# Recognition and disclosure of Deferred Tax in Financial Statements

***By Harshani Rajapaksha***

***What is Deferred Tax***

**Definition**

Deferred Tax is the amount of Income taxes payable /recoverable in future periods in respect of taxable/ deductible temporary differences.

A deferred tax liability is the result of differences in the way a company does its financial accounting for reporting purposes according to generally accepted accounting principles (GAAP) versus tax accounting.

***Temporary Differences***

Temporary differences are between the carrying amount of an asset or liability in the Statement of Financial Position and its tax base. Temporary Differences may be either:

> Taxable 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.
>
> Deductible Temporary Differences: Which are temporary differences that will result in amounts that are deductible in 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 attributable to that asset or liability for tax purposes.

**Recognition of Deferred Tax Liabilities**

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

Deferred Tax = Taxable Temporary Differences * tax rate (future)

A deferred tax liability should be recognised for all taxable temporary differences, unless the deferred tax liability arises from the initial recognition of goodwill or the initial recognition of an asset or liability in a transaction which

- Is not a business combination and
- At the time of transaction, affect neither accounting profit nor taxable profit (or tax loss)

**Recognition of Deferred Tax Assets**

Deferred Tax assets are the amounts of income taxes recoverable in future period in respect of

- Deductible temporary differences.
- The carry forward of unused tax losses and

- The carry forward of unused tax credits.

A deferred tax asset shall be recognised for all deductible differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized.

***Recognising Deferred Tax Assets arising from unused Losses***

In relation to deferred tax assets arising from unused losses, LKAS 12 says that the existence of unused losses is strong evidence that profits might not be available. It requires four criteria to be considered before a deferred tax asset can be recognised in respect unused losses or credits.

- Whether the Company has enough taxable temporary differences relating to the same tax authority and the same taxable entity, to create taxable amounts against which the losses or credits can be used before they expire.
- Whether it is otherwise probable that the entity will have taxable profits in that period.
- Whether the unused tax losses result from identifiable causes that are unlikely to recur.
- Are tax – planning opportunities available to allow taxable profits to be created in the period in which the losses or credits can be used?.

*Review of Deferred Tax Assets*

The determination whether there is likely to be enough future taxable profit is not a one- off exercise, made only at the time of initially recognizing the asset. The availability of future taxable profits must be reassessed at each Statement of Financial Statement date, and the amount of deferred tax assets must be adjusted if necessary. Such an adjustment can be either up or down, if conditions have improved since the last assessment.

Consider:

1. The recoverability of the deferred tax asset is reviewed at each Statement of Financial Position date.
2. The carrying amount should be reduced to the extent that it is no longer probable that enough taxable profit will be available to allow the asset to be recovered.
3. Any such reduction should be reversed to the extent that it once again becomes probable that enough taxable profit will exist.

**Presentation and Disclosures**

*Presentation*

The following guidance of LKAS 01 Presentation of Financial Statements requires that deferred tax assets and liabilities are clearly distinguished in the Statement of Financial Position. The requirement for Statement of Financial Position are :

- Deferred tax asset and liability and current assets and liabilities should be presented separately from other assets and liabilities in the Statement of Financial Position
- Deferred tax assets and liabilities should not be classified within current assets and liabilities, if the Statement of Financial Position makes such a distinction.

*Offset of Deferred Tax Asset and Liabilities*

- It has a legally enforceable right to setoff
- The deferred tax assets and liabilities relate to tax levied by the same authority on either the same taxable entity or different taxable entities, which intend either to settle current tax liabilities and assets on a net basis, or realize the assets and settle the liabilities simultaneously, in each future period in which significant amount of deferred tax liabilities or assets are expected to be settled or recovered.

*Disclosures*

- ❖ Statement of Financial Position : for each type of temporary difference. The amount of the deferred tax asset and liabilities recognised in the Statement of Financial Position.
- ❖ Statement of Comprehensive Income: for each type of temporary differences, the amount of the deferred tax income or expense recognised in the Statement of Comprehensive Income, if the information is not evident from the movement in Statement of Financial Position amounts.
- ❖ Temporary Difference Reversals: the deferred tax expense relating to the organization or reversal of temporary differences and changes in tax rates or to the importation of new taxes.
- ❖ Reduction of taxes : by using previously unrecognized tax loss, tax credit or temporary difference of a prior period.
- ❖ The written down of a deferred tax asset.
- ❖ Deductible Temporary Difference : 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 Statement of Financial Position.
- ❖ The aggregate amount of temporary differences related to specific Investments.
- ❖ Deferred tax relating to items that are charged or credited to equity.
- ❖ Future taxable profits : the amount of deferred tax asset and the nature of the evidence supporting its recognition. When its utilization depends on future taxable profits exceeding those arising from the reversal of existing taxable temporary differences. And the entity has made a taxable loss in either the current or proceding period in the relevant tax jurisdiction (This Disclosure is required when deferred tax assets are recognised in relevance on future accounting profits. Despite the existence of recent losses).