Tax Accounting: Current and Deferred Tax

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Introduction

Who is responsible for tax accounting? If you ask an accountant about "tax accounting", they will see the word "tax" and likely refer you to the tax department. Ask a tax professional about tax accounting, and they will see the word "accounting" and probably refer you to the accounting/finance department. As a result, tax accounting often ends up falling between the gaps.

Regardless of who is responsible for it and best placed to deal with it, the fact is that tax accounting is becoming more relevant to tax professionals. In particular, for tax professionals working in the plc/multinational space, tax accounting is something that they must at least have a working knowledge of, as ultimately the amount booked in respect of tax in the profit and loss account will have an impact on the earnings released to the market.

Accounting Frameworks

Before considering tax accounting, we will briefly set out some of the background to the accounting frameworks available to Irish companies. Currently, most Irish companies prepare their financial statements using Irish GAAP (generally accepted accounting principles), referred to hereinafter as "old Irish GAAP". However, some companies choose to prepare their financial statements using IFRS (International Financial Reporting Standards). Generally, EU-listed groups must prepare their consolidated financial statements using IFRS.[1]

In an Irish context, currently an Irish plc may prepare its consolidated financial statements in accordance with IFRS. However, it may prepare the individual statutory financial statements of the companies within the group under, say, old Irish GAAP, i.e. the statutory or individual financial statements of the parent or subsidiary companies need not be prepared under IFRS. Note that in preparing the individual parent or subsidiary financial statements, the directors are obliged to apply a consistent accounting framework throughout the group unless there are good reasons to do otherwise.

1 The requirement for groups on EU stock markets to prepare their consolidated financial statements using IFRS is confined to groups with securities admitted to trading on a regulated market of any EU Member State within the meaning of Article 1(13) of Council Directive 93/22/EEC of 10 May 1993.

In addition, Irish companies currently have the option of preparing financial statements for periods ending on or after 31 December 2012 using FRS (Financial Reporting Standard) 101[2] or FRS 102. For all accounting periods beginning after 1 January 2015, old Irish GAAP will no longer be an option, and most Irish companies must choose to prepare their financial statements under IFRS, FRS 101 or FRS 102. It is likely that most Irish companies currently preparing their financial statements using old Irish GAAP will choose to transition to FRS 102 ("new Irish GAAP").

Transitioning from old Irish GAAP to IFRS, FRS 101 or FRS 102 may result in different treatment of particular items (including deferred tax) in the financial statements and thus impact on the numbers. For example, a company preparing its financial statements under FRS 102 may get a profit of X; however, using the same facts, if the company prepared its financial statements under IFRS, it may get a profit of Y. In addition, the various accounting standards have different disclosure requirements: for example, although the accounting treatment under FRS 101 is broadly the same as IFRS, there are fewer disclosure requirements under FRS 101.

Accounting Standards: Tax

Broadly, the relevant accounting standards to be considered in respect of current and deferred tax under each framework are:

- Old Irish GAAP: FRS 16, which deals with current taxes; and FRS 19, which deals with deferred taxes.
- IFRS/FRS 101: IAS (International Accounting Standard) 12, which deals with both current and deferred taxes.
- FRS 102 (new Irish GAAP): s29 of FRS 102, which deals with current and deferred taxes.

IAS 12

Income taxes

Before going any further, it is worthwhile setting out what taxes IAS 12 is concerned with. IAS 12 deals with accounting for income taxes and defines income taxes as all domestic and foreign taxes that are based on taxable profits.

The starting point in determining whether IAS 12 applies to a particular tax is whether such tax is based on taxable profits as opposed to another metric, such as sales. In an Irish context, corporation tax would be an "income tax", as broadly the starting point in determining the amount of corporation tax due is the accounting profits. This should be contrasted with VAT, which is not an "income tax" for the purposes of IAS 12, as the amount of VAT is based on sales values rather than taxable profits.

Interest and penalties assessed on underpayments or late payments of income taxes are not based on taxable profits and are therefore not "income taxes" for the purposes of IAS 12. Such interest and penalties should be included under finance costs (interest) or operating costs (penalties) in the profit and loss account.

It should also be noted that research and development (R&D) credits should not be accounted for on the tax line in the profit and loss account. Generally, R&D credits are more akin to a grant, and therefore the credit should be netted against the relevant expenditure above the profit-before-tax (PBT) line in the profit and loss account. The accounting treatment would be:

Cr	(Say) Wages and salaries, or cost of sales	Profit and loss account
Dr	Income taxes due	Balance sheet[3]

Current tax

Current tax is defined in IAS 12 as the amount of income taxes payable/(recoverable) in respect of the taxable profit/(tax loss) for a period. It is the tax that the entity expects to pay/(recover) in respect of a financial period.

Corporation tax

As mentioned, in an Irish context, the most common type of current tax is corporate tax. Corporate tax is accounted for as follows:

Dr	Income taxes	Profit and loss account
Cr	Income taxes due	Balance sheet

It should be noted that income tax on medical insurance premiums is not an "income tax" for the purposes of IAS 12, and thus this tax should not be booked on the tax line in the profit and loss

2 FRS 101 is available only for qualifying entities. Broadly, a qualifying entity is a member of a group where the parent of that group prepares publicly available consolidated financial statements.

3 Referred to as the "statement of financial position" in IFRS, but we use "balance sheet" here for ease of reference.

account. Income tax on medical premiums should be accounted for as follows:

Dr	Wages and salaries	Profit and loss account
Cr	Income taxes due	Balance sheet

The income tax on medical insurance premiums will be paid to Revenue at the same time as corporation tax is due.

Withholding taxes on dividends/royalties and interest received

Withholding taxes (WHT) deducted from dividends received are an income tax for the purposes of IAS 12 and therefore should be accounted for in "income taxes" in the profit and loss account, i.e. they should not be netted against the dividend income above the PBT line. For example, if a subsidiary of a company declared a dividend of €100K but deducted WHT of €20K on payment, the accounting treatment in the parent company would be:

Cr	Dividend income	Profit and loss account	€100K
Dr	Income taxes	Profit and loss account	€20K
Dr	Bank	Balance sheet	€80K

Similarly, where WHT is deducted from interest and royalty income, the interest and royalty income is booked gross above the tax line in the profit and loss account. The WHT suffered is then booked on the income tax line in the profit and loss account. For example, Company A is due royalty income of €100K from Company B. On payment of the royalty, Company B deducts WHT of €20K. The accounting treatment in Company A is:

Journal 1: On invoicing the royalty income

Cr	Royalty income	Profit and loss account	€100K
Dr	Trade debtors	Balance sheet	€100K

Journal 2: On receipt of the income

Dr	Bank	Balance sheet	€80K
Cr	Trade debtors	Balance sheet	€80K

Journal 3: To account for WHT

Dr	Income taxes	Profit and loss	€20K
Cr	Trade debtors	Balance sheet	€20K

Withholding taxes on dividends paid

One of the key concepts of IAS 12 is that where amounts are recognised outside the profit and loss account, for example in equity, the tax should also be recognised in equity (i.e. includes reserves). Dividends paid are recognised as a debit to equity, and thus any WHT deducted by the company should also be recognised in equity. For example, if a dividend of €100 is paid but WHT of €20 is deducted from that dividend, the appropriate accounting treatment is:

Journal 1: When the dividend is declared

Dr	Equity (reserves)	Balance sheet	€100
Cr	Dividend payable	Balance sheet	€100

Journal 2: On payment of the dividend

Cr	Bank	Balance sheet	€80
Dr	Dividend payable	Balance sheet	€80

Journal 3: To account for WHT

Dr	Dividend payable	Balance sheet	€20
Cr	Other creditors – WHT due to Revenue	Balance sheet	€20

Thus in this example the WHT of €20 is recorded in equity as part of the €100 charged to equity in Journal 1. No WHT is charged to the income tax line in the profit and loss account.

In the case of an Irish company, the tax of €20 included as "Other creditors – WHT due to Revenue" should be paid to Revenue by the fourteenth day of the month following the month in which the dividend is paid.

Interest and royalties paid

For a company that has incurred a royalty of €100 but must deduct WHT of €20 before paying the royalty, the accounting treatment is:

Journal 1: To account for royalty incurred

Dr	Cost of sales	Profit and loss account	€100
Cr	Trade creditors	Balance sheet	€100

Journal 2: On payment of royalty to trade creditor

Cr	Bank	Balance sheet	€80
Dr	Trade creditors	Balance sheet	€80

Journal 3: To account for WHT

Dr	Trade creditors	Balance sheet	€20
Cr	Other creditors – WHT due to Revenue	Balance sheet	€20

The treatment of interest paid is similar.

In the case of an Irish company, the WHT of €20 included as "Other Creditors – WHT due to Revenue" will be paid to Revenue at the same time as the corporation tax is paid by the company.

Uncertain tax positions

What is an uncertain tax position? Unfortunately, tax law is not always black and white, and in certain circumstances, legislation is open to interpretation. Tax positions taken by an entity where the interpretation of tax law is unclear are referred to as uncertain tax positions. A common example of an uncertain tax position is where an entity has filed an expression of doubt in relation to a transaction.

This should be contrasted with a situation where a company has taken a position in filing its tax returns that has no basis in law: e.g. an Irish company has taken a deduction for client entertainment. In this case, there is no uncertain tax position. The tax is due in accordance with the law, and that tax should be recognised in full in the financial statements.

IAS 12 does not include explicit guidance on the recognition and measurement of uncertain tax positions. Although income taxes are outside the scope of IAS 37, "Provisions, Contingent Liabilities and Contingent Assets", the guidance in IAS 37 is considered relevant when determining the appropriate recognition and measurement of uncertain tax positions.

The entity should first determine whether it is "probable" that, on a tax authority investigation, an outflow of economic resources will occur, i.e. whether on investigation the tax authority will successfully challenge the position and taxes will become due. In determining whether it is probable, the company should presume that the tax authority has full knowledge of all relevant information. An outflow of economic resources is considered "probable" if it is more likely than not to occur, i.e. if there is a more than 50% chance that the tax authority's challenge will be successful.

If the probability threshold is met, the entity will need to measure the potential impact, i.e. the directors will need to make their best estimate of the amount of the tax that will become payable. This amount should then be booked/provided for in the financial statements. It should be noted that there are a number of different ways of measuring a provision for uncertain tax positions, but we do not propose to cover these various measurement options here. A provision should not be recognised where a reliable estimate cannot be made.

Whether or not to recognise a provision for an uncertain tax position can often be quite subjective. It is not always an easy task to determine whether a tax position would be defendable in the event of a tax authority investigation. Determining whether a provision should be booked often comes down to the experience or judgement of management and its tax advisers. A common situation that arises is where a company and its tax advisers take a different view from the auditors. In this event, the company and its tax advisers must provide further suitable evidence in support of why they consider that a provision is not required.

Where it is decided that a provision should be recognised, the appropriate accounting treatment would be:

Dr	Income taxes	Profit and loss account
Cr	Income taxes due	Balance sheet

Generally, it is necessary to disclose the nature of the provision in the financial statements by way of a note describing the provision and setting out the amount provided for. In the case of a dispute, the company may take the position that disclosing the nature of the provision is prejudicial to its position. However, in a tax context this may be difficult to argue if Revenue is not aware of the position, as at that point there is no dispute.

In addition, even if it is decided that a successful Revenue challenge is not probable, or if a successful challenge is probable but a reliable estimate of the provision cannot be made, it is necessary to disclose a contingent liability: i.e. no provision is booked in the financial statements, but a note must be included giving a description of the contingent liability and the reason why it has not been recognised.

Other

Close company surcharge

Where a close company has franked investment income or estate and investment income, a close company surcharge will arise unless the required distribution is made within 18 months of the year-end. Even if it intends to make the required distribution, the company should be prudent and recognise the close company surcharge in the financial period in which the franked investment income or estate and investment income is earned, as circumstances change, and it may not be possible to make the required distribution.

Under- or over-provision

When preparing the financial statements, a tax computation is often prepared based on materiality. Thus the corporation tax calculated for inclusion in the financial statements is not always the same as the corporation tax calculated when filing the tax return. This may result in the corporate tax in the financial statements being under- or over-provided. The financial statements should not be reopened to adjust for the under/over-provision, but instead the under/over-provision should be booked in the financial statements of the following year. The under/over-provision is booked on the income tax line in the profit and loss account and disclosed separately in the tax reconciliation note in the financial statements.

Old Irish GAAP/FRS 102 (New Irish GAAP)

The requirements of IAS 12 on accounting for current taxes do not differ significantly from those in FRS 16, "Current Tax", or FRS 102. It is in respect of deferred tax that there is a greater divergence in accounting treatment between the standards, which we will discuss below.

Deferred Taxes

At a high level, FRS 19 deals with what is known as "timing differences"; FRS 102 takes a "timing difference plus" approach; and IFRS/FRS 101 is concerned with "temporary differences". It should be noted that whereas all timing differences are temporary differences, not all temporary differences are timing differences.

In the case of timing differences that are also temporary differences, the main difference is in the approach rather than the result. For example, the method used to calculate the deferred tax on plant and machinery under old Irish GAAP (profit and loss approach) is different from the method used under IFRS (balance sheet approach), but the resulting deferred tax asset or liability should in most cases be the same.

It should also be noted that more deferred tax balances will arise under IFRS/FRS 101/FRS 102 than under old Irish GAAP, so expect deferred tax to arise more frequently in future.

Deferred Tax: Theory

Before going through a number of examples, we will set out some of the theoretical background.

IAS 12: IFRS/FRS 101

The key points in IAS 12 are:

› Broadly, deferred tax is recognised on "temporary differences".

› "Temporary differences" are differences between the "carrying amount" of an asset or liability in the balance sheet (e.g. the net book value (NBV) in respect of plant and machinery) and its "tax base" (e.g. the tax written-down value (TWDV) of plant and machinery).

› "Temporary differences" are either "**taxable** or **deductible** temporary differences".

› Deferred tax assets (DTAs) are recognised for "**deductible** temporary differences" and for unused tax losses forward.

› Deferred tax liabilities (DTLs) are recognised for "**taxable** temporary differences" and for income taxes payable in future years.

FRS 19: old Irish GAAP

FRS 19 requires deferred tax to be recognised in respect of all timing differences that have originated but not reversed by the balance sheet date. FRS 19 defines timing differences as "differences between an entity's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements. Timing differences originate in one period and are capable of reversal in one or more subsequent periods."

FRS 19 also makes reference to "permanent differences", which it defines as "differences between an entity's taxable profits and its results as stated in the financial statements that arise because certain types of income and expenditure are non-taxable or disallowable or because certain tax charges or allowances have no corresponding amount in the financial statements". Deferred tax should not be recognised in respect of permanent differences. An example of a permanent difference is client entertainment, which is not deductible for tax purposes in Ireland.

FRS 102: new Irish GAAP

As mentioned above, FRS 102 takes a "timing difference plus" approach. Financial statements prepared under FRS 102 will recognise the same timing differences as those prepared under old Irish GAAP, but additional deferred tax balances may arise under FRS 102. These include deferred tax on:

› revaluations of property (including investment properties), plant and equipment, and

› fair-value uplifts arising on business combinations.

Practical Examples

The above is probably best explained by way of some examples of typical situations in which deferred tax occurs.

Fixed assets

A company incurs €500K in respect of fixtures and fittings during an accounting period.

The fixtures and fittings are depreciated for accounting purposes over ten years. Capital allowances are available in respect of the fixtures and fittings over an eight-year period.

Under IAS 12, the DTA/DTL is computed by comparing the carrying amount of the assets (NBV) with their tax base (TWDV). At the end of FY1, the carrying amount and tax base of the fixtures and fittings are:

Carrying amount (equal to NBV)	€450K (€500K less depreciation of 10%)
Tax base (equal to TWDV)	€437.5K (€500K less wear-and-tear allowance of €62.5K (€500K @ 12.5%))

As the carrying amount exceeds the tax base, a taxable temporary difference will arise of €12.5K (€450K – €437.5K). Thus, the deferred tax liability is €1,562 (€12.5K @ 12.5%).

This is accounted for as follows:

Cr	Deferred taxes	Balance sheet	€1,562
Dr	Income taxes	Profit and loss account	€1,562

The "temporary difference" approach applied in IAS 12 is considered a balance sheet approach as, in calculating the deferred tax, consideration is given to the closing balances. However, under either old Irish GAAP or FRS 102, a "timing difference" approach is applied, which is essentially a profit and loss approach. Using the same facts as above, the deferred tax under Irish GAAP or FRS 102 would be calculated as follows:

FY1 depreciation charge €50K

FY1 wear-and-tear allowance €62.5K

The timing difference is €12.5K, and this results in a deferred tax liability of €1,562. The deferred tax is accounted for in the FRS 102/old Irish GAAP financial statements in the same manner as set out above in respect of IAS 12.

Losses forward

An Irish trading company incurs Case I trading losses of €1m in FY1. Subject to recoverability (discussed below), a deferred tax asset of €125K may be recognised (€1m @ 12.5%, the corporation tax rate). The accounting treatment would be:

Dr	Deferred taxes	Balance sheet	€125K
Cr	Income taxes	Profit and loss account	€125K

In FY2 the company incurs Case I trading profits of €500K, and these profits are sheltered using €500K of the losses forward. In this case, the DTA on the balance sheet is reduced to take account of the losses utilised, and the accounting treatment would be:

Cr	Deferred taxes	Balance sheet	€62.5K (€500K @ 12.5%)
Dr	Income taxes	Profit and loss account	€62.5K

The deferred tax asset recognised should be the same, whether accounted for under IAS 12, FRS 19 or FRS 102. Again, this is subject to recoverability, which is discussed further below.

Patent royalties/interest as a charge

Another common situation in which a DTA/DTL may arise is patent royalties and interest as a charge. Patent royalties and interest as a charge are allowed on a paid basis and thus do not follow the accounting treatment as regards the timing of the deduction.

For example, if €100 is charged to the profit and loss account in respect of patent royalties in FY1 but is not paid until FY2, using the IAS 12 approach the carrying amount and the tax base in FY1 will be:

Carrying amount	Nil
Tax base	€100

In this case, a deductible temporary difference will arise, as the tax base exceeds the carrying amount, and a deferred tax asset of €12.5 (€100 @ 12.5%) will be recognised subject to recoverability, as set out below.

Using the same facts, a deferred tax asset of €12.5 would also be recognised under FRS 19 and FRS 102.

Intellectual property

In general, a DTA/DTL will not arise in respect of intellectual property (IP) allowances claimed in accordance with s291A TCA 1997. This is because the tax treatment generally follows the accounting treatment, i.e. a deduction is given in line with the amortisation to the profit and loss account. However, note that where IP allowances are not utilised in full in an accounting period as a result of the 80% rule in s291A, recognition of a DTA subject to recoverability may be required.

Revaluation of non-investment property

When a non-investment property is revalued in the financial statements, its carrying amount is increased or decreased, but there is generally no effect on its tax base: e.g. the CGT base cost will remain the same, being the amount actually incurred on acquisition of the property. As a result, a deferred tax balance may arise, regardless of the fact that for tax purposes no actual disposal of the asset has occurred.

For example, an industrial building used for a manufacturing activity is acquired for €1m in FY1 and is depreciated for accounting and tax purposes over 25 years. At the end of FY2, when the NBV and TWDV are €920K (€1m – ((€1m @ 4%) x 2)), the building is revalued to €1.5m. As the carrying amount exceeds the tax base, there is a taxable temporary difference of €580K under IAS 12. The value of the industrial building is expected to be recovered through use (see below on recovery through use or sale). This gives rise to a DTL of *c.* €72.5K (€580K @ 12.5%).

The revaluation of a fixed asset (not being an investment property) will be credited to the statement of other comprehensive income (SOCI), which is akin to the statement of total recognised gains and losses (STRGL) under old Irish GAAP. The tax should follow the underlying accounting treatment, i.e. the accounting in respect of the deferred tax arising on the revaluation should be consistent with the treatment of the revaluation itself. The accounting treatment of the revaluation is:

On revaluation

Dr	Fixed assets	€500K
Dr	Fixed assets: accumulated depreciation	€80K
Cr	SOCI	€580K

Recognition of deferred tax

Cr	Deferred tax	Balance sheet	€72.5K
Dr	SOCI		€72.5K

The above example applies where the deferred tax is recognised in accordance with IAS 12 or FRS 102. Generally, under old Irish GAAP, no deferred tax is recognised on a revaluation unless there is a binding agreement to sell.

Business combinations

Broadly, a business combination will arise where, for example, a company acquires a new subsidiary. Generally, the acquisition of the subsidiary will not impact on the deferred tax in the statutory financial statements of the subsidiary company. However, in the consolidated financial statements, the assets and liabilities of the subsidiary must be brought in at fair value. This may result in the tax base of an asset being different from the carrying amount. Where the financial statements are prepared in accordance with IFRS/FRS 101 or FRS 102, the resulting deferred tax on acquisition will be an adjustment to goodwill in the balance sheet, i.e. the deferred tax should not be recognised in the profit and loss account. This requirement to book deferred tax to goodwill is only on the initial acquisition of the subsidiary; after the acquisition, deferred tax is dealt with in the usual manner (through the profit and loss account, other comprehensive income, equity etc.).

For example, Company A acquires Company B for €2m. In Company B's statutory financial statements, the book value and tax base of the assets are €1m. The aggregate fair value of the identifiable assets is €1.6m, with the remaining €400K relating to goodwill.

The tax base and carrying amount of the net assets are therefore:

Tax base	€1m
Fair value of identifiable net assets	€1.6m

As the fair value of the identifiable assets exceeds the tax base by €600K (€1.6m – €1m), a taxable temporary difference arises. Accordingly, assuming that the assets will be recovered through use (see below), there is a DTL of €75K (€600K @ 12.5%, the corporation tax rate).

However, the DTL is not debited to the tax line in the profit and loss account but instead is debited to goodwill. In the consolidated financial statements, the accounting entries are:

On recognition of assets (before considering deferred tax)

Dr	Assets/liabilities	€1.6m
Dr	Goodwill	€0.4m
Cr	Investment in subsidiary	€2m

Deferred tax

Dr	Goodwill	€75K
Cr	Deferred tax liability	€75K

A key point is that no deferred tax is recognised on goodwill when accounting for tax on a business combination.

In a set of consolidated financial statements prepared in accordance with old Irish GAAP, no deferred tax needs to be recognised on a business combination.

Elimination of unrealised intra-group profits

When a group entity sells goods to another group entity, the seller recognises profits made on those sales in its individual financial statements. Where the stock is still held by the purchaser at the year-end, on consolidation, the unrealised profits/costs are eliminated and the closing inventory of the group is recognised at the original cost to the purchaser. However, the tax consequences are not eliminated.

Generally, tax is charged on the profits of the individual entities and not on the profits of the group. Thus the seller will pay tax on any profits generated from the intra-group sale, while the purchaser will get a tax deduction only when it sells the stock to a non-group member. Accordingly, deferred tax should be recognised, as the purchasing company will get a tax deduction when the stock is sold.

For example, a company (Company A) sells stock with an original cost of €1,000 to its subsidiary (Company B) for €1,100. At the year-end, Company B has not sold the stock. The tax rates of Company A and Company B are 10% and 15% respectively.

The accounting treatment in the statutory financial statements is:

Company A	Dr	Cr
Intra-group debtor (balance sheet)	€1,100	
Sales		€1,100
Current tax (balance sheet)		€10
Tax: (€100 @ 10%) (profit and loss)	€10	

Company B	Dr	Cr
Intra-group creditor (balance sheet)		€1,100
Cost of sales: purchases (profit and loss)	€1,100	
Stock (balance sheet)	€1,100	
Cost of sales: stock (profit and loss)		€1,100

The accounting journals on consolidation of Company A and Company B are:

Consolidation: IFRS	Dr	Cr
Sales (profit and loss)	€1,100	
Purchases (profit and loss)		€1,100
Intra-group creditor (balance sheet)	€1,100	
Intra-group debtor (balance sheet)		€1,100
Stock (balance sheet)		€100
Cost of sales: stock (profit and loss)	€100	
Deferred tax asset (balance sheet)	€15	
Tax: (€100 @ 15%) (profit and loss)		€15

Thus, subject to recoverability, a deferred tax asset of €15 is recognised in respect of the deduction of €100 that Company B will receive when it sells the stock. In calculating the deferred tax asset, the appropriate rate for the purposes of IFRS is 15%, i.e. the purchaser's rate. Under old Irish GAAP, the correct rate would be the seller's rate, and therefore a deferred tax asset of €10 would be recognised, instead of €15.

Defined-benefit pension schemes

Deferred tax can arise on pension schemes, as a tax deduction is allowed only when the amount has been paid, as opposed to when it has been accounted for in the financial statements. For defined-benefit pension schemes, under IAS 12 any deferred tax arising on the recognised surplus or deficit should be presented with other deferred tax assets or liabilities, and not netted against the defined-benefit asset or liability. This differs from old Irish GAAP, where the deferred tax may be netted against the defined-benefit asset or liability.

Recovery

Deferred tax assets should be recognised only to the extent that it is probable that future taxable profits will be available against which they can be utilised. For example, a company that has losses forward should recognise a deferred tax asset in respect of those losses only to the extent that the company will have future profits to "mop up" the losses. This is no more than common sense as, unless there are future profits to absorb the losses, the losses have no value.

The main issue here is predicting the future. In determining whether a deferred tax asset should be recognised, the company should have regard to, among other indicators, financial projections, business outlook and contracts. Care needs to be taken in reviewing financial projections, as the further forward projections go, the less reliable they become. Also, consideration should be given to the reliability of the projections and the strength of the company's budgeting systems. For example, if a company predicted profits in FY13 of €1m and the actual result was a €1m loss, it may be appropriate not to rely too heavily on the projections in determining whether a deferred tax asset should be recognised.

In the case of a company with a historical record of losses, to support the recognition of a DTA the company would need to provide persuasive evidence (e.g. orders on its books that will result in profitability) before a DTA should be recognised.

Recovery Through Use or Sale

When the amount of tax payable or receivable is dependent on how the company recovers the asset or settles the liability, the rate and tax base used to calculate the deferred tax balances should reflect the manner in which the entity expects, at the end of the accounting period, to recover the asset or settle the liability. The manner of recovery may affect either, or both, the applicable tax rate and the tax base of the asset or liability.

For example, a company acquires an industrial building for €1m in FY1. The building is being depreciated for accounting and tax purposes over 25 years. At the end of FY2, when the NBV and TWDV are €920K (€1m – ((€1m @ 4%) x 2)), the building is revalued to €1.5m. As the carrying amount exceeds the tax base, there is a taxable temporary difference of €580K under IAS 12.

If the company sells the building for more than its original cost of €1m, a balancing charge of €80K (taxable at 12.5%) will arise, and the sales proceeds in excess of the CGT base cost of €1m will also be taxed (at a rate of 33%).

The question arises of what are the correct tax rate and tax base to use in calculating the deferred tax. If the company's intention is to recover the asset through use in its trading operations, the appropriate rate is 12.5%, giving a DTL of €72.5K.

If the company expects to recover the asset by selling it in the near future, the taxable temporary difference should be calculated as follows:

	Carrying amount	Tax base	Taxable temporary difference	Tax rate	DTL
Clawback of allowances	€1,000	€920K	€80K	12.5%	€10K
Capital gain	€1,500	€1,000	€500K	33%	€167K
					€177K

Deferred Tax Calculation: Appropriate Tax Rate

IAS 12 requires deferred tax assets and liabilities to be measured at the tax rates that are expected to apply in the period in which the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted by the end of the reporting period.

For example, a company has a year-end of 31 December 2014, and in the Budget in October 2014 the Government announces an increase in the corporate tax rate to 15%. The Finance Act will not be passed until early 2015. In this case the appropriate rate to use in calculating the deferred tax in the year-end 31 December 2014 financial statements is 12.5%, as the 15% rate will not be substantially enacted in Ireland until early 2015, i.e. the formalities of the enactment process will not be finalised until the passing of the Finance Act.

Reconciliation Note and Disclosures

Depending on which framework the financial statements are prepared under, different tax disclosures may be required. For example, the disclosure requirements under IAS 12 are much more stringent than those of old Irish GAAP.

Whether the financial statements are prepared under old Irish GAAP, IFRS/FRS 101 or FRS 102, there is a requirement to prepare a tax reconciliation note, which reconciles the expected tax (i.e. the expected tax that would arise if the standard tax rate were applied to the profits in the financial statements) with the actual tax in the financial statements. Under old Irish GAAP, the expected tax figure is reconciled to the actual current tax figure. However, under IFRS/FRS 101 and FRS 102, the expected tax is reconciled with the combined actual current and deferred tax in the profit and loss account.

Conclusion

This article touches on the more common tax accounting scenarios. Other issues that are beyond its scope would include deferred tax on:

- the recognition or revaluation of financial instruments,
- unrepatriated foreign profits and
- share-based payments.

Also, the article has an Irish focus, and as you can imagine in preparing consolidated financial statements for large corporates, the deferred tax position of non-Irish companies needs to be considered. This can be a significant challenge. There are many pitfalls for the practitioner or in-house accountants, and care should be exercised when considering tax accounting, in particular for deferred tax.

As tax professionals, we can become very narrowly focused on cash tax and underestimate the importance of provisions and deferred tax. As the figures that a company reports include cash tax, provisions and deferred tax, we need at all times to factor in the accounting implications of the advice we give and, in particular, whether tax provisions will be required. Ultimately, it is not only the cash tax that will impact on earnings but also deferred tax and provisions.

Read more on TaxFind Tax Accounting under FRS 102, *Irish Tax Review*, Issue 2, 2013