

## SSAP-12

New Zealand Society of Accountants

STATEMENT OF STANDARD  
ACCOUNTING PRACTICE NO. 12  
Revised 1991

# ACCOUNTING FOR INCOME TAX

*Issued by the Council, New Zealand Society of Accountants*

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*(This Statement replaces SSAP-12, Accounting for Inter-period Allocation of Income Tax (1980), although that Statement will continue to apply until the completion of accounting periods which commence prior to 1 October 1991. Earlier application of the revised Standard, however, is encouraged.)*

*The requirements of International Accounting Standard No. 12, Accounting for Taxes on Income (1979) accord closely with the contents of this SSAP. Compliance with SSAP-12 (Revised) will accordingly ensure compliance with IAS-12 in all material respects.*

*This Statement should be read in the context of the Explanatory Foreword to Statements of Standard Accounting Practice*

## 1 INTRODUCTION

1.1 This Statement deals with accounting for income tax in financial statements. This includes determination of the amount of the expense or benefit related to income tax in respect of an accounting period, the income tax liabilities and assets in existence

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at the balance sheet date and the presentation of such amounts in the financial statements.

1.2 The Statement deals also with accounting for withholding taxes and imputation type credits attached to dividends.

### 2 APPLICATION

2.1 The Standard in this Statement applies to the external financial statements of all entities subject to income tax.

2.2 This Statement of Standard Accounting Practice (as revised in June 1991) becomes operative for financial statements covering periods commencing on or after **1 October 1991**.

### 3 DEFINITIONS

The following terms are used in this Statement with the meanings specified:

3.1 *Accounting Profit* is the aggregate of operating profit, other net income and extraordinary items for any period, before charging and/or crediting any amounts in respect of either current or deferred income tax.

3.2 *Accounting Results* include accounting profit and all movements in reserves.

3.3 *Assessable Income* is the amount upon which current income tax will be assessed.

3.4 *Deferred Tax* is income tax attributable to timing differences.

3.5 *Imputation Credits* are credits attached to the gross amount of dividends. Examples include New Zealand imputation credits and Foreign Dividend Withholding Payments (section 394ZM of the Income Tax Act 1976).

3.6 *Income Tax* includes all taxes levied on or in respect of assessable income. It also includes New Zealand Foreign Dividend Withholding Payments but excludes Goods and Services Tax, "Use of Money" charges (tax financing charges) and similar taxes.

3.7 *Income Tax Expense (Benefit)* for the period is the amount of income tax charged or credited (at current rates of tax), in the profit and loss or operating statement.

3.8 *Income Tax Loss* is the amount which may be carried forward to a subsequent period or periods for income tax purposes and applied against future assessable income, thus reducing the income tax payable in respect of that period or periods.

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3.9 *Permanent Differences* are differences between the accounting results and assessable income for a period that originate in the current period and do not reverse in subsequent periods.

3.10 *Subvention Payment* is an amount paid by one company to another within the same taxation group, as referred to in section 191 of the Income Tax Act 1976.

3.11 *Timing Differences* are differences between the accounting results and assessable income for a period that originate in one period and reverse in one or more subsequent periods.

3.12 *Withholding Taxes* are deductions from the gross amount of income. Examples include New Zealand's resident withholding taxes on interest, dividends and other income (PAYE) and foreign non-resident withholding taxes. New Zealand's Foreign Dividend Withholding Payments is not a withholding tax.

## 4 DISCUSSION

4.1 The amount of income tax payable for a period, is calculated in accordance with rules for determining tax payable on assessable income established by Government. In some circumstances these rules differ from accounting policies applied to determine accounting results. The amount of income tax expense (benefit) for a period is based on accounting results while the income tax payable is based on assessable income. There are two types of differences between accounting results and assessable income:

- (a) permanent differences; and
- (b) timing differences.

4.2 Permanent differences affect the calculation of income tax in respect of the accounting results for the period in which they occur, but they do not affect the computation of income tax in respect of other periods. That is, permanent differences arising in any period relate only to that period and do not give rise to tax effect accounting.

4.3 Timing differences affect the calculation of income tax in respect of the accounting results for the period in which they occur but, because they reverse, they have an opposite effect on the computation of income tax payable in other periods. Examples include:

- (a) the use of depreciation rates in the calculation of accounting results which differ from those adopted in the calculation of assessable income;
- (b) the use of bases for recognising income for hire purchase and similar credit instalment transactions in the calculation of accounting results which differ from those adopted in the calculation of assessable income;
- (c) a revaluation of land and buildings where an income tax liability will arise on disposal.

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### **Taxes Payable Method**

4.4 Under the taxes payable method, income tax expense in respect of the current period is equal to the income tax payable for the same period. The income tax effects of timing differences are not recognised but may be disclosed in notes to the financial statements.

Where timing differences exist this method is not in accordance with the concept of matching revenues and expenses and is not supported in this Statement.

### **Tax Effect Accounting**

4.5 Under tax effect accounting, income tax is considered to be an expense incurred by the entity in earning income and is recognised in the same period as the revenue and expenses to which it relates. The income tax effects of timing differences are included in income tax expense (benefit) in the profit and loss or operating statement and in deferred tax balances in the balance sheet. There are two main tax effect accounting methods, namely:

- (a) the liability method, and
- (b) the deferral method.

### **Liability Method**

4.6 Under the liability method:

- (a) the income tax effects of currently outstanding timing differences are determined and reported either as liabilities for income tax payable in the future or as assets representing future income tax benefits;
- (b) the income tax effect of cumulative timing differences is adjusted for changes in the income tax rate.

### **Deferral Method**

4.7 Under the deferral method:

- (a) the income tax effects of timing differences originating in the current period are determined using the current income tax rate;
- (b) the income tax effects of timing differences originating from previous periods and reversing during the current period are determined using the income tax rates originally applied;
- (c) deferred tax already reflected in the balance sheet is not adjusted to reflect changes in the income tax rate.

### **Required Method**

4.8 This Statement requires the use of the liability method. The deferral method does not produce useful information about the effects of timing differences on the financial position and performance of an entity. In contrast, the liability method produces information about the amounts of economic benefits that are expected to flow to or from the entity through the income tax system.

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- 4.9 The income tax expense (benefit) for a period comprises:
- (a) income tax payable on assessable income for that period;
  - (b) income taxes deferred or considered to be prepaid in respect of timing differences reversing or originating in the current period calculated at current rates (subject to paragraph 4.36);
  - (c) any adjustment to the income tax effect of timing differences brought forward from prior periods necessary to reflect a change in the income tax rate.

### **Comprehensive Basis**

4.10 Tax effect accounting can be applied on a comprehensive basis to all timing differences. On this basis, the income tax effect of all timing differences is recognised and considered to be an integral part of the income tax expense matched against revenue for the period.

### **Partial Basis**

4.11 On the partial basis, the deferred income tax taken into account will be different from that which would be taken into account if the income tax effect of all timing differences was recognised.

The partial basis is applied by considering the cumulative income tax effect of all timing differences but recognising in the accounts, as deferred tax, the income tax effect only to the extent that it can be foreseen to crystallise in the future.

The amount of deferred tax crystallising in the future depends, inter alia, on :

- (a) profits in the future; and
- (b) the reversal of existing timing differences in future periods; and
- (c) the origination or reversal in future periods of timing differences similar to existing differences.

4.12 The partial basis requires consideration of timing differences that have arisen and similar timing differences that are expected to arise or reverse in the future. Timing differences originating in the future may be taken into consideration only where they arise from an established regular pattern of originating timing differences replacing existing timing differences of the same nature. No consideration should be taken of future timing differences which are of a different nature to existing timing differences. This requirement should be interpreted restrictively.

4.13 The partial basis differs from the comprehensive basis in that:

- (a) the comprehensive basis takes into account the income tax effect of all timing differences as they arise in each period, whereas
- (b) the partial basis attempts to look ahead and to take into account (to the extent that information is reasonably available) the income tax effect of only those timing differences which are expected to result in a decrease in the cumulative deferred tax liability balance in any accounting period in the future.

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4.14 The partial basis does not include:

- (a) applying tax effect accounting selectively to particular timing differences.
- (b) applying tax effect accounting to future timing differences which are of a different nature to existing timing differences.
- (c) applying tax effect accounting limited by an arbitrary future time period when information is available beyond that time period.

4.15 It will be reasonable to assume that timing differences will continue and income tax liabilities will therefore not crystallise if, but only if:

- (a) the entity is a going concern; and
- (b) there is reasonable evidence that no liability is likely to arise as a result of reversal of timing differences for some considerable period ahead; and
- (c) there is no indication that after this period the situation is likely to change so as to crystallise the liabilities.

4.16 Where the criteria in paragraph 4.15 are satisfied it will be reasonable to assume that the period which can be foreseen sets the pattern for the indefinite future and, accordingly, the income tax effect of such timing differences need not be recognised in the current period.

4.17 The income tax effects of accumulated timing differences not recognised should be reassessed at the end of each accounting period on a consistent basis. Unless the criteria in paragraph 4.15 are satisfied at the end of each accounting period there is no basis for assuming the timing differences will not reverse and, accordingly, the full potential deferred tax in respect of existing timing differences should be recognised.

4.18 This Statement supports the comprehensive basis as the preferred basis. However, while it is preferred that deferred tax be accounted for in respect of the income tax effects arising from all timing differences, the income tax expense for the period may exclude income tax effects which, based on the criteria set out in paragraph 4.15 and calculated on the cumulative basis described in paragraph 4.11, can be demonstrated with reasonable probability to continue in the future.

4.19 The potential income tax effect of all outstanding timing differences in respect of the current and prior periods that is not recognised in the deferred tax account should be disclosed in the notes to the financial statements.

### **Debit Balances**

4.20 Accounting for timing differences may result in a debit balance in the deferred tax account. Prudence requires that such debit balance should be retained only to the extent that there is virtual certainty of its recovery in future periods. A debit balance in the deferred tax account is often termed "future tax benefits".

Virtual certainty of recovery of a debit balance in a deferred tax account requires that there is assurance beyond any reasonable doubt that:

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- (a) future assessable income will be sufficient for the income tax liability arising from that assessable income to absorb the debit balance in the deferred tax account; and
- (b) the income tax liabilities arising will occur in such periods as will enable that absorption to take place.

### **Income Tax Losses**

4.21 Although income tax losses may give rise to income tax benefits, prudence dictates that those benefits should not be recognised unless there is virtual certainty of realisation.

4.22 Virtual certainty of realising the income tax benefit on an income tax loss requires all three of the following conditions to be present:

- (a) the income tax loss results from identifiable and non-recurring causes; and
- (b) a record of assessable income has been established over a long period by the entity or its predecessor with any occasional income tax losses being more than absorbed by assessable income in subsequent years; and
- (c) there is assurance beyond any reasonable doubt that future assessable income will be sufficient for the income tax liability thereon to absorb the income tax loss carry-forward and will be earned during any carry-forward period prescribed by income tax legislation.

4.23 Where the criteria in paragraph 4.22 are not met, the income tax benefits attributable to income tax losses should be recognised in the profit and loss or operating statement only to the extent of accumulated net credits from timing differences in the deferred tax account.

4.24 Where an income tax benefit on an income tax loss is recognised prior to its realisation, there should be a statement that the subsequent realisation of that income tax benefit is subject to the requirements of income tax legislation being met.

4.25 Where the income tax benefit of a prior year income tax loss is realised, the benefit not previously recognised should be shown separately in the reconciliation required in paragraph 5.10.

4.26 Companies qualifying as part of a group for income tax purposes may transfer losses inter-company:

- (a) by means of a subvention payment; or
- (b) by set-off.

4.27 Where the transfer is by way of a subvention payment, the paying company should disclose the payment, and the receiving company should disclose the receipt, as a separate item in their financial statements.

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4.28 The transfer of income tax benefits by set-off should be treated as a permanent difference. The effect of set-off should be disclosed by way of note to the financial statements of each of the entities involved.

### **Taxation Movements Arising from Movements in Reserves**

4.29 A timing difference may arise as a result of the revaluation of an asset. The deferred income tax effect of that timing difference should be recognised directly against the revaluation reserve if the income tax effect is expected to crystallise through the realisation by sale of the asset in the foreseeable future. Any income tax effects on revaluation not recognised, but which could crystallise if the revalued asset was sold at its carrying amount, should be disclosed in the notes to the financial statements.

4.30 Some movements in other reserves (for example, foreign currency translation reserve) have an income tax effect. This income tax effect should be recognised directly against the related reserve and allocated to deferred tax or current income taxes payable as appropriate.

### **Imputation Credits**

4.31 Equity investors, both current and potential, should be informed of the available amounts of imputation credits and dividend withholding payment credits. There should be disclosed in the notes to the financial statements:

- (a) the credits distributed to the shareholders of the parent company during the period; and
- (b) the credits available to the shareholders of the parent company at balance date:
  - (i) through their shareholdings in that parent company; and, separately,
  - (ii) through their indirect interests in subsidiaries and in-substance subsidiaries.

4.32 Imputation credits do not represent dividend distributions and therefore should not be deducted from income tax expense and added to the provision for dividend.

4.33 Dividends received should be recognised as income net of imputation credits. The effect, if any, of the credits should be recognised only when achieved, as an adjustment of tax expense or tax liability.

4.34 Where an entity pays New Zealand Foreign Dividend Withholding Payments tax in terms of section 394ZM of the Income Tax Act 1976, the tax paid should be recognised as income tax expense.

### **General**

4.35 Deferred tax balances should be carried at the current rate of income tax. The effect of a change in the rate of income tax should be separately disclosed in the profit and loss or operating statement.



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4.36 When a change in the entity's rate of income tax applicable to the period after balance date has been announced and there is reasonable certainty that enactment of legislation will follow, the deferred tax expense in the current period should be determined on the basis of that announced rate of income tax.

4.37 Where more than one income tax group exists within a reporting entity, for example where operations are carried out in different income tax jurisdictions, a debit in one group should not be offset against a credit in another group.

4.38 There should be a reconciliation:

- (a) between income tax expense and income tax calculated at the current rate of income tax on the reported accounting profit; and also
- (b) of the opening and closing balances of the deferred tax account(s) showing the movements in those account(s) in the period.

## 5 STANDARD ACCOUNTING PRACTICE

### Accounting for Income Tax

*The Standard set out in the following paragraphs should be read in the context of the foregoing paragraphs of this Statement and the Explanatory Foreword to Statements of Standard Accounting Practice issued by the Council of the New Zealand Society of Accountants.*

5.1 The income tax expense in the profit and loss or operating statement should be calculated using the liability method.

5.2 Deferred tax should generally be accounted for in respect of all timing differences. However, some timing differences may be excluded because it has been demonstrated with reasonable probability that the cumulative timing differences will continue and that the related income tax liabilities, therefore, will not crystallise because:

- (a) the entity is a going concern; and
- (b) there is reasonable evidence to foresee that no liability is likely to arise as a result of reversal of timing differences for some considerable period ahead; and
- (c) there is no indication that after this period the situation is likely to change so as to crystallise the liabilities.

5.3 Where some timing differences are excluded in accordance with paragraph 5.2, the amount of deferred tax to be taken into account should be that portion of the income tax effect of the total timing differences which is expected to result in a decrease in the cumulative deferred tax liability balance in any accounting period in the future.

5.4 A debit balance in the deferred tax account should be retained and carried forward only to the extent that there is virtual certainty of recovery in future periods.

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Virtual certainty of recovery of a debit balance in a deferred tax account requires that there is assurance beyond any reasonable doubt that:

- (a) future assessable income will be sufficient for the income tax liability arising from that assessable income to absorb the debit balance in the deferred tax account; and
- (b) the income tax liabilities arising will occur in such periods as will enable that absorption to take place.

5.5 Income tax benefits arising from income tax losses should be recognised only to the extent of accumulated net credits from timing differences in the deferred tax account unless there is virtual certainty of their realisation. Virtual certainty requires all three of the following conditions to be present:

- (a) the income tax loss results from identifiable and non-recurring causes; and
- (b) a record of assessable income has been established over a long period by the entity or its predecessor, with any occasional income tax losses being more than absorbed by assessable income in subsequent years; and
- (c) there is assurance beyond any reasonable doubt that future assessable income will be sufficient to absorb the income tax loss carry-forward and will be earned during any carry-forward period prescribed by income tax legislation.

5.6 Where the income tax benefit of a prior year tax loss is realised, the income tax benefit not previously recognised should be shown separately in the reconciliation required in paragraph 5.10.

5.7 Where an income tax loss is transferred within a group by way of a subvention payment, the paying company should disclose the payment, and the receiving company should disclose the receipt, as a separate item in their financial statements.

5.8 The transfer of income tax benefits by set-off should be treated as a permanent difference. The effect of set-off should be disclosed by way of note in the financial statements of each of the entities involved.

5.9 Any income tax effect of movements in reserves should be recognised directly against the related reserve and allocated to deferred tax or current income taxes payable as appropriate.

5.10 The notes to the financial statements should include an explanation and reconciliation of the difference, if any, between:

- (a) the income tax expense in the profit and loss or operating statement; and
- (b) the income tax calculated at the current rate on the accounting profit.

There should also be a reconciliation of the opening and closing balances of the deferred tax account(s) showing the movements in those account(s) in the period.

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5.11 Except as noted in paragraph 5.12, deferred tax balances should be carried at the entity's current rate of income tax. The effect of a change in the rate of income tax should be separately disclosed in the profit and loss or operating statement.

5.12 When a change in the rate of income tax applicable to the period after balance date has been announced, the deferred tax expense in the current year should be determined on the basis of that announced rate of income tax.

5.13 Where more than one income tax group exists within a reporting entity, for example where operations are carried out in different income tax jurisdictions, a debit in one group should not be offset against a credit in another group.

5.14 The following further information should be included in the notes to the financial statements, unless otherwise disclosed:

- (a) a description of the method adopted in accounting for income tax; including whether the comprehensive or partial basis has been applied.
- (b) the amount of income tax payable or recoverable;
- (c) the amount of unrecognised income tax losses carried forward and available to be set-off against future assessable income together with the related income tax effect and any significant restriction on the availability of the unrecognised income tax losses;
- (d) the potential income tax effect of all outstanding timing differences in respect of the current and prior periods that are not recognised in the deferred tax account, including any income tax effects on the revaluation of an asset not recognised, but which could crystallise if the asset was sold at its revalued carrying amount;
- (e) the separate amounts of current income tax and deferred income tax in income tax expense (benefit) in the profit and loss or operating statement;
- (f) with regard to imputation credits and dividend withholding payment credits available to shareholders;
  - (i) the movements during the period in the Imputation Credit Account and Dividend Withholding Payments Account of the parent company.
  - (ii) the credits available to the shareholders of the parent company at balance date:
    - through their shareholdings in that parent company; and, separately,
    - through their indirect interests in subsidiaries and in-substance subsidiaries.
- (g) where an income tax benefit on an income tax loss is recognised prior to its realisation, there should be a statement that the subsequent realisation of that income tax benefit is subject to the requirements of income tax legislation being met.

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