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# CL 02 – Financial Reporting and Governance

## Corporate Level

(LKAS 12 – Income Taxes)



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# Income Taxes

Topic No 09

LKAS 12 Income taxes deals with accounting for two types of tax:

(a) Current tax, being the tax payable on profits in the year (or the tax recoverable on losses in the year)
(b) Deferred tax, being the tax that may become payable (or recoverable) in the future as a result of assets and liabilities that are recognized in an entity's financial statements now.

It is important to remember that while **current tax payable is an existing liability** to the tax authorities, deferred tax is not. **Deferred tax** is simply an **accounting adjustment**.

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.

## 1. CURRENT TAX

Current tax is the amount payable to the tax authorities in relation to the trading activities of the period.

| | |
|---|---|
| **Current tax** | The amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period |
| **Taxable profit (tax loss)** | The profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable) |
| **Accounting profit** | Profit or loss for a period before deducting tax expense |
| **Tax expense (tax income)** | The aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax |

### 1.1 Recognition and Measurement of Current Tax

Tax arising on profits in the period is measured at the amount expected to be paid to the tax authorities and is generally recognized:

(a) As part of the tax charge to profit or loss
(b) As a current liability to the extent that it is unpaid at the period end

In Sri Lanka, corporate income tax is payable quarterly in advance on set payment dates, and therefore the year-end liability is unlikely to represent the full amount of tax payable on the year's profits.

| | | | |
|---|---|---|---|
| DR | Income Tax Expense | XXX | (SoPL) |
| CR | Income Tax Payable | XXX | (SoFP) |

**Question 01 – Current Tax**

The tax accountant of Batticaloa Trading (Pvt) Ltd has calculated the taxable profits of the company to be Rs. 740,000 in the year ended 31 December 2023. The company pays tax at 28% and has already recorded quarterly payments in respect of the year of Rs. 46,500 in August 2023 and Rs. 48,350 in November 2023.

Required to show the accounting entries to be made and the amounts to be reported in the financial statements for the year ended 31 December 2023.



### 1.1.1 Over and Under Provisions

The current tax provision is based on year-end estimates of taxable profit and so they may change before payment of the final instalment is made. Where the tax charged to profit or loss in a given year is not equal to the amount of tax ultimately paid for that year, the tax charge of the following year must be adjusted to compensate for the under or over provision.

| Overprovision | Under provision |
|---|---|
| An overprovision arises where the tax paid in respect of profits for a given year is less than the tax charged to profit or loss for that year. | An under provision arises where the tax paid in respect of profits for a given year exceeds the tax charged to profit or loss for that year. |
| The amount of the **overprovision is deducted** from the following year's tax charge. | The amount of the **under provision is added** to the following year's tax charge. |

An under or overprovision does not normally affect the **current tax liability** of the following year.

### 1.1.2 Unpaid tax in respect of prior periods

Any unpaid tax in respect of prior periods is included in the year-end current tax liability.

### 1.1.3 Recoverable tax

If the tax paid in respect of current and prior periods exceeds the amount due for those periods, the **excess is recognized as an asset**.

### 1.1.4 Tax losses

Where tax losses are made and utilized in a period, a tax credit is measured at the amount expected to be recovered from the tax authorities and is generally recognized:

(a) As a credit within the tax charge to profit or loss
(b) As a current asset at the period end

In some jurisdictions, corporate tax losses may be carried back to reduce the current tax charge of previous periods. In this case, the benefit of the tax loss carried back is recognized as an asset. This treatment of tax losses is not permitted in Sri Lanka.

### 1.1.5 Recognition of current tax outside profit or loss

As we have seen, the current tax charge (or credit) is generally recognized in profit or loss. If, however, a transaction or event is recognized in other comprehensive income or directly in equity (in the same or a different period), then the related tax is also recognized in **other comprehensive income** or **directly in equity**.

An example of such a situation is where, under LKAS 8, an adjustment is made to the **opening balance of retained earnings** due to either a change in accounting policy that is applied retrospectively, or the correction of a material prior period error.

**Question 02 – Current Tax**

Jaffna Supplies (Pvt) Ltd had taxable profits of Rs. 950,000 in 2018. In the previous year, income tax on profits had been estimated as Rs. 405,000. The corporate income tax rate is 28%.

**Required:** Calculate the tax charge to profit or loss for 2018 if the tax due on 2017 profits was subsequently settled with the tax authorities as:

(a) Rs. 380,000
(b) Rs. 415,000

## 1.2 Presentation of Current Tax

In the statement of financial position, **current tax assets and liabilities** should be shown separately from other assets and liabilities.

Current tax assets and liabilities can be **offset**, but this should happen only when certain conditions apply.

(a) The entity has a **legally enforceable right** to set off the recognized amounts.
(b) The entity intends to settle the amounts on a **net basis**, or to realize the asset and settle the liability at the same time.

The **tax expense (income)** related to the profit or loss from ordinary activities should be shown in the statement of profit or loss.

## 2. DEFERRED TAX

Deferred tax is an **accounting measure** used to match the future tax effects of transactions with their accounting impact.

| | |
|---|---|
| **Deferred Tax Liabilities** | The amounts of income taxes payable in future periods in respect of taxable temporary differences. |
| **Deferred Tax Assets** | The amounts of income taxes recoverable in future periods in respect of:<br>(a) deductible temporary differences<br>(b) the carry forward of unused losses<br>(c) the carry forward of unused tax credits |
| **Temporary Differences** | Differences between the carrying amount of an asset or liability in the statement of financial position and its tax base |
| **Taxable Temporary Differences** | 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** | 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 |
| **Tax Base** | The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes. |

### 2.1 Purpose of deferred tax

Deferred tax compensates for temporary differences between taxable and accounting profits and attempts **to match the tax impact of a transaction to the accounting impact for the purposes of financial reporting**, so that both are reported in the same period.

For example:

(a) If a provision for a future expense is made in the current accounting period, but the expense is not tax allowable until paid, a deferred tax adjustment will result in tax relief being recognized as a reduction to the tax charge in the statement of profit or loss in the current period alongside the expense.

(b) If an entity buys an asset and depreciates is over ten years but 100% tax relief is given immediately, a deferred tax adjustment will result in tax relief being delayed in the statement of profit or loss and spread over the ten-year depreciation period. A deferred tax charge or credit will therefore form an additional element of the tax charge for the year alongside the current year tax charge and any under or overprovision for the previous year.

## 2.2 Approach to deferred tax

LKAS 12 takes a 'balance sheet' approach to deferred tax, calculating temporary differences based on the accounting and tax carrying amounts of the underlying assets or liabilities. The steps to calculate deferred tax amounts for inclusion in the financial statements are:

1. Calculate the tax base of the underlying asset or liability.
2. Calculate the temporary difference as the difference between carrying amount and tax base.
3. Apply the relevant tax rate to calculate the deferred tax asset or liability.
4. Record the overall deferred tax asset or liability.

## 2.3 Tax Base

Remember that some items do have a tax base even though they are not recognized as assets and liabilities in the statement of financial position.

### 2.3.1 Tax Base of an Asset

(a) 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 the entity when it recovers the carrying amount of the asset.

(b) Where those **economic benefits are not taxable**, the **tax base** of the asset is the same as **its carrying amount**.

## Question 03 – Tax Base of an asset

State the tax base of each of the following.

(a) A machine cost Rs. 100,000 and has a carrying amount of Rs. 80,000. For tax purposes, depreciation of Rs. 30,000 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.
(b) Interest receivable has a carrying amount of Rs. 10,000. The related interest revenue will be taxed on a cash basis.
(c) Prepaid rental expenses have a carrying amount of Rs. 30,000. Tax relief was given for the rental expenses when paid.
(d) Undepreciated land that originally cost Rs. 30m has been impaired by Rs. 8m. The impairment loss is not recognized for tax purposes until the land is sold.
(e) A loan receivable has a carrying amount of Rs. 10m. The repayment of the loan will have no tax consequences.
(f) Trade receivables have a gross carrying amount of Rs.100m and the provision for impairment is Rs.10m. The related revenue has already been included in taxable profit (tax loss).
(g) Dividends receivable from a subsidiary have a carrying amount of Rs.30m. The dividends are not taxable.

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### 2.3.2 Tax Base of a Liability

(a) The tax base of a liability is its **carrying amount less any amount that is deducted** for tax purposes in relation to the liability in future periods.
(b) For revenue received in advance, the tax base of the resulting liability is its carrying amount less any amount of revenue that will not be taxable in future periods.

## Question 04 – Tax Base of a Liability

State the tax base of each of the following liabilities.

(a) Current liabilities include accrued expenses with a carrying amount of Rs. 100,000. The related expense will be deducted for tax purposes on a cash basis.

(b) Current liabilities include interest revenue received in advance, with a carrying amount of Rs. 100,000. The related interest revenue was taxed on a cash basis.
(c) Current liabilities include accrued expenses with a carrying amount of Rs. 200,000. The related expense has already been deducted for tax purposes.
(d) Current liabilities include accrued fines and penalties with a carrying amount of Rs. 100,000. Fines and penalties are not deductible for tax purposes.
(e) A loan payable has a carrying amount of Rs. 10m. The repayment of the loan will have no tax consequences.

### 2.3.3 Circumstances where tax base is equal to carrying amount

LKAS 12 gives the following examples of circumstances in which the **tax base** of an asset or liability will be **equal to its carrying amount**.

- Accrued expenses which have already been deducted in determining an entity's current tax liability for the current or earlier periods.
- A loan payable which is measured at the amount originally received and this amount is the same as the amount repayable on final maturity of the loan.
- Accrued expenses which will never be deductible for tax purposes.
- Accrued income which will never be taxable.

## 2.4 Temporary differences

Temporary differences may be either:

(a) **Taxable Temporary Differences (TTD)**, 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 (DTD)**, 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.

Type of temporary difference will depend on the **carrying amount (CA)** and the **tax base (TB)** of the considered asset or liability. It is summarized as follows.

| | | |
|---|---|---|
| Asset | CA>TB | Taxable Temporary Difference |
| | CA<TB | Deductible Temporary Difference |
| Liability | CA>TB | Deductible Temporary Difference |
| | CA<TB | Taxable Temporary Difference |

## 2.5 Calculation of deferred tax assets and liabilities

The relevant tax rate is applied to a temporary difference in order to calculate the deferred tax asset or liability:

- Taxable temporary difference × Tax rate = Deferred tax liability
- Deductible temporary difference × Tax rate = Deferred tax asset

## 2.6 Taxable temporary differences

A taxable temporary difference results in increased amounts of tax in the future and so a deferred tax liability. It is useful to understand the reasoning behind the recognition of deferred tax liabilities on taxable temporary differences.

(a) When an **asset is recognized**, it is expected that its carrying amount will be recovered in the form of economic benefits that flow to the entity in future periods.

(b) If the carrying amount of the **asset is greater** than its tax base, then taxable economic benefits will also be greater than the amount that will be allowed as a deduction for tax purposes.

(c) The difference is therefore a **taxable temporary difference** and the obligation to pay the resulting income taxes in future periods is a **deferred tax liability**.

(d) As the entity recovers the carrying amount of the asset, the taxable temporary difference will **reverse,** and the entity will have taxable profit.

(e) It is then probable that economic benefits will flow from the entity in the form of tax payments, and so the recognition of deferred tax liabilities is required by LKAS 12.



### 2.6.1 Examples of taxable temporary differences

The following are examples provided by LKAS 12 of circumstances that give rise to taxable temporary differences. They will all result in a higher tax charge in one or more future periods.

#### 2.6.1.1 Items carried at historical cost

1. **Interest revenue** received in arrears and included in accounting profit when receivable but included in taxable profit on a cash basis.

| | |
|---|---|
| Carrying Amount | Interest receivable |
| Tax Base | Nil (0) |

***Ex**: An entity with a financial year ending on 31 December 203 holds a medium–term cash deposit on which interest of CU10,000 is received annually on 31 March. The interest is taxed in the year of receipt. At 31 December 20X3, the entity recognizes a receivable of CU7,000 in respect of interest accrued but not yet received. The receivable has a tax base of nil, since its recovery has tax consequences and no tax deductions are available in respect of it. The temporary difference associated with the receivable is CU7,000 (CU7,000 carrying amount less nil tax base).*

2. **Depreciation** of an asset is accelerated for tax purposes, i.e. tax depreciation is given at a faster rate than accounting depreciation such that the carrying amount of an asset exceeds its tax base. This may be referred to as 'accelerated capital allowances'.

| | |
|---|---|
| Carrying Amount | Cost – Acc. Depreciation |
| Tax Base | Cost – Acc. Tax Depreciation |

***Ex**: An entity has an item of PPE whose cost is fully tax deductible, but with deductions being given over a period shorter than the period over which the asset is being depreciated. At the reporting date, the asset has been depreciated to CU500,000 for financial reporting purposes but to CU300,000 for tax purposes.*

*Recovery of the PPE has tax consequences since, although there is no deduction for accounting depreciation in the tax return, the PP&E is recovered through future taxable profits. There is a taxable temporary difference of CU200,000 between the carrying value of the asset (CU500,000) and its tax base (CU300,000).).*

3. **Development costs** which have been capitalized will be amortized in profit or loss, but they were deducted in full of taxable profit in the period in which they were incurred.

| | |
|---|---|
| Carrying Amount | Cost – Acc. Amortization |
| Tax Base | Nil (0) |

***Ex**: An entity incurred development costs of CU1 million during the year ended 31 December 20X3. The costs were fully deductible for tax purposes in the tax return for that period but were recognized as an intangible asset under IAS 38 in the financial statements. The amount carried forward at 31 December 20X3 is CU800,000.*

*Recovery of the intangible asset through use has tax consequences since, although there is no deduction for accounting amortization in the tax return, the asset is recovered through future profits which will be taxed. There is a taxable temporary difference of CU800,000 between the carrying value of the asset (CU800,000) and its tax base (nil). Although the expenditure to create the asset is tax–deductible in the current period, its tax base is the amount deductible in future periods, which is nil, since all deductions were made in the tax return for 20X3.*

*A similar analysis would apply to prepaid expenses that have already been deducted on a cash basis in determining the taxable profit of the current or previous periods.*

4. A borrower records a **loan** at proceeds received (amount due at maturity) less transaction costs. The carrying amount of the loan is subsequently increased by amortization of the transaction costs against accounting profit. The **transaction costs were, however, deducted for tax purposes in the period when the loan was first recognized**.

| | |
|---|---|
| Carrying Amount | Amortized Cost |
| Tax Base | Loan Proceed |

| **Question 05 – TTD** |
|---|

Perera Chemicals Ltd is involved in the development of new chemical processes. At the start of October 20X6, it capitalized development costs of Rs. 160,000 and started to amortized them over 10 years in accordance with LKAS 38. These costs were relieved in full for tax purposes in the year ended 31 March 20X7.

The company also acquired a van on 1 April 20X6 for use in the business, costing Rs. 60,000. It is being depreciated over six years and attracts tax allowances of 20% on cost.

**Required**
**Calculate** the temporary difference that arises on these assets at 31 March 20X7.

#### 2.6.1.2 Items carried at fair value

5. **Financial instruments (including equity and debt investments)** may be carried at fair value. This may exceed cost, but no equivalent adjustment is made for tax purposes.

| | |
|---|---|
| Carrying Amount | Fair Value |
| Tax Base | Cost |

***Ex**: An entity holds investments, accounted for at fair value through profit or loss, with a carrying amount of CU2 million and an original cost (and tax base) of CU1.3 million. There is a taxable temporary difference of CU700,000 associated with the investments, being the amount on which the entity would pay tax if the investments were realized at their carrying value.*

6. Property, plant and equipment (including right-of-use assets) can be revalued by an entity (as permitted by LKAS 16), but no equivalent adjustment is made for tax purposes. This also applies to long-term investments.

| | |
|---|---|
| Carrying Amount | Revalued Amount |
| Tax Base | Original Cost – Acc. Tax Depreciation |

In these cases, the deferred tax provision recognizes that additional profit will be realized on the use or eventual disposal of these assets, leading to a higher tax charge.

**Question 06 – Revaluation**

Moratuwa Supplies (Pvt) Ltd revalued a factory to Rs. 32,000,000 on 31 December 20X8. The property had cost Rs. 24,000,000 four years previously and was being depreciated over 50 years on a straight-line basis. Capital allowances were provided on the property at 6.67% of cost. The applicable tax rate is 28%.

**Required**
**Calculate** the deferred tax that arises on the revaluation, assuming that the revaluation gain does not form part of taxable income.

### 2.6.2 Timing differences

LKAS 12 refers to some of the temporary differences listed above as **timing differences**. These are temporary differences where income or expense is included in accounting profit in one period but in taxable profit in a different period.

Examples of timing differences which result in taxable temporary differences are:
(a) Interest revenue which is included in accounting profit when receivable but included in taxable profit when received.
(b) Tax depreciation allowances which are given at a faster rate than accounting depreciation ('accelerated capital allowances').
(c) Development costs which are capitalized and amortized for accounting purposes but are tax allowable in the period in which they are incurred.

### 2.6.3 Taxable temporary differences that do not result in deferred tax liabilities.

LKAS 12 provides two circumstances where a taxable temporary difference does not give rise to a deferred tax liability:

(a) The deferred tax liability arises from the initial recognition of goodwill.

(b) The deferred tax liability arises from the initial recognition of an asset or liability in a transaction that:
- Is not a business combination
- At the time of the transaction, affects neither accounting profit nor taxable profit

**Example: initial recognition of an asset**

The Liyanage Bus Company purchases an item of property, plant and equipment for Rs. 200,000. No tax deduction is available for this asset either through its use or on its eventual disposal.

There is therefore a taxable temporary difference of Rs. 200,000 on initial recognition of the asset. The asset was not purchased in a business combination, and therefore the resulting deferred tax liability would not be recognized.

## 2.7 Deductible temporary differences

A deductible temporary difference results in decreased amounts of tax in the future and so a deferred tax asset. It is useful to understand the reasoning behind the recognition of deferred tax liabilities on taxable temporary differences.

(a) When a **liability is recognized**, it is assumed that its carrying amount will be settled in the form of outflows of economic benefits from the entity in future periods.

(b) When these resources flow from the entity, part or all may be deductible in determining taxable profits of a **period later** than that in which the liability is recognized.

(c) A **temporary tax difference** then exists between the carrying amount of the liability and its tax base.

(d) A **deferred tax asset** therefore arises, representing the income taxes that will be recoverable in future periods when that part of the liability is allowed as a deduction from taxable profit.

(e) Similarly, when 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.

### 2.7.1 Examples of deductible temporary differences

The following are examples provided by LKAS 12 of circumstances that give rise to deductible temporary differences. They will all result in a lower tax charge in one or more future periods.

1. **Pension costs** (Retirement Benefit Obligations) are deducted from accounting profit, as service is provided by the employee. They are not deducted in determining taxable profit until the entity pays either retirement benefits or contributions to a fund. (This may also apply to similar expenses.)

| | |
|---|---|
| Carrying Amount | Carrying amount of pension asset/liability |
| Tax Base | Nil (0) - Carrying amount less the amount that will be tax deductible in the future |

2. An item of **PPE is impaired**, but that reduction is ignored for tax purposes until the asset is sold.

| | |
|---|---|
| Carrying Amount | Impaired Amount |
| Tax Base | Cost – Acc. Tax Depreciation |

3. **Research costs** (or organization/other start-up costs) are recognized as an expense for accounting purposes but are not deductible against taxable profits until a later period.

| | |
|---|---|
| Carrying Amount | Nil (0) |
| Tax Base | Research costs deductible in future |



### 2.7.2 Unused tax losses and unused tax credits

An entity may have unused tax losses or credits which it can offset against taxable profits at the end of a period.

In Sri Lanka, tax losses should be first used in the current year, and remaining amount can be carried forward for future years. **Where they are carried forward, LKAS 12 states that a deferred tax asset may be recognized to the extent that it is probable that future taxable profit will be available against which the unused tax losses/credits can be utilized.**

Example:

- *At 31 December 20X1, Corea Communications Ltd has unused tax losses of Rs. 750,000 and taxable temporary differences of Rs. 250,000 relating to*

- *the same taxation authority. Corea Communications has been loss making for the last two years.*
- *In the absence of convincing evidence that there will be sufficient taxable profits against which the deductible temporary differences can be realized, a deferred tax asset is only recognized to the extent of the taxable temporary differences.*
- *Therefore, a deferred tax asset is recognized for Rs. 250,000 of the unused tax losses and a deferred tax liability is recognized for the Rs. 250,000 taxable temporary differences.*

### 2.7.3 Deductible temporary differences that do not result in deferred tax assets

As with temporary taxable differences, there are also circumstances where the overall rule for recognition of a deferred tax asset is not allowed. This applies where the **deferred tax asset arises from initial recognition of an asset or liability in a transaction which is not a business combination** and, at the time of the transaction, affects neither accounting nor taxable profit/tax loss.

- *The example given by the standard is of a non-taxable government grant related to an asset, deducted in arriving at the carrying amount of the asset. For tax purposes, however, it is not deducted from the asset's depreciable amount (i.e. its tax base). The carrying amount of the asset is less than its tax base and this gives rise to a deductible temporary difference, however this is not recognized as a deferred tax asset.*

## 2.8 Measurement of deferred tax assets or liabilities

LKAS 12 adopts the full provision method of providing for deferred tax, meaning that deferred tax is provided for on all temporary differences regardless of the plans of an entity.

| | |
|---|---|
| Tax Rate | ▪ At the **tax rates that are expected to apply** to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.<br>▪ If announcement of new tax rates by the government has substantive effect on actual enactment, then **announced rate** can be used.<br>▪ If different tax rates apply to different levels of taxable income, then an **average rate** can be used. |
| Manner of recovery | ▪ The tax rate applied to a temporary difference in order to measure a deferred tax asset or liability reflects the tax consequences of the expected manner of recovery of the carrying amount of the underlying asset or liability.<br>▪ In some jurisdictions, the manner of recovery may affect: |

| | |
|---|---|
| | ○ The **tax rate** applicable and the **tax base** of the asset or liability |
| Discounting | ▪ Shall not be discounted. |

**Question 07 – Tax Rate**

Negombo (Pvt) Ltd has an asset with a carrying amount of Rs. 800,000 and a tax base of Rs. 500,000. The current tax rate is 28% and the rate is being reduced to 25% in the next tax year. Negombo plans to dispose of the asset for its carrying amount and will do so after the tax rate falls.

**Calculate** the deferred tax asset or liability resulting from the above asset.

**Question 08 – Manner of recovery**

**Explain** how the deferred tax asset or liability need to be recognized in below situations as per LKAS 12.

a. Dambulla Imports (Pvt) Ltd has an asset with a carrying amount of Rs. 1,000,000 and a tax base of Rs. 600,000. The company operates in a jurisdiction where, if the asset were sold, a tax rate of 25% would apply. A tax rate of 32% would apply to other income.
b. An item or property, plant and equipment with a cost of Rs.100,000 and a carrying amount of Rs.80,000 is revalued to Rs.150,000. No equivalent adjustment is made for tax purposes. Cumulative depreciation for tax purposes is Rs.30,000 and the tax rate is 30%. If the item is sold for more than cost, the cumulative tax depreciation of Rs.30,000 will be included in taxable income but sale proceeds in excess of cost will not be taxable.
c. An investment property has a cost of 100 and fair value of 150. It is measured using the fair value model in LKAS 40. It comprises land with a cost of 40 and fair value of 60 and a building with a cost of 60 and fair value of 90. The land has an unlimited useful life. Cumulative depreciation of the building for tax purposes is 30. Unrealized changes in the fair value of the investment property do not affect taxable profit. If the investment property is sold for more than cost, the reversal of the cumulative tax depreciation of 30 will be included in taxable profit and taxed at an ordinary tax rate of 30%. For sales proceeds in excess of cost, tax law specifies tax rates of 25% for assets held for less than two years and 20% for assets held for two years or more.

## 2.9 Recognition of deferred tax assets or liabilities

- A deferred tax liability should be recognized in respect of **all taxable temporary differences**.
- A deferred tax asset should be recognized for all deductible temporary differences **to the extent that it is probable that future taxable profit will be available** against which related deductible temporary differences can be utilized.

LKAS 12 states that there is **assumed to be future taxable profit available when sufficient taxable temporary differences exist** which relate to the same taxation authority and the same taxable entity. These should be expected to reverse as follows.

(a) In the same period as the expected reversal of the deductible temporary difference

(b) In periods into which a tax loss arising from the deferred tax asset can be carried back or forward Only in these circumstances is the deferred tax asset recognized, in the period in which the deductible temporary differences arise.

However, **when there are insufficient taxable temporary differences** (relating to the same taxation authority and the same taxable entity) it may still be possible to recognize the deferred tax asset, but only to the following extent.

- **Taxable profits are sufficient 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 forward or backward), ignoring taxable amounts arising from deductible temporary differences arising in future periods.
- **Tax planning opportunities exist** that will allow the entity to create taxable profit in the appropriate periods.

### 2.9.1 Recognition of the movement in deferred tax asset/liability

The movement in the overall deferred tax asset or liability from year to year is normally recognized as income or an expense and included in the net profit or loss for the period. The exceptions to this rule are where the tax arises from the events below.

1. A transaction or event that is recognized (in the same or a different period) **in other comprehensive income** (e.g., a revaluation)
2. A transaction or event that is recognized (in the same or a different period) **directly in equity** (e.g. the correction of an error)

Where transactions or events are recognized in other comprehensive income or directly in equity, the related tax is recognized similarly.

# 3. PRESENTATION & DISCLOSURE

Refer LKAS 12 requirements in the standard through http://www.slaasc.lk/accounting/ACS01.php?item=29 . Below are illustrative examples.

The major components of income tax expense for the years ended 31 December 2024 and 2023 are: *IAS 12.79*

| **Consolidated profit or loss** | **2024** | **2023** | |
|---|---|---|---|
| | **€000** | **€000** | |
| *Current income tax:* | | **Restated** | |
| Current income tax charge | 2,883 | 2,770 | *IAS 12.80(a)* |
| Adjustments in respect of current income tax of previous year | (18) | (44) | *IAS 12.80(b)* |
| *Deferred tax:* | | | |
| Relating to origination and reversal of temporary differences | 227 | (493) | *IAS 12.80(c)* |
| **Income tax expense reported in the statement of profit or loss** | **3,092** | **2,233** | |

| **Consolidated other comprehensive income** | **2024** | **2023** | *IAS 12.81(ab)* |
|---|---|---|---|
| | **€000** | **€000** | |
| ***Deferred tax related to items recognised in OCI during in the year:*** | | | *IAS 1.90* |
| Net (gain)/loss on cash flow hedges | 265 | (10) | |
| Net change in costs of hedging | 10 | – | |
| Net loss on debt instruments at fair value through OCI | 6 | – | |
| Net (gain)/loss on equity instruments designated at fair value through OCI | 8 | (3) | |
| Revaluation of office properties in Euroland | (254) | – | |
| Net gain on hedge of net investment | (83) | – | |
| Remeasurement (gain)/loss on actuarial gains and losses | (110) | 117 | |
| **Deferred tax charged to OCI** | **(158)** | **104** | |

Reconciliation of tax expense and the accounting profit multiplied by Euroland's domestic tax rate for 2023 and 2024: *IAS 12.81 (c)(i)*

| | **2024** | **2023** |
|---|---|---|
| | **€000** | **€000** |
| | | **Restated** |
| Accounting profit before tax from continuing operations | 11,088 | 8,880 |
| Profit/(loss) before tax from a discontinued operation | 213 | (193) |
| **Accounting profit before income tax** | **11,301** | **8,687** |
| At Euroland's statutory income tax rate of 30% (2023: 30%) | 3,390 | 2,606 |
| Adjustments in respect of current income tax of previous years | (18) | (44) |
| Government grants exempted from tax | (316) | (162) |
| Utilisation of previously unrecognised tax losses | (231) | (89) |
| Share of results of an associate and joint ventures | (201) | (191) |
| Non-deductible expenses for tax purposes: | | |
| Impairment of goodwill | 60 | – |
| Contingent consideration remeasurement (Note 8) | 107 | – |
| Other non-deductible expenses | 10 | – |
| Effect of higher tax rates in the United States | 284 | 108 |
| **At the effective income tax rate of 27% (2023: 26%)** | **3,085** | **2,228** |
| Income tax expense reported in the statement of profit or loss | 3,092 | 2,233 |
| Income tax attributable to a discontinued operation | (7) | (5) |
| | **3,085** | **2,228** |

| Reconciliation of deferred tax liabilities, net | 2024 | 2023 |
|---|---|---|
| | €000 | €000 |
| | | Restated |
| **As of 1 January** | (242) | (459) |
| Tax expense during the period recognised in profit or loss | (227) | 493 |
| Tax income/(expense) during the period recognised in OCI | (158) | 104 |
| Discontinued operation | (2) | – |
| Deferred taxes acquired in business combinations | (1,511) | (380) |
| **As at 31 December** | **(2,140)** | **(242)** |

**Deferred tax**

Deferred tax relates to the following:

| | Consolidated statement of financial position | | Consolidated statement of profit or loss | | |
|---|---|---|---|---|---|
| | 2024 | 2023 | 2024 | 2023 | IAS 12.81(g)(i) |
| | €000 | €000 | €000 | €000 | IAS 12.81(g)(ii) |
| | | Restated | | Restated | |
| Accelerated depreciation for tax purposes | (2,838) | (599) | 723 | (298) | |
| Revaluations of investment properties to fair value | (1,330) | (1,422) | (92) | (90) | |
| Revaluations of office properties in Euroland to fair value | (254) | – | – | – | |
| Revaluations of equity instruments to fair value through profit or loss | (16) | (5) | 11 | 3 | |
| Revaluations of financial assets at fair value through OCI | 13 | (4) | – | – | |
| Revaluation of forward contracts and embedded derivatives | 196 | – | (196) | – | |
| Revaluation of a hedged loan to fair value | (11) | – | 11 | – | |
| Net gain on hedge of a net investment | (83) | – | – | – | |
| Share based payments | 51 | 100 | 49 | – | |
| Post-employment medical benefits | 102 | 59 | (43) | (33) | |
| Pension | 813 | 834 | (89) | 55 | |
| Revaluations of an interest rate swap (fair value hedge) to fair value | 11 | – | (11) | – | |
| Revaluations of cash flow hedges | 270 | 30 | 35 | – | |
| Expected credit losses of debt financial assets | 110 | 70 | (40) | 3 | |
| Contract liabilities for customer loyalty points | 270 | 203 | (67) | (199) | |
| Right-of-use assets | (246) | (267) | (21) | (62) | |
| Lease liabilities | 322 | 339 | 17 | 42 | |
| Convertible preference shares | 91 | 55 | (36) | (31) | |
| Losses available for offsetting against future taxable income | 389 | 365 | (24) | (44) | |
| **Deferred tax expense/(benefit)** | | | **227** | **(654)** | |
| **Net deferred tax liabilities** | **(2,140)** | **(242)** | | | |
| Reflected in the statement of financial position as follows: | | | | | |
| Deferred tax assets | 389 | 365 | | | |
| Deferred tax liabilities: | | | | | |
| Continuing operations | (2,454) | (607) | | | |
| Included in liabilities directly associated with the assets held for sale | (75) | – | | | |
| **Deferred tax liabilities, net** | **(2,140)** | **(242)** | | | |