IFRS Accounting Standards discussion fora: Income taxes

2023

Addis Ababa, Ethiopia

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Applicable version of IFRS Accounting Standards

Unless specified otherwise, the accounting requirements that are the subject matter of this discussion forum are IFRS Accounting Standards as issued by the International Accounting Standards Board that are applicable for annual period beginning on or after 1 January 2023 without early applying new and amended IFRS Accounting Standards that have a later mandatory application date.

Aims

» Develop a more cohesive understanding of IFRS accounting and reporting for income taxes in Ethiopia.

» Enhance capacity in Ethiopia to apply IAS 12 *Income Taxes* more consistently.

Index of issues

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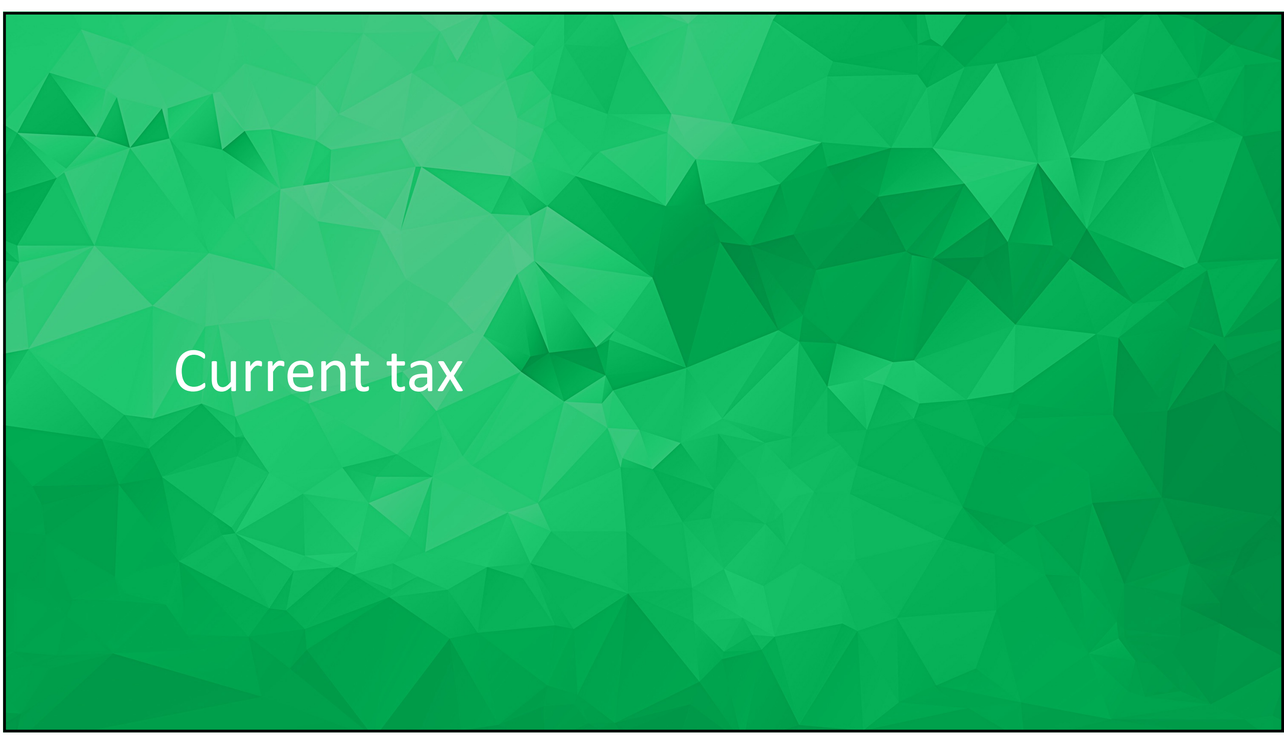

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Index of current tax issues

» Issue 1: accounting for uncertain tax positions
» Issue 2: accounting for the resolution of uncertain tax positions
» Issue 3: accounting for the effects of tax evasion: income tax, interest and penalties

Issue 1: accounting for uncertain tax positions

Accounting for uncertain current tax positions
What do you think?

Like applying tax law in many jurisdictions, due to uncertain tax positions, a reporting entity's current tax liability cannot always be determined precisely in accordance with Ethiopian tax law.

How, if at all, must entities account for uncertain tax positions?

Accounting for uncertain current tax positions
Summary of discussion

How, if at all, must entities account for uncertain tax positions?

Discussants' consensus view = in accordance with IFRIC 23, the accounting depends on whether it is probable that the taxation authority will accept the treatment of an uncertain tax position in the reporting entity's income tax filings (IFRIC 23.10 and .11):

- » If acceptance is probable, the reporting entity must account for its current income taxes consistently with the tax treatment used or planned to be used in its income tax filings.
- » If acceptance is not probable, the reporting entity must reflect the effect of uncertainty for each uncertain tax treatment by using either: (i) single most likely amount; or (ii) expected value, depending on which method the entity expects to better predict the resolution of the uncertainty.

Note: "In assessing whether and how an uncertain tax treatment affects the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, an entity shall assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations." (IFRIC 23.8)

Accounting for uncertain current tax positions
Summary illustration of discussion

- » Corporate tax rate is 30%
- » Entity determines for the year ended 31 December 2021:
  - » taxable income before uncertain item = ETB1,000,000; and
  - » 60% probability that a further ETB100,000 gain is taxable.

Discussants' consensus view = in accordance with IFRIC 23, Entity's current tax expense for 2021 is:

- » ETB330,000 (probable outcome) if management included the ETB100,000 gain is taxable income when submitting the Entity's tax return (or is planning to do so if the financial statements are prepared in advance of submitting the tax return).
- » ETB318,000 (expected value) or ETB330,000 (most likely outcome) if management did not include (or is not planning to include) the ETB100,000 gain in taxable income when submitting the Entity's tax return, whichever measurement best reflects the expected resolution of the uncertain outcome.

Issue 2: accounting for the resolution of uncertain tax positions

Accounting for the resolution of an uncertain tax position
What do you think?

"An entity shall reflect the effect of a change in facts and circumstances or of new information as a change in accounting estimate applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*." (IFRIC 23.14)

Material prior period errors must be corrected by retrospective restatement. (IAS 8.42)

How must an entity account for the resolution of an uncertain tax position?

Accounting for the resolution of an uncertain tax position
Summary of discussion

How must an entity account for the resolution of an uncertain tax position?

Discussants' consensus view = in accordance with IFRIC 23, if the facts and circumstances on which the judgement or estimate was based change (for example, as a result of new information that affects the judgement or estimate), the reporting entity must account for the change in accounting estimate prospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. (IFRIC 23.13 and .14)

Issue 3: accounting for the effects of tax evasion: income tax, interest and penalties

Accounting for the effects of tax evasion: income tax, interest and penalties
What do you think?

"An entity shall reflect the effect of a change in facts and circumstances or of new information as a change in accounting estimate applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*." (IFRIC 23.14)

Material prior period errors must be corrected by retrospective restatement. (IAS 8.42)

How must an entity account for the effects of tax evasion: income tax, interest and penalties?

Accounting for the effects of tax evasion: income tax, interest and penalties
Summary of discussion

How must an entity account for the effects of tax evasion: income tax, interest and penalties?

Discussants' consensus view = because of its nature, errors in prior period financial statement that arise from tax evasion are likely to be judged to be material prior period errors.

In accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors,* material prior period errors must be corrected by retrospective restatement (IAS 8.42).

Accounting for the effects of tax evasion: income tax, interest and penalties

Summary illustration of discussants' consensus view

Management filed Entity's tax return for the year ended 31/12/2021 after authorizing the issue of Entity's 2021 financial statements.

On 30/12/2022 Entity pays ETB330,000 to the tax authorities in respect of taxes payable for 2021 arising from management's **deliberate misinterpretation** of the tax law which resulted in ETB1,000,000 understatement of taxable income in the 2021 tax return filed with the tax authorities. Assessment resulted in:

- » additional income tax = ETB300,000;
- » penalty for late payment (ie after 2021) = ETB20,000; and
- » interest on late payment (ie after 2021) = ETB10,000.

Assuming judged to be material, how must Entity present the above amounts in its 31/12/2022 annual financial statements?

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Accounting for the effects of tax evasion: income tax, interest and penalties

Summary illustration of discussants' consensus view

In the restatement of its profit or loss for 31/12/2021 (ie the comparative figures in its 2022 financial statements), Entity must reflect the following expense:

- » ETB300,000 current tax expense (description: restatement, correction of prior period error in current tax expense for **2021**).

In the determination of its profit or loss for 31/12/2022, Entity must reflect the following expenses:

- » ETB20,000 penalty expense (before tax) because the violation of the law (the event that gave rise to the liability) occurred in 2022 when the erroneous tax return was filed; and
- » ETB10,000 additional finance cost (before tax) incurred in 2022.

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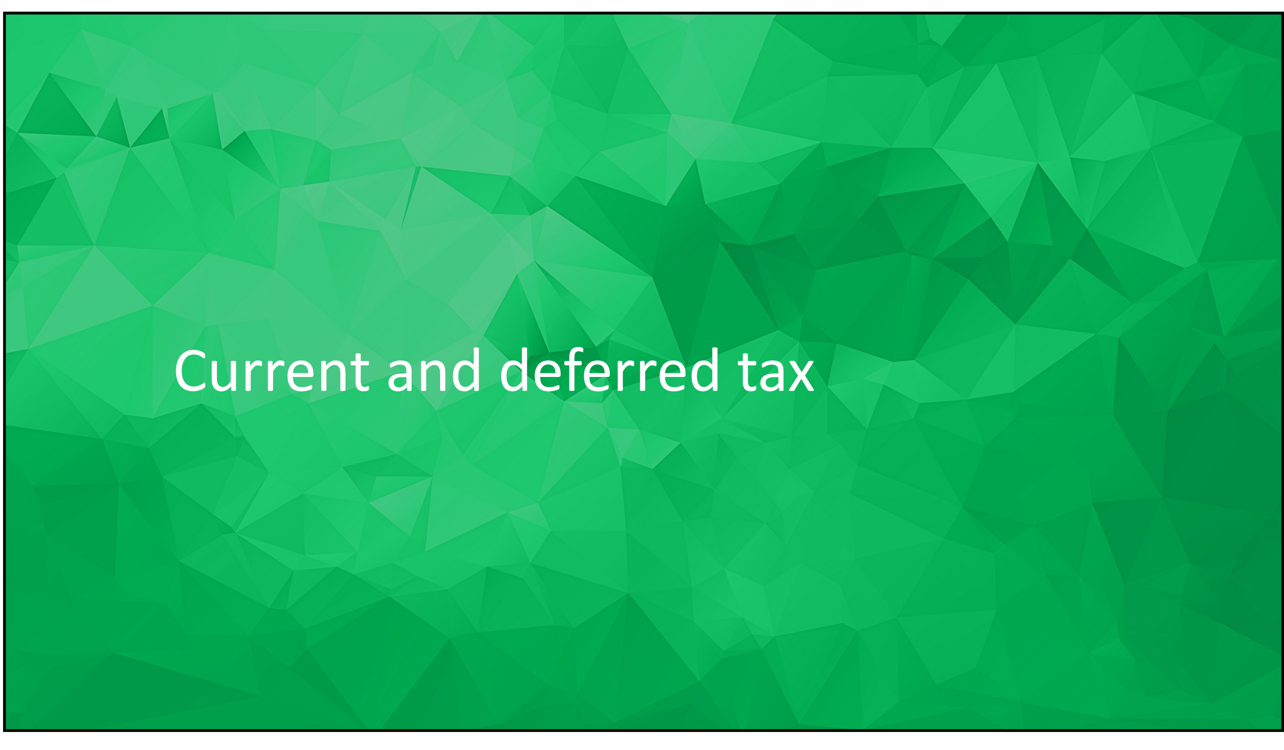

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» Issue 1: accounting for the differences between tax depreciation and accounting depreciation

Issue 1: accounting for the differences between tax depreciation and accounting depreciation

Accounting for the differences between tax depreciation and accounting depreciation

What do you think?

Tax depreciation is specified in tax law that gives effect to the Government's fiscal policy. Accounting depreciation reflects the consumption of the item's service potential. The consequent timing differences between accounting depreciation and tax depreciation effect both current tax and deferred tax.

How must an entity account for the effects of differences between tax depreciation and accounting depreciation?

Accounting for the differences between tax depreciation and accounting depreciation
Summary illustration of discussants' consensus view

- On 31 December 2023 Company buys a machine for ETB500,000.
- Company's accounting profit and taxable profit before depreciation = ETB400,000 per year (2023 through 2028).
- **Accounting:**
  - depreciate machine on straight-line method over 5 years to nil residual value
  - accounting profit = ETB300,000 per year (ie ETB400,000 less ETB100,000 machine depreciation)
- **Tax information:**
  - corporate tax rates: 30% on taxable profit (accounting profit less tax depreciation)
  - depreciate machine on straight-line method over 24 months to nil residual value

Accounting for the differences between tax depreciation and accounting depreciation: deferred tax
Summary illustration of discussants' consensus view

Date	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Deferred tax liability (30%)	Deferred tax expense (income)[1]
31/12/2023	500,000	500,000	-	-	-
31/12/2024	400,000	250,000	150,000	45,000	45,000
31/12/2025	300,000	-	300,000	90,000	45,000
31/12/2026	200,000	-	200,000	60,000	(30,000)
31/12/2027	100,000	-	100,000	30,000	(30,000)
31/12/2028	-	-	-	-	(30,000)

[1] change in the deferred tax liability in the year (increase in liability = expense; decrease in liability = income)

Accounting for the differences between tax depreciation and accounting depreciation: deferred tax, current tax and tax expense

Summary illustration of discussants' consensus view

Date	Deferred tax liability	Deferred tax expense (income)[1]	Taxable profit[2]	Current tax expense[3]	Tax expense[4]
31/12/2024	45,000	45,000	150,000	45,000	90,000
31/12/2025	90,000	45,000	150,000	45,000	90,000
31/12/2026	60,000	(30,000)	400,000	120,000	90,000
31/12/2027	30,000	(30,000)	400,000	120,000	90,000
31/12/2028	-	(30,000)	400,000	120,000	90,000

[1] change in the deferred tax liability in the year (increase in liability = expense; decrease in liability = income)
[2] ETB400,000 taxable profit before depreciation (minus tax depreciation of ETB250,000 in 2024 and 2025)
[3] 30% of taxable profit
[4] current tax expense + deferred tax expense (absent permanent differences etc = 30% of ETB300,000 accounting profit)

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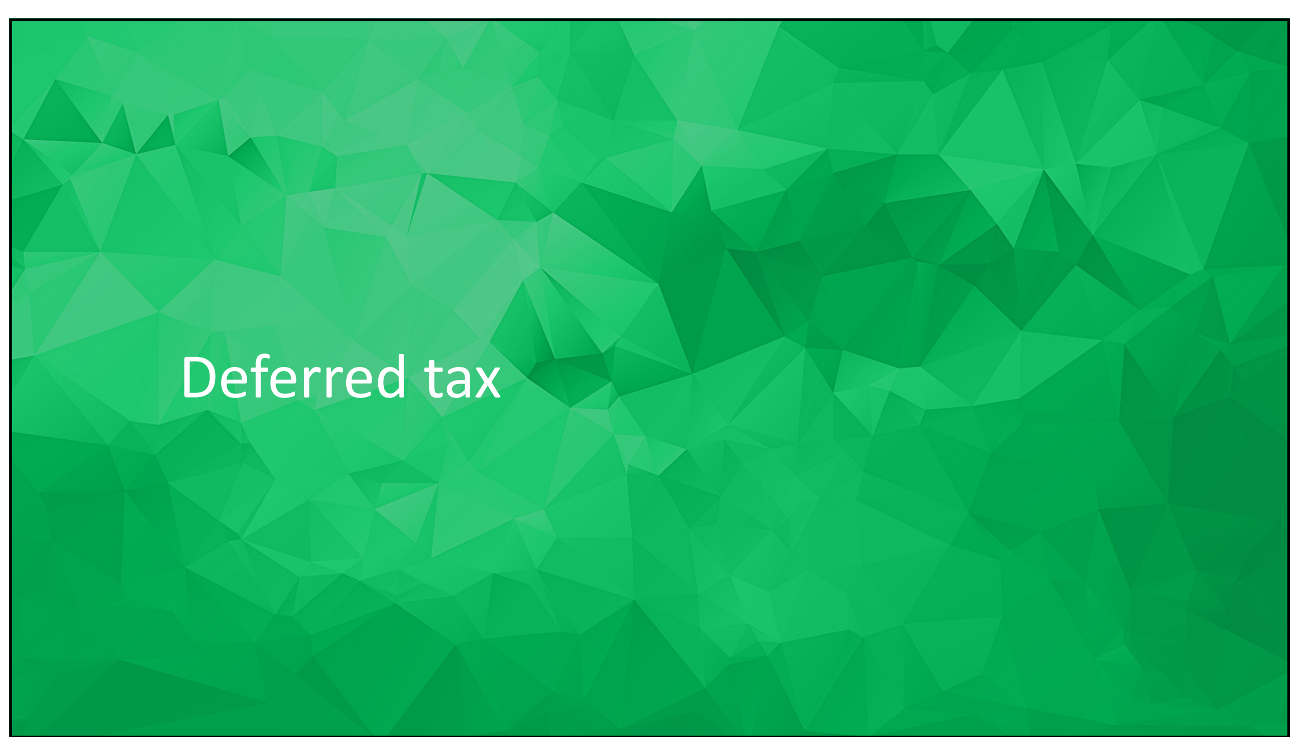

Index of deferred tax issues

- Issue 1: accounting for deferred tax relating to accounts receivable
- Issue 2: accounting for deferred tax relating to accounts payable
- Issue 3: accounting for deferred tax when using the revaluation model
- Issue 4: for deferred tax assets arising from tax losses incurred during a tax holiday
- Issue 5: offsetting deferred tax assets against deferred tax liabilities

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Accounting for deferred tax
overview of deferred tax measurement requirements

- Measure deferred tax liability (asset) using:
  - undiscounted amounts the entity expects to pay (recover)
  - substantively enacted tax rates that apply to undistributed profits reflecting the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover the carrying amount of the asset/settle the liability
    - recovery of revalued non-depreciable items of PPE is through sale *(a principle)*
    - rebuttable presumption that investment property carried at fair value is recoverable through sale (rebutted if the depreciable and objective is to recover substantially all of its carrying amount through use) *(a rebuttable 'rule')*
  - (Note: when differential tax rates apply, the average substantively enacted rate that is expected to apply to its taxable profits of the relevant future periods, for example, when the taxable temporary differences reverse.)

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Issue 1: accounting for deferred tax relating to a financial asset

Accounting for deferred tax relating to a financial asset
What do you think?

The taxing of income and expenses relating to financial assets are specified in the tax laws that give effect to fiscal policy.

IFRS 9 *Financial Instruments* specifies the accounting for financial assets.

Temporary differences between IFRS and tax accounting typically gives rise to deferred tax in accordance with IAS 12 *Income Taxes*.

How must an entity account for deferred tax relating to a financial asset?

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Accounting for deferred tax relating to a financial asset: debt instrument held

Summary illustration of discussants' consensus view

- 1 January 2025 Entity A purchases a debt instrument for ETB100,000 with the following contractual cash flow:
  - on 1 January 2028: ETB106,121 (redemption capital and interest)
- In the jurisdiction in which Entity A is based
  - income tax is levied at **30%** on taxable profits
  - taxable profits (losses) = all realised gains (losses)
- Changes in market interest rates result in fair value changes

	01/01/2025	31/12/2025	31/12/2026	31/12/2027
Market interest rate	2%	10%	1%	irrelevant
Fair value	ETB100,000	ETB87,703	ETB105,070	ETB106,121

Accounting for deferred tax relating to a financial asset: debt instrument held, an asset carried at fair value (Scenario A)

Summary illustration of discussants' consensus view

Date	Carrying amount of asset	Tax base (ie future tax deductions)	Taxable/ (deductible) temporary difference	Deferred tax liability / (asset)	Deferred tax expense / (income)[1]
01/01/2025	100,000	100,000			
fair value change	(12,297)	-	(12,297)	(3,690)	(3,690)
31/12/2025	**87,703**	**100,000**	**(12,297)**	**(3,690)**	
fair value change	17,367	-	17,367	5,211	5,211
31/12/2026	**105,070**	**100,000**	**5,070**	**1,521**	
fair value change	1,051	-	1,051	315	315
31/12/2027	**106,121**	**100,000**	**6,121**	**1,836**	
settlement	(106,121)	(100,000)	(6,121)	(1,836)	(1,836)
01/01/2028	**-**	**-**	**-**	**-**	**-**

[1] change in the deferred tax (asset) liability in the year (increase in asset = income; decrease in asset = expense; increase in liability = expense; decrease in liability = income)

Accounting for deferred tax relating to a financial asset: debt instrument held, an asset carried at amortised cost (Scenario B)

Summary illustration of discussants' consensus view

Date	Carrying amount of asset	Tax base (ie future tax deductions)	Taxable / (deductible) temporary difference	Deferred tax liability / (asset)	Deferred tax expense / (income)[1]
01/01/2025	100,000	100,000			
accreted interest	2,000	-	2,000	600	600
31/12/2025	**102,000**	**100,000**	**2,000**	**600**	
accreted interest	2,040	-	2,040	612	612
31/12/2026	**104,040**	**100,000**	**4,040**	**1,212**	
accreted interest	2,081	-	2,081	624	624
31/12/2027	**106,121**	**100,000**	**6,121**	**1,836**	
settlement	(106,121)	(100,000)	(6,121)	(1,836)	(1,836)
01/01/2028	**-**	**-**	**-**	**-**	**-**

[1] change in the deferred tax (asset) liability in the year (increase in liability = expense; decrease in liability = income)

Issue 2: accounting for deferred tax relating to a financial liability

Accounting for deferred tax relating to a financial liability
What do you think?

The taxing of income and expenses relating to financial liabilities are specified in the tax laws that give effect to fiscal policy.

IFRS 9 *Financial Instruments* specifies the accounting for financial liabilities.

Temporary differences between IFRS and tax accounting typically gives rise to deferred tax in accordance with IAS 12 *Income Taxes*.

How must an entity account for deferred tax relating to a financial liability?

Accounting for deferred tax relating to a financial liability: debt instrument issued
Summary illustration of discussants' consensus view

- 1 January 2025 Entity Z issues a debt instrument for ETB100,000 with the following contractual cash flow:
  - on 1 January 2028: ETB106,121 (redemption capital and interest)
- In the jurisdiction in which Entity A is based
  - income tax is levied at **30%** on taxable profits
  - taxable profits (losses) = all **realised** gains (losses)
- Changes in market interest rates result in fair value changes

	01/01/2025	31/12/2025	31/12/2026	31/12/2027
Market interest rate	2%	10%	1%	irrelevant
Fair value	ETB100,000	ETB87,703	ETB105,070	ETB106,121

Accounting for deferred tax relating to a financial liability—debt instrument issued: carried at fair value (Scenario A)

Summary illustration of discussants' consensus view

Date	Carrying amount of liability	Tax base (ie carrying amount less future tax deductions)	Taxable/ (deductible) temporary difference	Deferred tax liability/ (asset)	Deferred tax expense (income)
01/01/2025	100,000	100,000			
fair value change	(12,297)	-	12,297	3,690	3,690
31/12/2025	**87,703**	**100,000**	**12,297**	**3,690**	
fair value change	17,367	-	(17,367)	(5,211)	(5,211)
31/12/2026	**105,070**	**100,000**	**(5,070)**	**(1,521)**	
fair value change	1,051	-	(1,051)	(315)	(315)
31/12/2027	106,121	100,000	(6,121)	(1,836)	
settlement	(106,121)	(100,000)	6,121	1,836	1,836
01/01/2028	**-**	**-**	**-**	**-**	**-**

Accounting for deferred tax relating to a financial liability—debt instrument issued: carried at amortised cost (Scenario B)

Summary illustration of discussants' consensus view

Date	Carrying amount of liability	Tax base (ie carrying amount less future tax deductions)	Taxable/ (deductible) temporary difference	Deferred tax liability/ (asset)	Deferred tax expense (income)
01/01/2025	100,000	100,000	-	-	
accreted interest	2,000	-	(2,000)	(600)	(600)
31/12/2025	**102,000**	**100,000**	**(2,000)**	**(600)**	
accreted interest	2,040	-	(2,040)	(612)	(612)
31/12/2026	**104,040**	**100,000**	**(4,040)**	**(1,212)**	
accreted interest	2,081	-	(2,081)	(612)	(612)
31/12/2027	**106,121**	**100,000**	**(6,121)**	**(1,836)**	
settlement	(106,121)	(100,000)	6,121	1,836	1,836
01/01/2028	**-**	**-**	**-**	**-**	**-**

Issue 3: accounting for deferred tax when using the revaluation model

Accounting for deferred tax when using the revaluation model
What do you think?

The taxing of income and expenses relating to depreciable non-financial assets are specified in the tax laws that give effect to fiscal policy.

IFRS Accounting Standards (IAS 16, IAS 38 etc) specify the accounting when using the revaluation model for qualifying items.

Temporary differences between IFRS and tax accounting typically gives rise to deferred tax in accordance with IAS 12 *Income Taxes*.

How must an entity account for deferred tax when using the revaluation model?

Accounting for deferred tax when using the revaluation model
Summary of discussants' consensus view

31 December 2020 Entity A buys a commercial building for ETB1 million.

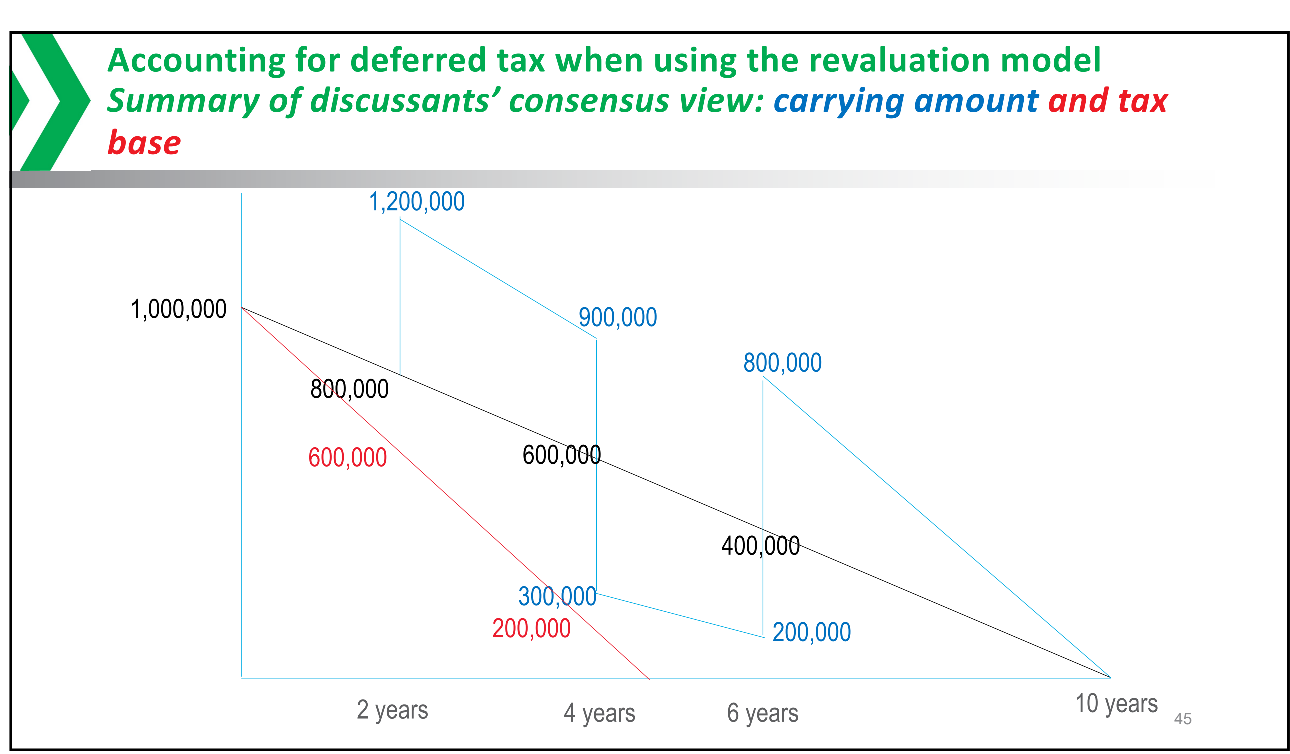
» **Accounting**

- » depreciation: straight-line to nil residual value over 10 years
- » revaluation model:
  - » **31/12/2022:** fair value = ETB1.2 million
  - » **31/12/2024:** recoverable amount (fair value less costs to sell) = ETB300,000
  - » **31/12/2026:** fair value = ETB800,000

Accounting for deferred tax when using the revaluation model
Summary of discussants' consensus view

» **Tax**

- » depreciation: straight-line to nil residual value over 5 years
- » tax rates
  - » 30% on taxable income (including recoupment of past depreciation on sale of an asset but excluding capital gains)
  - » 15% on capital gains (for example, proceeds from sale of building less its original cost)



Accounting for deferred tax when using the revaluation model

Summary of discussants' consensus view

Date	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Deferred tax liability	Deferred tax expense (income)
31/12/2020	**1,000,000**	**1,000,000**	**-**	**-**	**-**
depreciation	(100,000)	(200,000)	100,000	30,000	30,000
31/12/2021	**900,000**	**800,000**	**100,000**	**30,000**	
depreciation	(100,000)	(200,000)	100,000	30,000	30,000
revaluation	400,000 OCI	-	400,000	120,000	120,000 OCI
31/12/2022	**1,200,000**	**600,000**	**600,000**	**180,000**	
depreciation	(150,000)	(200,000)	50,000	15,000	15,000
31/12/2023	**1,050,000**	**400,000**	**650,000**	**195,000**	

Accounting for deferred tax when using the revaluation model

Summary of discussants' consensus view

Date	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Deferred tax liability	Deferred tax expense (income)
31/12/2023	**1,050,000**	**400,000**	**650,000**	**195,000**	
depreciation	(150,000)	(200,000)	50,000	15,000	15,000
revaluation decrease	(300,000) OCI		(300,000)	(90,000)	(90,000) OCI
impairment	(300,000)		(300,000)	(90,000)	(90,000)
31/12/2024	**300,000**	**200,000**	**100,000**	**30,000**	
depreciation	(50,000)	(200,000)	150,000	45,000	45,000
31/12/2025	**250,000**	**-**	**250,000**	**75,000**	

Accounting for deferred tax when using the revaluation model

Summary of discussants' consensus view

Date	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Deferred tax liability	Deferred tax expense (income)
31/12/2025	**250,000**	**-**	**250,000**	**75,000**	
depreciation	(50,000)	-	(50,000)	(15,000)	(15,000)
reverse impairment	200,000	-	200,000	60,000	60,000
revaluation	400,000 OCI	-	400,000	120,000	120,000 OCI
31/12/2026	**800,000**	**-**	**800,000**	**240,000**	
depreciation	(200,000)	-	(200,000)	(60,000)	(60,000)
31/12/2027	**600,000**		**600,000**	**180,000**	

Accounting for deferred tax when using the revaluation model
Summary of discussants' consensus view

Date	Carrying amount	Tax base (ie future tax deductions)	Temporary difference	Deferred tax liability	Deferred tax expense (income)
31/12/2027	**600,000**	**-**	**600,000**	**180,000**	
depreciation	(200,000)	-	(200,000)	(60,000)	(60,000)
31/12/2028	**400,000**	**-**	**400,000**	**120,000**	
depreciation	(200,000)	-	(200,000)	(60,000)	(60,000)
31/12/2029	**200,000**	**-**	**200,000**	**60,000**	
depreciation	(200,000)	-	(200,000)	(60,000)	(60,000)
31/12/2030	**-**	**-**	**-**	**-**	

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Issue 4: accounting for deferred tax assets arising from tax losses incurred during a tax holiday

Accounting for deferred tax assets arising from tax losses incurred during a tax holiday
What do you think?

Governments sometimes grant tax holidays to give effect to their fiscal policies.

Government assistance in the form of a tax holiday is explicitly excluded from the scope of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* (IAS 20.2).

However, the exemption does not extend to accounting for deferred tax effects, if any, in accordance with IAS 12 *Income Taxes*.

How must an entity account for deferred tax assets arising from tax losses incurred during a tax holiday?

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Accounting for deferred tax assets arising from tax losses incurred during a tax holiday

» Government grants Entity a tax holiday for 2021 and 2022 (2 years).

» In **2021** Entity's **tax profit** = its **accounting profit** determined in accordance with the IFRS = ETB200 million profit.

» In **2022** Entity's **tax loss** = its **accounting loss** determined in accordance with the IFRS = ETB100 million loss.

» Government levies income tax at **30%** on tax profit
  - » specifies that the tax loss carried forward that arose during the tax holiday can be utilsed to reduce income tax payable in 2023 only (if unutilized in 2023 will expire unused).

» Entity realistically forecasts accounting and tax profit for 2023 = ETB40 million; 2024 = ETB50 million; and 2025 = ETB100 million.

KPMG, *Ethiopia Fiscal Guide 2019*, p6 "Business enterprises (registered investments) that suffer losses during a tax holiday period can carry forward such losses for a period equivalent to half of the income tax holiday period. However, this period of carrying forward of losses is capped to 5 years."

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Accounting for deferred tax assets arising from tax losses incurred during a tax holiday

Summary of discussion

Discussants' consensus view = the carrying amount of the Entity's deferred tax asset at 31/12/2022 is ETB12 million (ie 30% x ETB40 million forecast tax profit for 2023, because any unutilised balance expires at end of 2023).

Issue 5: offsetting deferred tax assets against deferred tax liabilities

Offsetting deferred tax assets against deferred tax liabilities
What do you think?

"Offsetting occurs when an entity recognises and measures both an asset and liability as separate units of account, but groups them into a single net amount in the statement of financial position." (paragraph 7.10 of *Conceptual Framework for Financial Reporting*)

Because offsetting classifies dissimilar items together it is prohibited unless explicitly required or permitted by an IFRS Accounting Standard. (IAS 1.32)

For example, IAS 12 *Income Taxes* explicitly specifies circumstances in which deferred tax assets and deferred tax liabilities must be offset. (IAS 12.74-.76)

When can an entity offset its deferred tax assets against its deferred tax liabilities?

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Offsetting deferred tax assets against deferred tax liabilities
Summary of discussion

Discussants' consensus view = an entity must offset deferred tax assets against deferred tax liabilities if, and only if (IAS 12.74):

(a) the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and

(b) the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:

- (i) the same taxable entity; or
- (ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered."

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