DEFERRED TAX: SIMPLIFYING THE COMPLEXITIES

Swipe

HEARD OF 'DEFERMENT'???

Can this term be applied in the tax world as well?
The answer is YES.

Differences in calculating taxable income against accounting income which are reversed at a later period gives rise to the concept of **“Deferred Tax”**.

International Accounting Standard 12 Income Taxes (IAS 12) requires companies to measure deferred tax at the expected tax rate to bring out the clear picture of current tax and future tax. For this, the temporary difference between the accounting base & tax base of assets and liabilities is considered.

WHAT IS A DEFERRED TAX ASSET??

Due to the temporary taxable difference:

TODAY YOU PAY MORE TAX, BUT TOMORROW, YOU PAY LESS: **DEFERRED TAX ASSET**

Carrying amount of assets in books	<	Carrying amount in the tax base
Carrying amount of liabilities in books	>	Carrying amount in the tax base

- Losses/Interest expenditure carried forward for future set off

e.g. Adhoc provisions made in accounting may be disallowed in the tax in the provision year but would be allowed in the year when expenses are actually incurred. This could result in higher current tax, but the actual expense is deductible in future would result in a lower future tax. Hence, a deferred tax asset is recognized in the financial statements.

WHAT IS A DEFERRED TAX LIABILITY??

Due to the temporary taxable difference:

TODAY YOU PAY LESS, BUT TOMORROW, YOU PAY MORE: **DEFERRED TAX LIABILITY**

- Carrying amount of assets in books > Carrying amount in the tax base

- Carrying amount of liabilities in books < Carrying amount in the tax base

e.g. An expenditure is capitalised for accounting purposes but treated as a one-off expense for tax purposes. In such case, the current tax would be lower due to the accelerated deduction for tax purposes. However, this would result in higher future tax in a subsequent year. Hence, deferred tax liability is recognised in the financial statements.

LET US DECODE WITH EXAMPLE

DEFERRED TAX ASSET

Let's say book profits of an entity before taxes are AED 1,000 (net of provision for bad debts).

Assuming that for the purpose of tax, bad debts will be allowed when it's actually written off, additional tax to be paid on the provision which will give rise to **Deferred Tax Asset**.

DEFERRED TAX LIABILITY

Similarly, let's say book profits of an entity before taxes are AED 1,000 (including unrealized gain on current asset (debtors))

Assuming that for the purpose of tax, the gains will be taxed only on actual realization, less tax to that extent will be paid which will give rise to **Deferred Tax Liability.**

LET US DECODE WITH EXAMPLE

DTA CREATION

DTL CREATION

Amounts in AED	DTA Creation		DTL Creation	
Particulars	As per Books	As per Tax	As per Books	As per Tax
Profit before Tax	1000	1000	1000	1000
Non-deductible expenses - Provision for Bad debts	NA	100		
Actual bad debts written off			NA	(100)
Profit	1000	1100	1000	900
Current Tax @9%	99 (1100*9%)	99	81 (900*9%)	81
Deferred Tax expense	(9)		9	
Profit after tax	910		910	
Accounting Entry	Deferred Tax Asset Dr AED 9 To Deferred Tax Expense AED 9		Deferred Tax Expense Dr AED 9 To Deferred Tax Liability AED 9	
Balance sheet impact	Deferred Tax Asset of AED 9 recognized in Asset side		Deferred Tax Liability of AED 9 recognized in Liability side	

IN SUBSEQUENT YEARS, WHEN THE BAD DEBTS ARE ACTUALLY WRITTEN OFF OR GAINS ARE ACTUALLY REALIZED, THE DTA/DTL SHALL BE REVERSED

FROM WHEN TO APPLY?

Deferred tax recognition is required based on tax rates that have been enacted or substantively enacted by the end of the reporting period. The Corporate Tax Law is now assessed and considered to be “enacted” effective **16 January 2023**.

Based on that, companies with reporting periods on or after 16 January 2023 may have to assess the deferred tax cost in their financial reporting.

IASB CONFIRMS TEMPORARY RELIEF FROM DEFERRED TAX ACCOUNTING FOR OECD PILLAR TWO TAXES

NEXT STEPS...

- Identify the areas giving rise to the deferred tax assets/liabilities eg. Carried forward losses, interest expenditure, entry/exit from tax groups, business combinations, unrealised gains/losses, Ad hoc provisions etc.
- Assess initial opening deferred tax costs, if any.
- Document the workings of deferred tax to keep track of reversal and recognition.
- Make adequate disclosures in the financial statements interim as well as annual in line with the IFRS requirements.
- Stay informed about changes in tax laws and regulations that may impact the company's tax obligations and financial reporting requirements.

PARTING THOUGHTS

Deferred tax is a crucial accounting concept that can significantly impact a company's financial statements.

Understanding deferred tax is important for investors, analysts, and business owners who want to make informed decisions based on accurate financial information.

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