

DEFERRED TAX (IAS 12)

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1. Introduction to Deferred Tax

Deferred tax arises because **accounting profit** (IFRS) and **taxable profit** (SARS) are calculated differently. *Please refer to Chapter 5 of the e-book for further explanation.*

Core principle: Deferred tax ensures the **tax effects of transactions** are recognised in the **same period** as the transactions themselves.

2. Key Definitions

- **Accounting Profit** — Profit before tax per IFRS, as it appears as a line-item on the face of the Statement of Comprehensive Income.
- **Taxable Profit** — Profit calculated using SARS rules, primarily the Income Tax Act.
- **Temporary Differences** — Differences between carrying amount and tax base.
- **Tax Base** — Amount attributed to an asset or liability for tax purposes.
- **Deferred Tax Liability (DTL)** — Future tax payable due to taxable temporary differences.
- **Deferred Tax Asset (DTA)** — Future tax recoverable due to deductible temporary differences.

3. Balance Sheet Approach

IAS 12 uses the **carrying amount vs tax base** comparison:

Temporary Difference = Carrying Amount – Tax Base

- Positive → **DTL**
- Negative → **DTA**

4. Tax Base Rules

4.1 Tax Base of an Asset

Tax base = amount deductible against future taxable economic benefits.

If future benefits are **taxable**: Tax base = carrying amount – future taxable amounts.

If future benefits are **not taxable**: Tax base = carrying amount.

4.2 Tax Base of a Liability

Tax base = carrying amount – amounts deductible in future.

If settlement is **not deductible**: Tax base = carrying amount.

5. Types of Temporary Differences

5.1 Taxable Temporary Differences (DTL)

Arise when carrying amount > tax base.

Examples:

- Accelerated tax depreciation
- Fair value gains not yet taxed
- Prepaid expenses (deductible now, expensed later)

5.2 Deductible Temporary Differences (DTA)

Arise when carrying amount < tax base.

Examples:

- Provisions
- Impairments
- Tax losses carried forward

6. Recognition Rules

6.1 Recognise DTL for all taxable temporary differences except:

- Initial recognition of goodwill
- Initial recognition of an asset/liability not in a business combination and not affecting accounting or taxable profit

6.2 Recognise DTA only when:

It is probable that future taxable profit will be available.

7. Measurement of Deferred Tax

Deferred Tax = Temporary Difference × Tax Rate

- Use enacted or substantively enacted tax rates
- Do not discount
- Recognise in Profit or Loss unless related to Other Comprehensive Income or Equity items

8. Worked Examples

Example 1: Accelerated Tax Wear and Tear Allowance (DTL)

- **Asset cost/depreciable amount:** R500,000
 - **Useful life:** 5 years
 - **Tax wear and tear allowance:** 40% in Year 1
 - **Tax rate:** 27%
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- ➔ **Carrying amount:** R400,000 [R500,000 – (R500,000 / 5)]
 - ➔ **Tax base:** R300,000 [R500,000 – (R500,000 x 40%)]
 - ➔ **Temporary difference:** R100,000 [R400,000 – R300,000]
 - ➔ **DTL:** R27,000 [R100,000 x 27%]

Example 2: Provision for Warranty (DTA)

- **Provision:** R150,000
 - **Tax deductible:** Only when paid
 - **Tax rate:** 27%
- ➔ **Temporary difference:** –R150,000
➔ **DTA:** R40,500 [R150,000 x 27%]

Example 3: Tax Assessed Losses

- **Tax loss:** R1,200,000
 - **Tax rate:** 27%
- ➔ **DTA:** R324,000 [R1,200,000 x 27%]

9. Deferred Tax on Revaluation (OCI)

- Revaluation increases carrying amount
- Tax base remains unchanged
- Creates **DTL**
- Recognised in **OCI**, not profit or loss

10. Deferred Tax in Business Combinations

- Recognise DTL/DTA on fair value adjustments
- Except goodwill
- Affects goodwill calculation

11. Disclosure Requirements

Entities must disclose:

- Components of deferred tax
- Amounts recognised in P/L and OCI
- Unused tax losses and expiry dates
- Reconciliation of tax expense to accounting profit (*Refer Chapter 5*)

12. Exam Tips

- Always start with carrying amount vs tax base
- Identify taxable vs deductible
- Apply correct tax rate
- Check recognition exceptions
- Link to OCI when related to revaluations
- For DTAs, assess probability of future taxable profits

13. Practice Question

Calculate the net increase/decrease in deferred tax, assuming the asset was acquired at the beginning of the financial year, and the provision was made during this year.

- **Equipment cost:** R800,000
 - **Accounting depreciation:** 10 years
 - **Tax wear and tear allowance:** 4 years
 - **Provision for leave pay:** R120,000
 - **Tax rate:** 28%
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- ➔ **Carrying amount:** R720,000 [R800,000 – (R800,000 / 10)]
 - ➔ **Tax base:** R600,000 [R800,000 – (R800,000 / 4)]
 - ➔ **Temporary difference on Equipment:** R120,000 [R720,000 – R600,000]
 - ➔ **Deferred Tax Liability increase:** R33,600 [R120,000 x 28%]
 - ➔ **Temporary difference on leave pay provision:** –R120,000
 - ➔ **Deferred Tax Asset increase:** R33,600 [R120,000 x 28%]
 - ➔ **Net increase/decrease in deferred tax:** R0 [R33,600 – R33,600]

14. Comprehensive Question Bank, together with Solutions

Available as a separate PDF on this web page.