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# CPD TECHNICAL UPDATE

# Deferred tax

**Wednesday 9 June | 10.00am–11.15am**

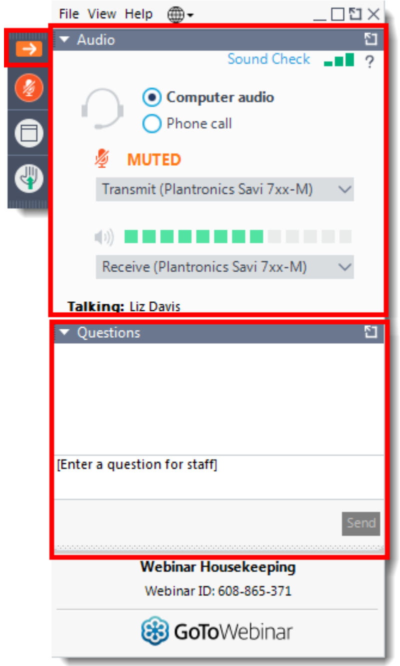
**Chris Smith (Chair)**
Partner, Audit

**Andrew Watchman**
Director, NAS – Financial Reporting

**Jonathan Shaw**
Director, NAS – Financial Reporting

**Dylan Ryninks**
Senior Manager, NAS – Financial Reporting

# GoToWebinar Housekeeping: Attendee Participation




## Your Participation

Open and close your control panel

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Submit questions and comments via the Questions panel

**Note:** Today's presentation is being recorded and will be provided within 48 hours.

 

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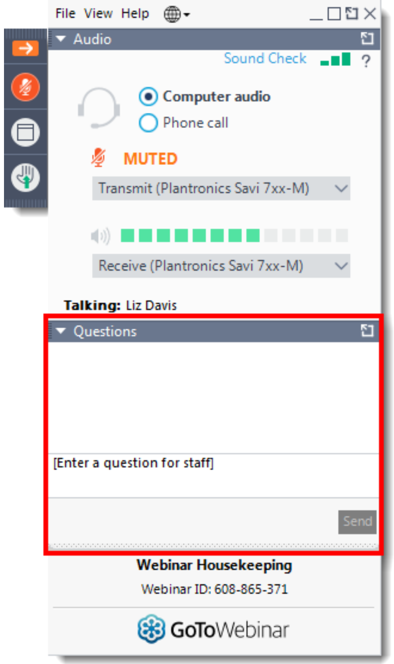
# Agenda




## Your Participation

- Please continue to submit your text questions and comments using the Questions panel

For more information, please contact [jessica.pearce@uk.gt.com]

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# Industry experts speaking today

## Chris Smith (Chair)
Partner
Audit

## Andrew Watchman
Director
National Assurance Services – Financial Reporting

## Jonathan Shaw
Director
National Assurance Services – Financial Reporting

## Dylan Ryninks
Senior Manager
National Assurance Services – Financial Reporting

 

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# Introduction

## Why are we here?

- When asked about a deferred tax webinar in our December 2020 webinar, 91% of our audience expressed interest
- Complex area of accounting with increasing regulatory challenge

 

# Agenda

1. Basic principles of deferred tax
2. Recognition of deferred tax assets
3. Super-deductions
4. Deferred tax arising on share-based payments
5. Deferred tax on pension liabilities/(assets)
6. Deferred tax arising on business combinations
7. Tax rate reconciliation

# Basic principles of deferred tax

# 1. Basic principles

## The fundamental principle of deferred tax is to:

Recognise the tax consequences of transaction at the same time and in the same manner as the transaction itself

**Or**

| Dr Tax expense (P&L, OCI or equity)<br>Cr Deferred tax Liability (SoFP) | Dr Deferred tax Asset (SoFP)<br>Cr Tax expense (P&L, OCI or equity) |
|---|---|

 

# IAS 12's approach to deferred tax

## Calculating deferred tax is a process of determining:

- Carrying amount
- Tax Base
- Temporary difference
- Qualifies for recognition
- Apply appropriate tax rate to calculate DT
- Presentation

 

# FRS102's approach to deferred tax

- Deferred tax on timing differences
- Deferred tax on unrelieved tax losses and deferred tax assets only to extent that is probable that will be recovered against reversal of deferred tax liabilities or future taxable profits
- Presentation: provisions (deferred tax liabilities) and debtors (deferred tax assets)

 

# Measurement – tax rate

The Finance Bill 2021 was substantively enacted on 24 May 2021.

'substantively enacted'

Temporary/timing difference x Tax Rate = Deferred Tax Asset/Liability

Tax rate
'expected to apply in future'

'based on tax rates enacted or substantively enacted'




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# Recognition of deferred tax assets

 

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# 2. Recognition of deferred tax assets

## IAS 12.24:

*"A deferred tax asset shall be recognised for all deductible temporary differences* ***to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised…"***

## IAS 12.34:

*"A deferred tax asset shall be recognised for the carry forward of unused tax losses and unused tax credits* ***to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised."***

**Same requirement for FRS 102.29.7**

*"Unrelieved tax losses and other deferred tax assets shall be recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits"*

 

# Probable future taxable profits?

Qualifying taxable temporary differences (irrespective of available future taxable profits)

- same taxable entity;
- same taxation authority; and
- reverses in the same period as deductible temporary differences or when the tax loss arising from the reversal of the deductible temporary difference might be carried back or forward.

Assess future taxable profit

Tax planning opportunities

 

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# Super-deductions (capital allowances)

 

# 3. Super-deductions (capital allowances)

- Applies to capital expenditure on new plant and equipment
- Acquired between 1 April 2021 and 31 March 2023
- 130% first year allowance on qualifying new plant and machinery assets
- 50% first-year allowance on long-life assets
- The additional 30% super-deduction can be clawed back if the asset is sold before 1 April 2023

# Super deduction – capital allowance

| IFRS | FRS 102 |
| --- | --- |
| **Additional 30% super-deduction is an investment tax credit**<br>Accounting policy options include:<br>• Flow-through<br>• Government grant | **Additional 30% super-deduction**<br>No intention to sell = permanent difference<br><br>Intention to sell = timing difference |

**50% first year allowance**

Temporary/timing difference

 

# Deferred tax arising on share-based payments

 

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# 4. Deferred tax on share-based payments

## Equity-settled

- Recognise cost of equity-settled share-based awards to employees based on grant date fair value
- Spread over the vesting period

## Cash-settled

- Cash-settled share-based payment transactions give rise to a liability
- Fair value of liability remeasured at each reporting date until settled

Tax deduction on an employee share option scheme is generally available under UK tax law at the **date of exercise**, measured on the basis of the option's **intrinsic value (share price – exercise price) at that date**

 

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## Example 1:
# Deferred tax on share-based payments

- On 1 January 2023, 100,000 options are issued with a fair value of £360,000. The vesting period is 3 years and all the share options are expected to be exercised. All of the share options are exercised in year 4.
- The intrinsic value of the options (ie market value of the underlying shares less exercise price) at the end of years 1, 2, 3 and 4 is: £330,000, £300,000, £380,000 and £400,000, respectively.
- The total share-based payment charge recognised in each year of the three year period is £120,000 (£360,000/3).
- Tax deductions are received at 30% when the options are exercised.

 

# Accounting under IFRS

| IFRS | Year 1 | | Year 2 | | Year 3 | |
|---|---|---|---|---|---|---|
| Cumulative Share based payment charge (a) | £ | 120,000 | £ | 240,000 | £ | 360,000 |
| Estimated tax deduction (b) | £ | 110,000 | £ | 200,000 | £ | 380,000 |
| Deductible temporary difference * | £ | 110,000 | £ | 200,000 | £ | 380,000 |
| Deferred tax asset @ 30% | £ | 33,000 | £ | 60,000 | £ | 114,000 |
| Movement for period | £ | 33,000 | £ | 27,000 | £ | 54,000 |
| Recognised through p&l | £ | 33,000 | £ | 27,000 | £ | 48,000 |
| Recognised through equity [(a<b) x 30%] | £ | - | £ | - | £ | 6,000 |
| * Based on intrinsic value at year end | | | | | | |

 

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# Accounting under FRS 102 – based on cumulative SBP charge

| FRS 102 - cumulative SBP charge | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| Cumulative Share based payment charge | £ 120,000 | £ 240,000 | £ 360,000 |
| Total Intrinsic value | £ 330,000 | £ 300,000 | £ 380,000 |
| Deductible timing difference * | £ 120,000 | £ 240,000 | £ 360,000 |
| Deferred tax asset @ 30% | £ 36,000 | £ 72,000 | £ 108,000 |
| Movement for period | £ 36,000 | £ 36,000 | £ 36,000 |

* equal to cumulative SBP charge, limited to total expected intrinsic value at year end

The excess tax deduction of £20,000 is a permanent difference. Tax benefit of £6,000 is recognised in equity when received in Year 4 (Dr current tax liability; Cr equity)

 

# Deferred tax on pension liabilities/(assets)



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# 5. Deferred tax – pensions

## Tax implications

| Tax relief is not automatic | Spreading rules | Special tax charge | Complexity |
|---|---|---|---|
| In the UK, employer pension contributions are only deductible as an expense if they are incurred 'wholly and exclusively for the purposes of the employer's trade or profession'; so tax relief is not automatic | Where tax relief is obtained, tax deductions on any significant contributions might also be subject to spreading rules | Special tax charge of 35% can arise on refund of a surplus | This is a complex area and consultation with a tax specialist is advised |

 

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# Deferred tax on pensions (IFRS)

**IFRS:** (Deficit)

- The tax base is usually nil
- A deferred tax asset is recognised if recoverable

**IFRS:** (Surplus)

- IFRIC 14 includes guidance on recognition of a scheme surplus
- If a surplus refund is subject to income tax, the deferred tax liability relating to the pension surplus is determined under IAS 12 and recognised separately from the pension asset
- Some additional considerations

 

# Deferred tax on pensions (FRS 102)

## FRS 102:

- Where the total of the pension costs differs from the actual contributions paid, the resulting asset or liability recognised in the balance sheet is a timing difference for deferred tax purposes.
- This is the case whether the defined benefit scheme is in a net deficit or a net surplus position.

 

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# Deferred tax arising on business combinations

 

# 6. Deferred tax on business combinations

### ISA 12

Carrying values = typically fair value

Tax base = typically based on acquired company's historic cost (nil for some intangibles)

### ISA 102

Similar to IAS 12
('timing differences plus' approach)

**Both standards require deferred tax to be accounted for on these differences other than goodwill**

 

# Example 2:
# Business combinations

**Entity H** acquired all of the share capital of Entity S for £1,500,000.

The book values of the identifiable assets and liabilities of **Entity S** at the date of acquisition were £970,000 with an aggregate tax base of £920,000.

- ✓ **Fair value adjustments** to the assets and liabilities acquired of £100,000 were recognised
- ✓ Goodwill arising on the acquisition is **not deductible** for tax purposes
- ✓ The tax rates in Entity H's and Entity S's tax jurisdictions are **30% and 40% respectively**

 

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# Example 2:
# Business combinations (continued)

**What are the temporary/timing differences that arise on acquisition?**

- Fair value of net assets acquired (excl. DT) = £1,070,000 (£970,000 + £100,000)
- Tax base in Entity S tax jurisdiction = £920,000
- Taxable temporary/timing difference = £150,000

**What is the deferred tax to recognise?**

Deferred tax liability of £60,000 (£150,000 x 40%)

**How much goodwill is recognised?**

- FV of net assets acquired (incl. DT) = £1,010,000 (£1,070,000 – £60,000)
- Purchase consideration = £1,500,000
- Goodwill of £490,000

# Tax rate reconciliation




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# 7. Tax rate reconciliation

**Purpose:**
Explain relationship between accounting profit and the tax expense

| | | | |
|---|---|---|---|
| Reconcile theoretical tax on accounting profit (loss) with tax expense (income) | Determine applicable tax rate | Disclosure in numerical form (expense and/or rates) | Disclosure of the basis on which the applicable tax rates have been computed and changes to those rates |

 

# Example 3:
# Tax rate reconciliation

| | 2021<br>£000 |
|---|---|
| Profit from continuing operations | 5 349 |
| Tax at the UK tax rate of 19% | 1 016 |
| 1. Tax loss not previously recognised | (80) |
| 2. Tax losses not recognised | 125 |
| 3. Non-taxable income/non-deductible expenses | 412 |
| 4. Capital allowance in excess of depreciation | (288) |
| 5. Goodwill impairment | 72 |
| 6. Tax on discontinued operations line | 61 |
| 7. Effect of foreign tax rates | 84 |
| 8. 'Other' reconciling items | 451 |
| 9. Remeasurement of deferred tax – change in UK tax rate | (20) |
| **Income tax expense** | **1 833** |

 

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# Questions

 

# Industry experts speaking today

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