in the statement of financial position. 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 Standard is based: that an entity shall, 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 51A 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 entity in the group.

Recognition of current tax liabilities and current tax assets

12 Current tax for current and prior periods shall, 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 shall 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 shall be recognised as an asset.

14 When a tax loss is used to recover current tax of a previous period, an entity 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 entity and the benefit can be reliably measured.

Recognition of deferred tax liabilities and deferred tax assets

Taxable temporary differences

15 A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:

(a) the initial recognition of goodwill; 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 arrangements, a deferred tax liability shall 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 entity 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 entity recovers the carrying amount of the asset, the taxable temporary difference will reverse and the entity will have taxable profit. This makes it probable that economic benefits will flow from the entity in the form of tax payments. Therefore, this Standard requires the recognition of all deferred tax liabilities, except in certain circumstances described in paragraphs 15 and 39.

Example
An asset which cost 150 has a carrying amount of 100. Cumulative depreciation for tax purposes is 90 and the tax rate is 25%. *The tax base of the asset is 60 (cost of 150 less cumulative tax depreciation of 90). To recover the carrying amount of 100, the entity must earn taxable income of 100, but will only be able to deduct tax depreciation of 60. Consequently, the entity will pay income taxes of 10 (40 at 25%) when it recovers 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 entity recognises a deferred tax liability of 10 (40 at 25%) representing the income taxes that it will pay when it recovers 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 statement of financial position 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 identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values in accordance with FRS 103 *Business Combinations*, 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 arises in a business combination (see paragraph 21);

(d) the tax base of an asset or liability on initial recognition differs from its initial carrying amount, for example when an entity 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 arrangements becomes different from the tax base of the investment or interest (see paragraphs 38–45).

Business combinations

19 With limited exceptions, the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed 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 FRSs permit or require certain assets to be carried at fair value or to be revalued (see, for example, FRS 16 *Property, Plant and Equipment*, FRS 38 *Intangible Assets*, FRS 40 *Investment Property* and FRS 39 *Financial Instruments: Recognition and Measurement*). 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 entity 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 entity 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 arising in a business combination is measured as the excess of (a) over (b) below:

(a) the aggregate of:

   (i) the consideration transferred measured in accordance with FRS 103, which generally requires acquisition-date fair value;

   (ii) the amount of any non-controlling interest in the acquiree recognised in accordance with FRS 103; and

   (iii) in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

(b) the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed measured in accordance with FRS 103.

Many taxation authorities do not allow reductions in the carrying amount 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 Standard does not permit the recognition of the resulting deferred tax liability because goodwill is measured as a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill.

21A Subsequent reductions in a deferred tax liability that is unrecognised because it arises from the initial recognition of goodwill are also regarded as arising from the initial recognition of goodwill and are therefore not recognised under paragraph 15(a). For example, if in a business combination an entity recognises goodwill of CU100 that has a tax base of nil, paragraph 15(a) prohibits the entity from recognising the resulting deferred tax liability. If the entity subsequently recognises an impairment loss of CU20 for that goodwill, the amount of the taxable temporary difference relating to the goodwill is reduced from CU100 to CU80, with a resulting decrease in the value of the unrecognised deferred tax liability. That decrease in the value of the unrecognised deferred tax liability is also regarded as relating to the initial recognition of the goodwill and is therefore prohibited from being recognised under paragraph 15(a).

21B Deferred tax liabilities for taxable temporary differences relating to goodwill are, however, recognised to the extent they do not arise from the initial recognition of goodwill. For example, if in a business combination an entity recognises goodwill of CU100 that is deductible for tax purposes at a rate of 20 per cent per year starting in the year of acquisition, the tax base of the goodwill is CU100 on initial recognition and CU80 at the end of the year of acquisition. If the carrying amount of goodwill at the end of the year of acquisition remains unchanged at CU100, a taxable temporary difference of CU20 arises at the end of that year. Because that taxable temporary difference does not relate to the initial recognition of the goodwill, the resulting deferred tax liability is recognised.

Initial recognition of an asset or liability

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 that led to the initial recognition of the asset or liability:

(a) in a business combination, an entity recognises any deferred tax liability or asset and this affects the amount of goodwill or bargain purchase gain it recognises (see paragraph 19);

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

(c) if the transaction is not a business combination, and affects neither accounting profit nor taxable profit, an entity 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 Standard does not permit an entity to recognise the resulting deferred tax liability or asset, either on initial recognition or subsequently (see example below). Furthermore, an entity does not recognise subsequent changes in the unrecognised deferred tax liability or asset as the asset is depreciated.

Example illustrating paragraph 22(c)
An entity 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 entity will earn taxable income of 1,000 and pay tax of 400. The entity 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 entity will pay tax of 320. The entity does not recognise the deferred tax liability of 320 because it results from the initial recognition of the asset.*

23 In accordance with FRS 32 *Financial Instruments: Presentation* 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) does not apply. Consequently, an entity recognises the resulting deferred tax liability. In accordance with paragraph 61A, the deferred tax is charged directly to the carrying amount of the equity component. In accordance with paragraph 58, subsequent changes in the deferred tax liability are recognised in profit or loss as deferred tax expense (income).

Deductible temporary differences

24 A deferred tax asset shall 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 the initial recognition of an asset or liability in a transaction that:

(a) is not a business combination; and

(b) 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 arrangements, a deferred tax asset shall 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 entity of resources embodying economic benefits. When resources flow from the entity, 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.

Example
An entity recognises a liability of 100 for accrued product warranty costs. For tax purposes, the product warranty costs will not be deductible until the entity pays claims. The tax rate is 25%. *The tax base of the liability is nil (carrying amount of 100, less the amount that will be deductible for tax purposes in respect of that liability in future periods). In settling the liability for its carrying amount, the entity will reduce its future taxable profit by an amount of 100 and, consequently, reduce its future tax payments by 25 (100 at 25%). The difference between the carrying amount of 100 and the tax base of nil is a deductible temporary difference of 100. Therefore, the entity recognises a deferred tax asset of 25 (100 at 25%), provided that it is probable that the entity will earn sufficient taxable profit in future periods to benefit from a reduction in tax payments.*

26 The following are examples of deductible temporary differences that 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 entity or when retirement benefits are paid by the entity. 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 entity 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) with limited exceptions, an entity recognises the identifiable assets acquired and liabilities assumed in a business combination at their fair values at the acquisition date. When a liability assumed is recognised at the acquisition date 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 when 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 entity only if it earns sufficient taxable profits against which the deductions can be offset. Therefore, an entity 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 entity 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 entity 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 entity that will create taxable profit in appropriate periods.

30 Tax planning opportunities are actions that the entity 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 entity has a history of recent losses, the entity considers the guidance in paragraphs 35 and 36.

32 [Deleted]

Goodwill

32A **If the carrying amount of goodwill arising in a business combination is less than its tax base, the difference gives rise to a deferred tax asset. The deferred tax asset arising from the initial recognition of goodwill shall be recognised as part of the accounting for a business combination to the extent that it is probable that taxable profit will be available against which the deductible temporary difference could be utilised.**

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