LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA
MALAYSIAN ACCOUNTING STANDARDS BOARD

MASB Standard 25

Income Taxes

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Summary of the Differences between this Standard and the Original IAS 12

Introduction

This Standard supersedes MASB Approved Accounting Standard IAS 12, Accounting for Taxes on Income ('the original IAS 12') as an approved accounting standard. The major changes from the original IAS 12 are as follows.

1. The original IAS 12 required an enterprise to account for deferred tax using either the deferral method or a liability method which is sometimes known as the income statement liability method. This Standard prohibits the deferral method and requires another liability method which is sometimes known as the balance sheet liability method.

   The income statement liability method focuses on timing differences, whereas the balance sheet liability method focuses on temporary differences. Timing differences are differences between taxable profit and accounting profit that originate in one period and reverse in one or more subsequent periods. Temporary differences are differences between the tax base of an asset or liability and its carrying amount in the balance sheet. The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

   All timing differences are temporary differences. Temporary differences also arise in the following circumstances, which do not give rise to timing differences, although the original IAS 12 treated them in the same way as transactions that do give rise to timing differences:

   (a) assets are revalued and no equivalent adjustment is made for tax purposes; and

   (b) the cost of a business combination that is an acquisition is allocated to the identifiable assets and liabilities acquired, by reference to their fair values but no equivalent adjustment is made for tax purposes.

Furthermore, there are some temporary differences which are not timing differences, for example those temporary differences that arise when:

(a) the non-monetary assets and liabilities of a foreign operation that is integral to the operations of the reporting entity are translated at historical exchange rates;

(b) non-monetary assets and liabilities are restated under the international best practice on financial reporting in hyperinflationary economies; or

(c) the carrying amount of an asset or liability on initial recognition differs from its initial tax base.

2. The original IAS 12 permitted an enterprise not to recognise deferred tax assets and liabilities where there was reasonable evidence that timing differences would not reverse for some considerable period ahead. This Standard requires an enterprise to recognise a deferred tax liability or (subject to certain conditions) asset for all temporary differences, with certain exceptions noted below.

3. The original IAS 12 required that:

(a) deferred tax assets arising from timing differences should be recognised when there was a reasonable expectation of realisation; and

(b) deferred tax assets arising from tax losses should be recognised as an asset only where there was assurance beyond any reasonable doubt that future taxable income would be sufficient to allow the benefit of the loss to be realised. The original IAS 12 permitted (but did not require) an enterprise to defer recognition of the benefit of tax losses until the period of realisation.

This Standard requires that deferred tax assets should be recognised when it is probable that taxable profits will be available against which the deferred tax asset can be utilised. Where an enterprise has a history of tax losses, the enterprise recognises a deferred tax asset only to the extent that the enterprise has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available.

4. As an exception to the general requirement set out in paragraph 2 above, this Standard prohibits the recognition of deferred tax liabilities and deferred tax assets arising from certain assets or liabilities whose carrying amount differs on initial recognition from their initial tax base. Because such circumstances do not give rise to timing differences, they did not result in deferred tax assets or liabilities under the original IAS 12.

5. The original IAS 12 did not refer explicitly to fair value adjustments made on a business combination. Such adjustments give rise to temporary differences and the Standard requires an enterprise to recognise the resulting deferred tax liability or (subject to the probability criterion for recognition) deferred tax asset with a corresponding effect on the determination of the amount of goodwill or negative goodwill. However, this Standard prohibits the recognition of deferred tax liabilities arising from goodwill itself (if amortisation of the goodwill is not deductible for tax purposes) and of deferred tax assets arising from negative goodwill that is treated as deferred income.

6. The original IAS 12 permitted, but did not require, an enterprise to recognise a deferred tax liability in respect of asset revaluations. This Standard requires an enterprise to recognise a deferred tax liability in respect of asset revaluations.

7. The tax consequences of recovering the carrying amount of certain assets or liabilities may depend on the manner of recovery or settlement, for example the amount that is deducted for tax purposes on sale of an asset is greater than the amount that may be deducted as depreciation.

   The original IAS 12 gave no guidance on the measurement of deferred tax assets and liabilities in such cases. This Standard requires that the measurement of deferred tax liabilities and deferred tax assets should be based on the tax consequences that would follow from the manner in which the enterprise expects to recover or settle the carrying amount of its assets and liabilities.

8. The original IAS 12 did not state explicitly whether deferred tax assets and liabilities may be discounted. This Standard prohibits discounting of deferred tax assets and liabilities.

9. The original IAS 12 did not specify whether an enterprise should classify deferred tax balances as current assets and liabilities or as non-current assets and liabilities. This Standard requires that an enterprise which makes the current/non-current distinction should not classify deferred tax assets and liabilities as current assets and liabilities.

10. The original IAS 12 stated that debit and credit balances representing deferred taxes may be offset. This Standard establishes more restrictive conditions on offsetting, based largely on those for financial assets and liabilities in MASB 24, Financial Instruments: Disclosure and Presentation.

11. The original IAS 12 required disclosure of an explanation of the relationship between tax expense and accounting profit if not explained by the tax rates effective in the reporting enterprise's country. This Standard requires this explanation to take either or both of the following forms:

    (i) a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s); or

    (ii) a numerical reconciliation between the average effective tax rate and the applicable tax rate.

    The Standard also requires an explanation of changes in the applicable tax rate(s) compared to the previous accounting period.

12. New disclosures required by the Standard include:

    (a) in respect of each type of temporary difference, unused tax losses and unused tax credits:

        (i) the amount of deferred tax assets and liabilities recognised; and

        (ii) the amount of the deferred tax income or expense recognised in the income statement, if this is not apparent from the changes in the amounts recognised in the balance sheet;

(b) in respect of discontinued operations, the tax expense relating to:

  (i) the gain or loss on discontinuance; and

  (ii) the profit or loss from the ordinary activities of the discontinued operation; and

(c) the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:

  (i) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and

  (ii) the enterprise has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.

Income Taxes

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The standards, which have been set in the bold type, should be read in the context of the background material and implementation guidance in this Standard, and in the context of the Foreword to MASB Standards. MASB Standards are not intended to apply to immaterial items.

Objective

The objective of this Standard is to prescribe the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of:

(a) the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an enterprise's balance sheet; and

(b) transactions and other events of the current period that are recognised in an enterprise's financial statements.

It is inherent in the recognition of an asset or liability that the reporting enterprise expects to recover or settle the carrying amount of that asset or liability. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, this Standard requires an enterprise to recognise a deferred tax liability (deferred tax asset), with certain limited exceptions.

This Standard requires an enterprise to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in the income statement, any related tax effects are also recognised in the income statement. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill or negative goodwill arising in that business combination.

This Standard also deals with the recognition of deferred tax assets arising from unused tax losses or unused tax credits, the presentation of income taxes in the financial statements and the disclosure of information relating to income taxes.

Scope

1. **This Standard should be applied in accounting for income taxes.**

2. This Standard supersedes MASB Approved Accounting Standard, IAS 12, Accounting for Taxes on Income.

3. For the purposes of this Standard, income taxes include all domestic and foreign taxes which are based on taxable profits. Income taxes also include other taxes, such as withholding taxes, which are payable by a foreign subsidiary, associate or joint venture on distributions to the reporting enterprise, and real property gains taxes payable on disposal of properties.

4. This Standard does not deal with the methods of accounting for government grants or investment tax credits. However, this Standard does deal with the accounting for temporary differences that may arise from such grants or investment tax credits.

Definitions

5. **The following terms are used in this Standard with the meanings specified:**

   Accounting profit is net profit or loss for a period before deducting tax expense.

   Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

   Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of:

   (a) deductible temporary differences;

   (b) the carryforward of unused tax losses; and

   (c) the carryforward of unused tax credits.

   Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Tax expense (tax income) is the aggregate amount included in the determination of net profit or loss for the period in respect of current tax and deferred tax.

Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:

(a) **taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or**

(b) **deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.**

The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

6. Tax expense (tax income) comprises current tax expense (current tax income) and deferred tax expense (deferred tax income).

Tax Base

7. The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an enterprise when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

Examples

1. A machine costs RM1,000. For tax purposes, capital allowances of RM300 have already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as annual capital allowances or through a balancing allowance on disposal. Revenue generated by using the machine is taxable, any gain or loss on disposal of the machine will be subject to a balancing charge or allowance for tax purposes. *The tax base of the machine is RM700.*

2. Interest receivable has a carrying amount of RM100. The related interest revenue will be taxed on a cash basis. *The tax base of the interest receivable is nil.*

3. Trade receivables have a carrying amount of RM100. The related revenue has already been included in taxable profit (tax loss). *The tax base of the trade receivables is RM100.*

4. Dividends receivable from a subsidiary have a carrying amount of RM100. The dividends are not taxable. *In substance, the entire carrying amount of the asset is deductible against the economic benefits. Consequently, the tax base of the dividends receivable is RM100.*[1]

   [1] *Under this analysis, there is no taxable temporary difference. An alternative analysis is that the accrued dividends receivable have a tax base of nil and that a tax rate of nil is applied to the resulting taxable temporary difference of RM100. Under both analyses, there is no deferred tax liability.*

5. A loan receivable has a carrying amount of RM100. The repayment of the loan will have no tax consequences. *The tax base of the loan is RM100.*

8. The tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods. In the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in future periods.

Examples

1. Current liabilities include accrued expenses with a carrying amount of RM100. The related expense will be deducted for tax purposes on a cash basis. *The tax base of the accrued expenses is nil.*

2. Current liabilities include interest revenue received in advance, with a carrying amount of RM100. The related interest revenue was taxed on a cash basis. *The tax base of the interest received in advance is nil.*

3. Current liabilities include accrued expenses with a carrying amount of RM100. The related expense has already been deducted for tax purposes. *The tax base of the accrued expenses is RM100.*

4. Current liabilities include accrued fines and penalties with a carrying amount of RM100. Fines and penalties are not deductible for tax purposes. *The tax base of the accrued fines and penalties is RM100.*[2]

   [2.] *Under this analysis, there is no deductible temporary difference. An alternative analysis is that the accrued fines and penalties payable have a tax base of nil and that a tax rate of nil is applied to the resulting deductible temporary difference of RM100. Under both analyses, there is no deferred tax asset.*

5. A loan payable has a carrying amount of RM100. The repayment of the loan will have no tax consequences. The tax base of the loan is RM100.

9. Some items have a tax base but are not recognised as assets and liabilities in the balance sheet. For example, research costs are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period. The difference between the tax base of the research costs, being the amount the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset.

10. Where the tax base of an asset or liability is not immediately apparent, it is helpful to consider the fundamental principle upon which this Standard is based: that an enterprise should, with certain limited exceptions, recognise a deferred tax liability (asset) whenever recovery or settlement of the carrying amount of an asset or liability would make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences. Example C following paragraph 50 illustrates circumstances when it may be helpful to consider this fundamental principle, for example, when the tax base of an asset or liability depends on the expected manner of recovery or settlement.

11. In consolidated financial statements, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. In Malaysia, the tax base is determined by reference to the tax returns of each enterprise in the group. Therefore, unrealised profits or losses which are eliminated on consolidation create temporary differences in the consolidated financial statements between carrying amounts of assets and liabilities and their corresponding tax bases.

Recognition of Current Tax Liabilities and Current Tax Assets

12. Current tax for current and prior periods should, to the extent unpaid, be recognised as a liability. If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess should be recognised as an asset.

13. In the Malaysian context, current income taxes, which were previously based on the preceding year basis, have been changed to the current year basis. Therefore, income taxes of current and prior periods should, to the extent unpaid, be recognised as a current tax liability. Conversely, if the amount of income taxes paid for current and prior periods exceeds the amount assessed for those periods, the excess should be recognised as a current tax asset. Any over or under-provision for current income taxes is accounted for as a change in estimate and is adjusted for when the Inland Revenue Board has made an assessment of the amount of current income tax payable. The current income tax laws do not permit a tax loss to be used to recover current tax of a previous period. The tax loss of a current period may be used to offset taxable income in a future period, and accordingly, represents only potential tax savings in future periods which should be accounted for in accordance with paragraph 37.

Recognition of Deferred Tax Liabilities and Deferred Tax Assets

Taxable Temporary Differences

14. **A deferred tax liability should be recognised for all taxable temporary differences, unless the deferred tax liability arises from:**

    (a) **goodwill for which amortisation is not deductible for tax purposes; or**

    (b) **the initial recognition of an asset or liability in a transaction which:**

    (i) **is not a business combination; and**

    (ii) **at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).**

15. It is inherent in the recognition of an asset that its carrying amount will be recovered in the form of economic benefits that flow to the enterprise in future periods. When the carrying amount of the asset exceeds its tax base, the amount of taxable economic benefits will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability. As the enterprise recovers the carrying amount of the asset, the taxable temporary difference will reverse and the enterprise will have taxable profit. This makes it probable that economic benefits will flow from the enterprise in the form of tax payments. Therefore, this Standard requires the recognition of all deferred tax liabilities, except in certain circumstances described in paragraph 14.

Example

An asset which costs RM150 has a carrying amount of RM100. Cumulative capital allowance for tax purposes is RM90 and the tax rate is 25%.

The tax base of the asset is RM60 (cost of RM150 less cumulative capital allowance of RM90). To recover the carrying amount of RM100, the enterprise must earn taxable profit of RM100, but will only be able to deduct capital allowance of RM60. Consequently, the enterprise will pay income taxes of RM10 (RM40 at 25%) when it recovers the carrying amount of the asset. The difference between the carrying amount of RM100 and the tax base of RM60 is a taxable temporary difference of RM40. Therefore, the enterprise recognises a deferred tax liability of RM10 (RM40 at 25%) representing the income taxes that it will pay when it recovers the carrying amount of the asset.

16. Some temporary differences arise when income or expense is included in accounting profit in one period but is included in taxable profit in a different period. Such temporary differences are often described as timing differences. The following are examples of temporary differences of this kind which are taxable temporary differences and which therefore result in deferred tax liabilities:

(a) interest revenue is included in accounting profit on a time proportion basis but may be included in taxable profit when cash is collected. The tax base of any interest receivable recognised in the balance sheet with respect to such revenues is nil because the revenues do not affect taxable profit until cash is collected;

(b) depreciation used in determining taxable profit (tax loss) may differ from that used in determining accounting profit. The temporary difference is the difference between the carrying amount of the asset and its tax base which is the original cost of the asset less all deductions in respect of that asset permitted by the taxation authorities in determining taxable profit of the current and prior periods. A taxable temporary difference arises, and results in a deferred tax liability, when capital allowance is accelerated (if capital allowance is less rapid than accounting depreciation, a deductible temporary difference arises, and results in a deferred tax asset); and

(c) development costs may be capitalised and amortised over future periods in determining accounting profit but deducted in determining taxable profit in the period in which they are incurred. Such development costs have a tax base of nil as they have already been deducted from taxable profit. The temporary difference is the difference between the carrying amount of the development costs and their tax base of nil.

17. Temporary differences also arise when:

(a) the cost of a business combination that is an acquisition is allocated to the identifiable assets and liabilities acquired by reference to their fair values but no equivalent adjustment is made for tax purposes (see paragraph 18);

(b) assets are revalued and no equivalent adjustment is made for tax purposes (see paragraph 19);

(c) goodwill or negative goodwill arises on consolidation (see paragraphs 22 and 34); or

(d) the tax base of an asset or liability on initial recognition differs from its initial carrying amount, for example when an enterprise acquires a non-industrial building or when it benefits from non-taxable government grants related to assets (see paragraphs 23 and 35).

Business Combinations

18. In a business combination that is an acquisition, the cost of the acquisition is allocated to the identifiable assets and liabilities acquired by reference to their fair values at the date of the exchange transaction. Temporary differences arise when the tax bases of the identifiable assets and liabilities acquired are not affected by the business combination or are affected differently. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. The resulting deferred tax liability affects goodwill (see paragraph 64).

Assets Carried at Fair Value

19. MASB Standards permit certain assets to be carried at fair value or to be revalued (see, for example, MASB 15, Property, Plant and Equipment, and MASB ED 31, Investment Property). In Malaysia, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the enterprise and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. For a depreciable property, plant or equipment, this is true even if:

(a) the enterprise does not intend to dispose of the asset. In such cases, the revalued carrying amount of the asset will be recovered through use and this will generate taxable income which exceeds the capital allowance that will be deductible for tax purposes in future periods; or

(b) the tax effect of a balancing charge and/or real property gains tax is deferred until the revalued asset is disposed. In such cases, the tax will ultimately become payable on sale of the revalued asset.

20. However, for a non-depreciable property, such as a freehold land, there is no recovery through use as the asset is not subject to depreciation. The tax effect of any upward revaluation for such asset relates only to real property gains tax. In such circumstances, deferred tax on the temporary difference (i.e., the revaluation surplus) is recognised on the expected property gains tax payable if the enterprise has a firm commitment to dispose of the property in the foreseeable future. If the enterprise has no firm commitment to dispose of the revalued property in the foreseeable future, the minimum property gains tax rate of five per cent should be used to recognise the deferred tax liability on the surplus arising from the revaluation. Similarly for an investment or investment property, which is not subject to depreciation or amortisation, no tax liability will crystallise through use. Accordingly, a deferred tax liability on a revaluation surplus is recognised if, and only if, a disposal of the revalued investment or revalued investment property will result in taxes payable and the enterprise has a firm commitment to dispose the investment or investment property.

21. For a building that does not qualify for tax allowances, a temporary difference arises on its initial recognition as it has a tax base of nil. Paragraph 14 (b) of the Standard does not permit an enterprise to recognise a deferred tax liability on its initial recognition and subsequently. This exemption, however, does not apply to any revaluation surplus arising if the building is revalued upward subsequent to its initial recognition. This is because a building is a depreciable asset and therefore tax liability on the revaluation surplus will crystallise when the carrying revalued amount of the building is recovered through use or by disposal. In the case when the enterprise has entered into a firm commitment, such as a binding sale arrangement, to dispose the building in the foreseeable future, the deferred tax liability should be measured by the sum of the income tax rate based on the additional depreciation arising from the surplus in the intervening periods prior to the date of the disposal, if any, plus the real property gains tax payable on its disposal. In all other circumstances, the deferred tax liability should be measured by the income tax rate on the revaluation surplus arising from the revaluation of the building. This is because in such cases, the future economic benefits generated from the use of the revalued building is subject to income tax.

Goodwill

22. Goodwill is the excess of the cost of an acquisition over the acquirer’s interest in the fair value of the identifiable assets and liabilities acquired. The Inland Revenue Board does not allow the amortisation of goodwill as a deductible expense in determining taxable profit. Moreover, the cost of goodwill is often not deductible when a subsidiary disposes of its underlying business. In such circumstances, goodwill has a tax base of nil. Any difference between the carrying amount of goodwill and its tax base of nil is a taxable temporary difference. However, this Standard does not permit the recognition of the resulting deferred tax liability because goodwill is a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill.

Initial Recognition of an Asset or Liability

23. A temporary difference may arise on initial recognition of an asset or liability, for example if part or all of the cost of an asset will not be deductible for tax purposes. The method of accounting for such a temporary difference depends on the nature of the transaction which led to the initial recognition of the asset:

(a) in a business combination, an enterprise recognises any deferred tax liability or asset and this affects the amount of goodwill or negative goodwill (see paragraph 18);

(b) if the transaction affects either accounting profit or taxable profit, an enterprise recognises any deferred tax liability or asset and recognises the resulting deferred tax expense or income in the income statement (see paragraph 57);

(c) if the transaction is not a business combination, and affects neither accounting profit nor taxable profit, an enterprise would, in the absence of the exemption provided by paragraphs 14 and 26, recognise the resulting deferred tax liability or asset and adjust the carrying amount of the asset or liability by the same amount. Such adjustments would make the financial statements less transparent. Therefore, this Standard does not permit an enterprise to recognise the resulting deferred tax liability or asset, either on initial recognition or subsequently (see example on next page). Furthermore, an enterprise does not recognise subsequent changes in the unrecognised deferred tax liability or asset as the asset is depreciated.

24. For example, a depreciable leasehold property that neither qualifies for industrial building allowance nor for capital allowances would have a tax base of nil on initial recognition and subsequently. Temporary difference on the leasehold property would, therefore, be the carrying amount on initial recognition and subsequently. However, no deferred tax liability should be recognised on this temporary difference, either on initial recognition or subsequently, because the tax effect arises from the initial recognition of the leasehold property. Similarly, temporary differences arising on initial recognition of other non-qualifying fixed assets, such as amounts in excess RM50,000 for non-commercial vehicles, should be disregarded in the recognition of deferred tax liability of the enterprise.

Example Illustrating Paragraph 23(c)

An enterprise intends to use a non-moveable fixture which costs RM1,000 throughout its useful life of five years and then dispose of it for a residual value of nil. The tax rate is 30%. Depreciation of the asset is not deductible for tax purposes. On disposal, any capital gain would not be taxable and any capital loss would not be deductible.

As it recovers the carrying amount of the asset, the enterprise will earn taxable income of RM1,000 and pay tax of RM300. The enterprise does not recognise the resulting deferred tax liability of RM300 because it results from the initial recognition of the asset.

In the following year, the carrying amount of the asset is RM800. In earning taxable income of RM800, the enterprise will pay tax of RM240. The enterprise does not recognise the deferred tax liability of RM240 because it results from the initial recognition of the asset.

25. In accordance with MASB 24, Financial Instruments: Disclosure and Presentation, the issuer of a compound financial instrument (for example, a convertible bond or a bond issued with warrants) should classify the instrument's liability component as a liability and the equity component as equity. In Malaysia, the tax base of the liability component on initial recognition is equal to the initial carrying amount of the sum of the liability and equity components. The resulting taxable temporary difference arises from the initial recognition of the equity component separately from the liability component. Therefore, the exception set out in paragraph 14(b) does not apply. Consequently, an enterprise recognises the resulting deferred tax liability. In accordance with paragraph 59, the deferred tax is charged directly to the carrying amount of the equity component. In accordance with paragraph 56, subsequent changes in the deferred tax liability are recognised in the income statement as deferred tax expense (income).

Deductible Temporary Differences

26. A deferred tax asset should 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 differences can be utilised, unless the deferred tax asset arises from:

(a) negative goodwill which is treated as deferred income; or

(b) the initial recognition of an asset or liability in a transaction which:

(i) is not a business combination; and

(ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

27. It is inherent in the recognition of a liability that the carrying amount will be settled in future periods through an outflow from the enterprise of resources embodying economic benefits. When resources flow from the enterprise, part or all of their amounts may be deductible in determining taxable profit of a period later than the period in which the liability is recognised. In such cases, a temporary difference exists between the carrying amount of the liability and its tax base. Accordingly, a deferred tax asset arises in respect of the income taxes that will be recoverable in the future periods when that part of the liability is allowed as a deduction in determining taxable profit. Similarly, if the carrying amount of an asset is less than its tax base, the difference gives rise to a deferred tax asset in respect of the income taxes that will be recoverable in future periods. This includes a general provision for doubtful debts which is setoff against the gross carrying amount of trade receivables on presentation in the balance sheet, but there is no equivalent deduction to the tax base of the trade receivables.

Example

An enterprise recognises a liability of RM100 for accrued product warranty costs. For tax purposes, the product warranty costs will not be deductible until the enterprise pays claims. The tax rate is 25%.

The tax base of the liability is nil (carrying amount of RM100, less the amount that will be deductible for tax purposes in respect of that liability in future periods). In settling the liability for its carrying amount, the enterprise will reduce its future taxable profit by an amount of RM100 and, consequently, reduce its future tax payments by RM25 (RM100 at 25%). The difference between the carrying amount of RM100 and the tax base of nil is a deductible temporary difference of RM100. Therefore, the enterprise recognises a deferred tax asset of RM25 (RM100 at 25%), provided that it is probable that the enterprise will earn sufficient taxable profit in future periods to benefit from a reduction in tax payments.

28. The following are examples of deductible differences which result in deferred tax assets:

(a) retirement benefit costs may be deducted in determining accounting profit as service is provided by the employee, but deducted in determining taxable profit either when contributions are paid to an approved fund by the enterprise or when retirement benefits are paid by the enterprise. A temporary difference exists between the carrying amount of the liability and its tax base; the tax base of the liability is usually nil. Such a deductible temporary difference results in a deferred tax asset as economic benefits will flow to the enterprise in the form of a deduction from taxable profits when contributions or retirement benefits are paid;

(b) research costs are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period. The difference between the tax base of the research costs, being the amount the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset;

(c) in a business combination that is an acquisition, the cost of the acquisition is allocated to the assets and liabilities recognised, by reference to their fair values at the date of the exchange transaction. When a liability is recognised on the acquisition but the related costs are not deducted in determining taxable profits until a later period, a deductible temporary difference arises which results in a deferred tax asset. A deferred tax asset also arises where the fair value of an identifiable asset acquired is less than its tax base. In both cases, the resulting deferred tax asset affects goodwill (see paragraph 64); and

(d) certain assets may be carried at fair value, or may be revalued, without an equivalent adjustment being made for tax purposes (see paragraph 19). A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.

29. The reversal of deductible temporary differences results in deductions in determining taxable profits of future periods. However, economic benefits in the form of reductions in tax payments will flow to the enterprise only if it earns sufficient taxable profits against which the deductions can be offset. Therefore, an enterprise recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised.

30. It is probable that taxable profit will be available against which a deductible temporary difference can be utilised when there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity which are expected to reverse:

(a) in the same period as the expected reversal of the deductible temporary difference; or

(b) in periods into which a tax loss arising from the deferred tax asset can be carried forward.

In such circumstances, the deferred tax asset is recognised in the period in which the deductible temporary differences arise. For example, when the reporting enterprise operates only in Malaysia and is subject only to the Malaysian income tax laws, a deferred tax asset is recognised on a tax loss or any other deductible temporary differences (such as a general provision for warranty expense) if there exists sufficient taxable temporary differences. This is because the deferred tax liability recognised on the taxable temporary differences will only crystallise when there is sufficient taxable profit in the future periods, and this will in itself provide assurance that the deferred tax asset will be realised.

31. When there are insufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, the deferred tax asset is recognised to the extent that:

    (a) it is probable that the enterprise will have sufficient taxable profit relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference (or in the periods into which a tax loss arising from the deferred tax asset can be carried forward). In evaluating whether it will have sufficient taxable profit in future periods, an enterprise ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from these deductible temporary differences will itself require future taxable profit in order to be utilised; or

    (b) tax planning opportunities are available to the enterprise that will create taxable profit in appropriate periods.

32. Tax planning opportunities are actions that the enterprise would take in order to create or increase taxable income in a particular period before the expiry of a tax loss or tax credit carryforward. For example, taxable profit may be created or increased by:

    (a) electing to have interest income taxed on either a received or receivable basis;

    (b) deferring the claim for certain deductions from taxable profit;

    (c) selling, and perhaps leasing back, assets that have appreciated but for which the tax base has not been adjusted to reflect such appreciation; and

    (d) selling an asset that generates non-taxable income (such as a government bond) in order to purchase another investment that generates taxable income.

    Where tax planning opportunities advance taxable profit from a later period to an earlier period, the utilisation of a tax loss or tax credit carryforward still depends on the existence of future taxable profit from sources other than future originating temporary differences.

33. When an enterprise has a history of recent losses, the enterprise considers the guidance in paragraphs 38 and 39.

Negative Goodwill

34. This Standard does not permit the recognition of a deferred tax asset arising from deductible temporary differences associated with negative goodwill which is treated as deferred income because negative goodwill is a residual and the recognition of the deferred tax asset would increase the carrying amount of negative goodwill.

Initial Recognition of an Asset or Liability

35. One case when a deferred tax asset arises on initial recognition of an asset is when a non-taxable government grant related to an asset is deducted in arriving at the carrying amount of the asset but, for tax purposes, is not deducted from the asset's depreciable amount (in other words its tax base); the carrying amount of the asset is less than its tax base and this gives rise to a deductible temporary difference. Government grants may also be set up as deferred income in which case the difference between the deferred income and its tax base of nil is a deductible temporary difference. Whichever method of presentation an enterprise adopts, the enterprise does not recognise the resulting deferred tax asset, for the reason given in paragraph 23. This non-recognition principle has traditionally been applied to permanent differences, which may include other items, such as a provision for an expense which is permanently disallowed for income tax purposes.

36. Another case when a deferred tax asset arises on initial recognition of an asset is when it qualifies for re-investment or other allowances in excess of its normal capital allowances. In such a case, the carrying amount of the asset is less that its tax base on initial recognition, and this gives rise to a deductible temporary difference. However, for the reason given in paragraph 23, the enterprise does not recognise the resulting deferred tax asset on initial recognition of the asset and subsequently.

Unused Tax Losses and Unused Tax Credits

37. A deferred tax asset should be recognised for the carryforward 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.

38. The criteria for recognising deferred tax assets arising from the carryforward of unused tax losses and tax credits are the same as the criteria for recognising deferred tax assets arising from deductible temporary differences. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an enterprise has a history of recent losses, the enterprise recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the enterprise has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the enterprise. In such circumstances, paragraph 80 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.

39. An enterprise considers the following criteria in assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised:

(a) whether the enterprise has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;

(b) whether it is probable that the enterprise will have taxable profits before the unused tax losses or unused tax credits expire;

(c) whether the unused tax losses result from identifiable causes which are unlikely to recur; and

(d) whether tax planning opportunities (see paragraph 32) are available to the enterprise that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

To the extent that it is not probable that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the deferred tax asset is not recognised.

Re-assessment of Unrecognised Deferred Tax Assets

40. At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets. The enterprise recognises a previously unrecognised deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered. For example, an improvement in trading conditions may make it more probable that the enterprise will be able to generate sufficient taxable profit in the future for the deferred tax asset to meet the recognition criteria set out in paragraphs 26 or 37. Another example is when an enterprise re-assesses deferred tax assets at the date of a business combination or subsequently (see paragraphs 65 and 66).

Investments in Subsidiaries, Branches and Associates, and Interests in Joint Ventures

41. In consolidated financial statements, the temporary difference of an investment in a subsidiary, branch, associate or a joint venture may be different from the temporary difference associated with that investment in the parent's separate financial statements if the parent carries the investment in its separate financial statements at cost or revalued amount. In respect of investments in local subsidiaries, associates or joint ventures, it is rare for temporary differences to arise because any such investments are usually carried at cost, which will be the same as its tax base. Similarly, investments in subsidiaries, associates and joint ventures are capital in nature, which are not tax-deductible or taxable on a subsequent disposal. Accordingly, no deferred tax asset or liability should be provided on initial recognition and subsequently. In the investor's separate financial statements, which must account for these investments under the cost method, no deferred tax liability would arise. Tax effects may, however, arise in respect of dividend receivable from overseas subsidiaries, associates and joint ventures and only when there exists a difference in the income tax rates between Malaysia and the overseas jurisdictions. Any such tax effect is normally accounted as a current tax expense (or tax income) in the period in which the dividend income is recognised. Accordingly, no deferred tax should be recognised in the separate accounts of the investor in respect of undistributed profits of overseas subsidiaries, associates or joint ventures.

42. As a parent controls the dividend policy of its overseas subsidiary, it is able to control the timing of the reversal of temporary differences associated with that investment (including the temporary differences arising not only from undistributed profits but also from any foreign exchange translation differences). Furthermore, it would often be impracticable to determine the amount of income taxes that would be payable when the temporary difference reverses. This is because the amount of income tax payable, if any, is dependent on numerous complex factors, such as whether there exist tax treaties between the overseas jurisdictions and Malaysia, the differential income tax rates, and the intended period(s) in which the profits would be remitted. Therefore, when the parent has determined that those profits will not be distributed in the foreseeable future, or when remittance of those profits will not attract additional income tax liability, the parent does not recognise a deferred tax liability. The same considerations apply to investments in branches.

43. An enterprise accounts in its own currency for the non-monetary assets and liabilities of a foreign operation that is integral to the enterprise's operations (see MASB 6, The Effects of Changes in Foreign Exchange Rates). Where the foreign operation's taxable profit or tax loss (and, hence, the tax base of its non-monetary assets and liabilities) is determined in the foreign currency, changes in the exchange rate give rise to temporary differences. Because such temporary differences relate to the foreign operation's own assets and liabilities, rather than to the reporting enterprise's investment in that foreign operation, the reporting enterprise recognises the resulting deferred tax liability or (subject to paragraph 26) asset. The resulting deferred tax is charged or credited in the income statement (see paragraph 56).

Measurement

44. Current tax liabilities (assets) for the current and prior periods should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

45. Deferred tax assets and liabilities should be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

46. Current and deferred tax assets and liabilities are usually measured using the tax rates (and tax laws) that have been enacted. In Malaysia, announcements of tax rates (and tax laws) by the Government in the yearly Budget have the substantive effect of actual enactment, which may follow the announcement by a period of several months. In these circumstances, tax assets and liabilities are measured using the announced tax rate (and tax laws).

47. When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using the average rates that are expected to apply to the taxable profit (tax loss) of the periods in which the temporary differences are expected to reverse.

48. For enterprises with sufficient tax credits, distribution of profits in the form of dividends would not attract additional tax liabilities. Consequently, no current or deferred tax liabilities should be recognised for the undistributed profits. For enterprises that have no or insufficient tax credits, the distribution of some or all of its retained profits may attract additional tax liabilities. Consequently, when a reporting enterprise has recognised a declared or proposed dividend as a component of equity in its balance sheet, a current liability should be recognised to the extent of the declared or proposed distribution not franked by its available tax credits. Paragraph 81 requires an enterprise to disclose whether it has sufficient tax credits to frank the distribution of its retained profits.

49. The measurement of deferred tax liabilities and deferred tax assets should reflect the tax consequences that would follow from the manner in which the enterprise expects, at the balance sheet date, to recover or settle the carrying amount of its assets and liabilities.

50. The manner in which an enterprise recovers (settles) the carrying amount of an asset (liability) may affect either or both of:

(a) the tax rate applicable when the enterprise recovers (settles) the carrying amount of the asset (liability); and

(b) the tax base of the asset (liability).

In such cases, an enterprise measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.

Example A

A machine has a carrying amount of RM1,000 and a tax base of RM600. The machine can be sold for cash of RM900. A balancing charge of 30% would apply if the machine were sold for cash, and similarly, a tax rate of 30% would apply to other income.

The enterprise recognises a deferred tax liability of RM90 (RM300 at 30%) if it expects to sell the asset without further use and a deferred tax liability of RM120 (RM400 at 30%) if it expects to retain the asset and recover its carrying amount through use.

Example B

An asset with a cost of RM100 and a carrying amount of RM80 is revalued to RM150. No equivalent adjustment is made for tax purposes. Cumulative capital allowance is RM30 and the tax rate is 30%. If the asset is sold for more than cost, the cumulative capital allowance of RM30 will be included in taxable income but sale proceeds in excess of cost will not be taxable.

The tax base of the asset is RM70 and there is a taxable temporary difference of RM80. If the enterprise expects to recover the carrying amount by using the asset, it must generate taxable income of RM150, but will only be able to deduct depreciation of RM70. On this basis, there is a deferred tax liability of RM24 (RM80 at 30%). If the enterprise expects to recover the carrying amount by selling the asset immediately for proceeds of RM150, the deferred tax liability is computed as follows:

	Taxable Temporary Difference RM	*Tax Rate*	*Deferred Tax Liability RM*
Cumulative capital allowance	*30*	*30%*	*9*
Proceeds in excess of cost	*50*	*nil*	*-*
Total	*80*		*9*

(Note: in accordance with paragraph 59, the additional deferred tax that arises on the revaluation is charged directly to equity)

Example C

The facts are as in example B, except that if the asset is sold for more than cost, the cumulative capital allowances will be included in taxable income (taxed at 30%) and the sale proceeds will be taxed at 40%, after deducting an indexed cost of RM110.

If the enterprise expects to recover the carrying amount by using the asset, it must generate taxable income of RM150, but will only be able to deduct depreciation of RM70. On this basis, the tax base is RM70, there is a taxable temporary difference of RM80 and there is a deferred tax liability of RM24 (RM80 at 30%), as in example B.

If the enterprise expects to recover the carrying amount by selling the asset immediately for proceeds of RM150, the enterprise will be able to deduct the indexed cost of RM110. The net proceeds of RM40 will be taxed at 40%. In addition, the cumulative capital allowances of RM30 will be included in taxable income and taxed at 30%. On this basis, the tax base is RM80 (RM110 less RM30), there is a taxable temporary difference of RM70 and there is a deferred tax liability of RM25 (RM40 at 40% plus RM30 at 30%). If the tax base is not immediately apparent in this example, it may be helpful to consider the fundamental principle set out in paragraph 10.

(note: in accordance with paragraph 59, the additional deferred tax that arises on the revaluation is charged directly to equity)

51. Deferred tax assets and liabilities should not be discounted.

52. In principle, assets and liabilities (including deferred tax assets and tax liabilities) which represent monetary amounts receivable and payable in future periods should be measured at their respective discounted present values. However, the reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each temporary difference. In many cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between enterprises. Therefore, this Standard does not require or permit the discounting of deferred tax assets and liabilities.

53. Temporary differences are determined by reference to the carrying amount of an asset or liability. This applies even where that carrying amount is itself determined on a discounted basis, for example in the case of retirement benefit obligations (see MASB ED 33, Employee Benefits).

54. The carrying amount of a deferred tax asset should be reviewed at each balance sheet date. An enterprise should reduce the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilised. Any such reduction should be reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Recognition of Current and Deferred Tax

55. Accounting for the current and deferred tax effects of a transaction or other event is consistent with the accounting for the transaction or event itself. Paragraphs 56 to 66 implement this principle.

Income Statement

56. Current and deferred tax should be recognised as income or an expense and included in the net profit or loss for the period, except to the extent that the tax arises from:

(a) a transaction or event which is recognised, in the same or a different period, directly in equity (see paragraphs 59 to 63); or

(b) a business combination that is an acquisition (see paragraphs 64 to 66).

57. Most deferred tax liabilities and deferred tax assets arise where income or expense is included in accounting profit in one period, but is included in taxable profit (tax loss) in a different period. The resulting deferred tax is recognised in the income statement. Examples are when:

(a) interest, royalty or dividend revenue is received in arrears and is included in accounting profit on a time apportionment basis in accordance with MASB 9, Revenue, but is included in taxable profit (tax loss) on a cash basis; and

(b) development costs have been capitalised in accordance with MASB 4, Research and Development Costs, and are being amortised in the income statement, but were deducted for tax purposes when they were incurred.

58. The carrying amount of deferred tax assets and liabilities may change even though there is no change in the amount of the related temporary differences. This can result, for example, from:

(a) a change in tax rates or tax laws;

(b) a re-assessment of the recoverability of deferred tax assets; or

(c) a change in the expected manner of recovery of an asset.

The resulting deferred tax is recognised in the income statement, except to the extent that it relates to items previously charged or credited to equity (see paragraph 61).

Items Credited or Charged Directly to Equity

59. Current tax and deferred tax should be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.

60. MASB Standards require or permit certain items to be credited or charged directly to equity. Examples of such items are:

(a) a change in carrying amount arising from the revaluation of property, plant and equipment (see MASB 15, Property, Plant and Equipment);

(b) an adjustment to the opening balance of retained earnings resulting from either a change in accounting policy that is applied retrospectively or the correction of a fundamental error (see MASB 3, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies);

(c) exchange differences arising on the translation of the financial statements of a foreign entity (see MASB 6, The Effects of Changes in Foreign Exchange Rates); and

(d) amounts arising on initial recognition of the equity component of a compound financial instrument (see paragraph 25).

61. In exceptional circumstances it may be difficult to determine the amount of current and deferred tax that relates to items credited or charged to equity. This may be the case, for example, when:

    (a) there are graduated rates of income tax and it is impossible to determine the rate at which a specific component of taxable profit (tax loss) has been taxed;

    (b) a change in the tax rate or other tax rules affects a deferred tax asset or liability relating (in whole or in part) to an item that was previously charged or credited to equity; or

    (c) an enterprise determines that a deferred tax asset should be recognised, or should no longer be recognised in full, and the deferred tax asset relates (in whole or in part) to an item that was previously charged or credited to equity.

    In such cases, the current and deferred tax related to items that are credited or charged to equity is based on a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction concerned, or other method that achieves a more appropriate allocation in the circumstances.

62. MASB 15, Property, Plant and Equipment, does not specify whether an enterprise should transfer each year from revaluation surplus to retained earnings an amount equal to the difference between the depreciation or amortisation on a revalued asset and the depreciation or amortisation based on the cost of that asset. If an enterprise makes such a transfer, the amount transferred is net of any related deferred tax. Similar considerations apply to transfers made on disposal of an item of property, plant or equipment.

63. When an asset is revalued for tax purposes and that revaluation is related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects of both the asset revaluation and the adjustment of the tax base are credited or charged to equity in the periods in which they occur. However, if the revaluation for tax purposes is not related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects of the adjustment of the tax base are recognised in the income statement.

Deferred Tax Arising from a Business Combination

64. As explained in paragraphs 18 and 28(c), temporary differences may arise in a business combination that is an acquisition. In accordance with MASB 21, Business Combinations, an enterprise recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 26) or deferred tax liabilities as identifiable assets and liabilities at the date of the acquisition. Consequently, those deferred tax assets and liabilities affect goodwill or negative goodwill. However, in accordance with paragraphs 14(a) and 26(a), an enterprise does not recognise deferred tax liabilities arising from goodwill itself (if amortisation of the goodwill is not deductible for tax purposes) and deferred tax assets arising from non-taxable negative goodwill which is treated as deferred income.

65. As a result of a business combination, an acquirer may consider it probable that it will recover its own deferred tax asset that was not recognised prior to the business combination. For example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree. In such cases, the acquirer recognises a deferred tax asset and takes this into account in determining the goodwill or negative goodwill arising on the acquisition.

66. When an acquirer did not recognise a deferred tax asset of the acquiree as an identifiable asset at the date of a business combination and that deferred tax asset is subsequently recognised in the acquirer's consolidated financial statements, the resulting deferred tax income is recognised in the income statement. In addition, the acquirer:

    (a) adjusts the gross carrying amount of the goodwill and the related accumulated amortisation to the amounts that would have been recorded if the deferred tax asset had been recognised as an identifiable asset at the date of the business combination; and

    (b) recognises the reduction in the net carrying amount of the goodwill as an expense.

    However, the acquirer does not recognise negative goodwill, nor does it increase the carrying amount of negative goodwill.

Example

An enterprise acquired a subsidiary which had deductible temporary differences of RM300. The tax rate at the time of the acquisition was 30%. The resulting deferred tax asset of RM90 was not recognised as an identifiable asset in determining the goodwill of RM500 resulting from the acquisition. The goodwill is amortised over 20 years. 2 years after the acquisition, the enterprise assessed that future taxable profit would probably be sufficient for the enterprise to recover the benefit of all the deductible temporary differences.

The enterprise recognises a deferred tax asset of RM90 (RM300 at 30%) and, in the income statement, deferred tax income of RM90. It also reduces the cost of the goodwill by RM90 and the accumulated amortisation by RM9 (representing 2 years' amortisation). The balance of RM81 is recognised as an expense in the income statement. Consequently, the cost of the goodwill, and the related accumulated amortisation, are reduced to the amounts (RM410 and RM41) that would have been recorded if a deferred tax asset of RM90 had been recognised as an identifiable asset at the date of the business combination.

If the tax rate has increased to 40%, the enterprise recognises a deferred tax asset of RM120 (RM300 at 40%) and, in the income statement, deferred tax income of RM120. If the tax rate has decreased to 20%, the enterprise recognises a deferred tax asset of RM60 (RM300 at 20%) and deferred tax income of RM60. In both cases, the enterprise also reduces the cost of the goodwill by RM90 and the accumulated amortisation by RM9 and recognises the balance of RM81 as an expense in the income statement.

Presentation

Tax Assets and Tax Liabilities

67. **Tax assets and tax liabilities should be presented separately from other assets and liabilities in the balance sheet. Deferred tax assets and liabilities should be distinguished from current tax assets and liabilities.**

68. When an enterprise makes a distinction between current and non-current assets and liabilities in its financial statements, it should not classify deferred tax assets (liabilities) as current assets (liabilities).

Offset

69. An enterprise should offset current tax assets and current tax liabilities if, and only if, the enterprise:

(a) has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

70. Although current tax assets and liabilities are separately recognised and measured they are offset in the balance sheet subject to criteria similar to those established for financial instruments in MASB 24, Financial Instruments: Disclosure and Presentation. An enterprise will normally have a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income taxes levied by the same taxation authority and the taxation authority permits the enterprise to make or receive a single net payment.

71. In consolidated financial statements, a current tax asset of one enterprise in a group is offset against a current tax liability of another enterprise in the group if, and only if, the enterprises concerned have a legally enforceable right to make or receive a single net payment and the enterprises intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously. However, in the Malaysian tax environment, such a legally enforceable right does not exist. Accordingly, a current tax asset of one enterprise in a group should not be offset against a current tax liability of another enterprise in the group.

72. An enterprise should offset deferred tax assets and deferred tax liabilities if, and only if:

(a) the enterprise 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.**

73. To avoid the need for detailed scheduling of the timing of the reversal of each temporary difference, this Standard requires an enterprise to set off a deferred tax asset against a deferred tax liability of the same taxable entity if, and only if, they relate to income taxes levied by the same taxation authority and the enterprise has a legally enforceable right to set off current tax assets against current tax liabilities.

74. In rare circumstances, an enterprise may have a legally enforceable right of set-off, and an intention to settle net, for some periods but not for others. In such rare circumstances, detailed scheduling may be required to establish reliably whether the deferred tax liability of one taxable entity will result in increased tax payments in the same period in which a deferred tax asset of another taxable entity will result in decreased payments by that second taxable entity.

Tax Expense

Tax Expense (Income) related to Profit or Loss from Ordinary Activities

75. The tax expense (income) related to profit or loss from ordinary activities should be presented on the face of the income statement.

Exchange Differences on Deferred Foreign Tax Liabilities or Assets

76. MASB 6, The Effects of Changes in Foreign Exchange Rates, requires certain exchange differences to be recognised as income or expense but does not specify where such differences should be presented in the income statement. Accordingly, where exchange differences on deferred foreign tax liabilities or assets are recognised in the income statement, such differences may be classified as deferred tax expense (income) if that presentation is considered to be the most useful to financial statement users.

Disclosure

77. The major components of tax expense (income) should be disclosed separately.

78. Components of tax expense (income) may include:

(a) current tax expense (income);

(b) any adjustments recognised in the period for current tax of prior periods;

(c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;

(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;

(e) the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce current tax expense;

(f) the amount of the benefit from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce deferred tax expense;

(g) deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 54; and

(h) the amount of tax expense (income) relating to those changes in accounting policies and fundamental errors which are included in the determination of net profit or loss for the period in accordance with the allowed alternative treatment in MASB 3, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.

79. The following should also be disclosed separately:

(a) the aggregate current and deferred tax relating to items that are charged or credited to equity;

(b) tax expense (income) relating to extraordinary items recognised during the period;

(c) an explanation of the relationship between tax expense (income) and accounting profit in either or both of the following forms:

(i) a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed; or

(ii) a numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed;

(d) an explanation of changes in the applicable tax rate(s) compared to the previous accounting period;

(e) the amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised in the balance sheet;

(f) in respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:

(i) the amount of the deferred tax assets and liabilities recognised in the balance sheet for each period presented;

(ii) the amount of the deferred tax income or expense recognised in the income statement, if this is not apparent from the changes in the amounts recognised in the balance sheet; and

(g) in respect of discontinued operations, the tax expense relating to:

(i) the gain or loss on discontinuance; and

(ii) the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented.

80. An enterprise should disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:

(a) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and

(b) the enterprise has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.

81. An enterprise should disclose whether there is sufficient tax credit to frank the distribution of its retained profits, and if there is insufficient tax credit, the extent of the retained profits not covered.

82. An enterprise discloses the nature and amount of each extraordinary item either on the face of the income statement or in the notes to the financial statements. When this disclosure is made in the notes to the financial statements, the total amount of all extraordinary items is disclosed on the face of the income statement, net of the aggregate related tax expense (income). Although financial statement users may find the disclosure of the tax expense (income) related to each extraordinary item useful, it is sometimes difficult to allocate tax expense (income) between such items. Under these circumstances tax expense (income) relating to extraordinary items may be disclosed in the aggregate.

83. The disclosures required by paragraph 79(c) enable users of financial statements to understand whether the relationship between tax expense (income) and accounting profit is unusual and to understand the significant factors that could affect that relationship in the future. The relationship between tax expense (income) and accounting profit may be affected by such factors as revenue that is exempt from taxation, expenses that are not deductible in determining taxable profit (tax loss), the effect of tax losses and the effect of foreign tax rates.

84. In explaining the relationship between tax expense (income) and accounting profit, an enterprise uses an applicable tax rate that provides the most meaningful information to the users of its financial statements. Often, the most meaningful rate is the domestic rate of tax in the country in which the enterprise is domiciled, aggregating the tax applied for national taxes with the rates applied for any local taxes which

are computed on a substantially similar level of taxable profit (tax loss). However, for an enterprise operating in several jurisdictions, it may be more meaningful to aggregate separate reconciliations prepared using the domestic rate in each individual jurisdiction. The following example illustrates how the selection of the applicable tax rate affects the presentation of the numerical reconciliation.

85. The average effective tax rate is the tax expense (income) divided by the accounting profit.

86. It would often be impracticable to compute the amount of unrecognised deferred tax liabilities arising from investments in overseas subsidiaries, branches and associates and interests in joint ventures (see paragraph 42). Therefore, this Standard requires an enterprise to disclose the aggregate amount of any underlying temporary differences but does not require disclosure of the deferred tax liabilities. Nevertheless, where practicable, enterprises are encouraged to disclose the amounts of the unrecognised deferred tax liabilities because financial statement users may find such information useful.

87. An enterprise discloses any tax-related contingent liabilities and contingent assets in accordance with MASB 20, Provisions, Contingent Liabilities and Contingent Assets. Contingent liabilities and contingent assets may arise, for example, from unresolved disputes with the taxation authorities. Similarly, where changes in tax rates or tax laws are enacted or announced after the balance sheet date, and enterprise discloses any significant effect of those changes on its current and deferred tax assets and liabilities (see MASB 19, Events After the Balance Sheet Date).

Example Illustrating Paragraph 84

In 19X2, an enterprise has accounting profit in its own jurisdiction (country A) of RM1,500 (19X1: RM2,000) and in country B of RM1,500 (19X1: RM500). The tax rate is 30% in country A and 20% in country B. In country A, expenses of RM100 (19X1: RM200) are not deductible for tax purposes.

The following is an example of a reconciliation to the domestic tax rate.

	19X1	*19X2*
	RM	*RM*
Accounting profit	*2,500*	*3,000*
Tax at the domestic rate of 30%	*750*	*900*
Tax effect of expenses that are not deductible for tax purposes	*60*	*30*
Effect of lower tax rates in country B	*(50)*	*(150)*
Tax expense	*760*	*780*

The following is an example of a reconciliation prepared by aggregating separate reconciliations for each national jurisdiction. Under this method, the effect of differences between the reporting enterprise's own domestic tax rate and the domestic tax rate in other jurisdictions does not appear as a separate item in the reconciliation. An enterprise may need to discuss the effect of significant changes in either tax rates, or the mix of profits earned in different jurisdictions, in order to explain changes in the applicable tax rate(s), as required by paragraph 79(d).

	RM	*RM*
Accounting profit	*2,500*	*3,000*
Tax at the domestic rates applicable to profits in the country concerned	*700*	*750*
Tax effect of expenses that are not deductible for tax purposes	*60*	*30*
Tax expense	*760*	*780*

Transitional Provision

88. When the adoption of this MASB Standard constitutes a change in accounting policy, the effects of the change in accounting policy should be applied retrospectively and adjusted against the opening retained earnings. The corresponding amounts of prior periods should be adjusted for the change in accounting policy.

Effective Date

89. This MASB Standard becomes operative for annual financial statements covering periods beginning on or after 1 July 2002. Earlier application of the Standard is encouraged.

Appendix 1

Compliance with International Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity, in all material respects, with International Accounting Standard IAS 12 (revised), Income Taxes.

Appendix 2

Examples of Temporary Differences

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

A. Examples of circumstances that give rise to taxable temporary differences

All taxable temporary differences give rise to a deferred tax liability.

Transactions that affect the income statement

1. Interest revenue is received in arrears and is included in accounting profit on a time apportionment basis but is included in taxable profit on a cash basis.

2. Revenue from the sale of goods is included in accounting profit when goods are delivered but is included in taxable profit when cash is collected. *(Note: as explained in B3 below, there is also a deductible temporary difference associated with any related inventory).*

3. Depreciation of an asset is accelerated for tax purposes.

4. Development costs have been capitalised and will be amortised to the income statement but were deducted in determining taxable profit in the period in which they were incurred.

5. Prepaid expenses have already been deducted on a cash basis in determining the taxable profit of the current or previous periods.

Transactions that affect the balance sheet

6. Depreciation of an asset is not deductible for tax purposes and no deduction will be available for tax purposes when the asset is sold or scrapped. *(Note: paragraph 14(b) of the Standard prohibits recognition of the resulting deferred tax liability unless the asset was acquired in a business combination, see also paragraph 23 of the Standard).*

7. A borrower records a loan at the proceeds received (which equal the amount due at maturity), less transaction costs. Subsequently, the carrying amount of the loan is increased by amortisation of the transaction costs to accounting profit. The transaction costs were

deducted for tax purposes in the period when the loan was first recognised. *(Notes: (1) the taxable temporary difference is the amount of transaction costs already deducted in determining the taxable profit of current or prior periods, less the cumulative amount amortised to accounting profit; and (2) as the initial recognition of the loan affects taxable profit, the exception in paragraph 14(b) of the Standard does not apply. Therefore, the borrower recognises the deferred tax liability).*

8. A loan payable was measured on initial recognition at the amount of the net proceeds, net of transaction costs. The transaction costs are amortised to accounting profit over the life of the loan. Those transaction costs are not deductible in determining the taxable profit of future, current or prior periods. *(Notes: (1) the taxable temporary difference is the amount of unamortised transaction costs; and (2) paragraph 14(b) of the Standard prohibits recognition of the resulting deferred tax liability).*

9. The liability component of a compound financial instrument (for example a convertible bond) is measured at a discount to the amount repayable on maturity, after assigning a portion of the cash proceeds to the equity component (see MASB 24 Financial Instruments: Disclosure and Presentation). The discount is not deductible in determining taxable profit (tax loss). *(Notes: (1) the taxable temporary difference is the amount of unamortised discount, see example 5 in Appendix 3; and (2) an enterprise recognises the resulting deferred tax liability and charges the deferred tax directly to the carrying amount of the equity component, see paragraphs 25 and 59 of the Standard. In accordance with paragraph 56, subsequent changes in the deferred tax liability are recognised in the income statement as deferred tax expense (income).)*

Fair value adjustments and revaluations

10. Financial assets or investment property are carried at fair value which exceeds cost but no equivalent adjustment is made for tax purposes.

11. An enterprise revalues property, plant and equipment (under the allowed alternative treatment in the MASB 15, Property, Plant and Equipment) but no equivalent adjustments are made for tax purposes. *(Note: paragraph 59 of the Standard requires the related deferred tax to be charged directly to equity).*

Business combinations and consolidation

12. The carrying amount of an asset is increased to fair value in a business combination that is an acquisition and no equivalent adjustment is made for tax purposes. *(Note: on initial recognition, the resulting deferred tax liability increases goodwill or decreases negative goodwill, see paragraph 64 of the Standard).*

13. Amortisation of goodwill is not deductible in determining taxable profit and the cost of the goodwill would not be deductible on disposal of the business. *(Note: paragraph 14(a) of the Standard prohibits recognition of the resulting deferred tax liability).*

14. Unrealised losses resulting from intragroup transactions are eliminated by inclusion in the carrying amount of inventory or property, plant and equipment.

15. Retained earnings of subsidiaries, branches, associates and joint ventures are included in consolidated retained earnings, but income taxes may be payable if the profits are distributed to the reporting parent. *(Note: paragraph 42 of the Standard prohibits recognition of the resulting deferred tax liability if the parent, investor or venturer is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future).*

16. Investments in foreign subsidiaries, branches or associates or interests in foreign joint ventures are affected by changes in foreign exchange rates. *(Notes: (1) there may be either a taxable temporary difference or a deductible temporary difference; and (2) paragraph 42 of the Standard prohibits recognition of the resulting deferred tax liability if the parent, investor or venturer is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future).*

17. An enterprise accounts in its own currency for the cost of the non-monetary assets of a foreign operation that is integral to the reporting enterprise’s operations but the taxable profit or tax loss of the foreign operation is determined in the foreign currency. *(Notes: (1) there may be either a taxable temporary difference or a deductible temporary difference; (2) where there is a taxable temporary difference, the resulting deferred tax liability is recognised, because it relates to the foreign operation’s own assets and liabilities, rather than to the*

reporting enterprise's investment in that foreign operation (paragraph 43 of the Standard); and (3) the deferred tax is charged in the income statement, see paragraph 56 of the Standard).

B. Examples of circumstances that give rise to deductible temporary differences

All deductible temporary differences give rise to a deferred tax asset. However, some deferred tax assets may not satisfy the recognition criteria in paragraph 26 of the Standard.

Transactions that affect the income statement

1. Retirement benefit costs are deducted in determining accounting profit as service is provided by the employee, but are not deducted in determining taxable profit until the enterprise pays either retirement benefits or contributions to a fund. *(Note: similar deductible temporary differences arise where other expenses, such as product warranty costs or interest, are deductible on a cash basis in determining taxable profit).*

2. Accumulated depreciation of an asset in the financial statements is greater than the cumulative depreciation allowed up to the balance sheet date for tax purposes.

3. The cost of inventories sold before the balance sheet date is deducted in determining accounting profit when goods or services are delivered but is deducted in determining taxable profit when cash is collected. *(Note: as explained in A2 above, there is also a taxable temporary difference associated with the related trade receivable).*

4. The net realisable value of an item of inventory, or the recoverable amount of an item of property, plant or equipment, is less than the previous carrying amount and an enterprise therefore reduces the carrying amount of the asset, but that reduction is ignored for tax purposes until the asset is sold.

5. Research costs (or organisation or other start up costs) are recognised as an expense in determining accounting profit but are not permitted as a deduction in determining taxable profit until a later period.

6. Income is deferred in the balance sheet but has already been included in taxable profit in current or prior periods.

7. A government grant which is included in the balance sheet as deferred income will not be taxable in future periods. *(Note: paragraph 26 of the Standard prohibits the recognition of the resulting deferred tax asset, see also paragraph 35 of the Standard).*

Fair value adjustments and revaluations

8. Financial assets or investment property are carried at fair value which is less than cost, but no equivalent adjustment is made for tax purposes.

Business combinations and consolidation

9. A liability is recognised at its fair value in a business combination that is an acquisition, but none of the related expense is deducted in determining taxable profit until a later period. *(Note: the resulting deferred tax asset decreases goodwill or increases negative goodwill, see paragraph 64 of the Standard).*

10. Negative goodwill is included in the balance sheet as deferred income and the income will not be included in the determination of taxable profit. *(Note: paragraph 26 of the Standard prohibits recognition of the resulting deferred tax asset).*

11. Unrealised profits resulting from intragroup transactions are eliminated from the carrying amount of assets, such as inventory or property, plant or equipment, but no equivalent adjustment is made for tax purposes.

12. Investments in foreign subsidiaries, branches or associates or interests in foreign joint ventures are affected by changes in foreign exchange rates. *(Notes: (1) there may be a taxable temporary difference or a deductible temporary difference; and (2) this Standard requires recognition of the resulting deferred tax asset to the extent, and only to the extent, that it is probable that: (a) the temporary difference will reverse in the foreseeable future; and (b) taxable profit will be available against which the temporary difference can be utilised).*

13. An enterprise accounts in its own currency for the cost of the non-monetary assets of a foreign operation that is integral to the reporting enterprise's operations but the taxable profit or tax loss of the foreign operation is determined in the foreign currency. *(Notes: (1) there may be either a taxable temporary difference or a deductible temporary difference; (2) where there is a deductible temporary difference, the resulting deferred tax asset is recognised to the extent that it is probable that sufficient taxable profit will be available, because the*

deferred tax asset relates to the foreign operation's own assets and liabilities, rather than to the reporting enterprise's investment in that foreign operation (paragraph 43 of the Standard); and (3) the deferred tax is charged in the income statement, see paragraph 56 of the Standard).

C. Examples of circumstances where the carrying amount of an asset or liability is equal to its tax base

1. Accrued expenses have already been deducted in determining an enterprise's current tax liability for the current or earlier periods.

2. A loan payable is measured at the amount originally received and this amount is the same as the amount repayable on final maturity of the loan.

Appendix 3

Illustrative Computations and Presentation

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning. Extracts from income statements and balance sheets are provided to show the effects on these financial statements of the transactions described below. These extracts do not necessarily conform with all the disclosure and presentation requirements of other MASB Standards.

All the examples in this appendix assume that the enterprises concerned have no transaction other than those described.

Example 1 - Depreciable Assets

An enterprise buys equipment for RM10,000 and depreciates it on a straight line basis over its expected useful life of five years. For tax purposes, the equipment qualifies for an initial allowance and an annual allowance of 20% each. Tax losses may only be carried forward to offset against future taxable profits. The enterprise has sufficient taxable profits in the next five years to utilise the benefit of any tax loss. The tax rate is 30%.

The enterprise will recover the carrying amount of the equipment by using it to manufacture goods for resale. Therefore, the enterprise's current tax computation is as follows:

			Year		
	1	2	3	4	5
	RM	RM	RM	RM	RM
Taxable income	2,000	2,000	2,000	2,000	2,000
Initial allowance	(2,000)				
Annual allowance	(2,000)	(2,000)	(2,000)	(2,000)	0
Taxable profit (tax loss)	(2,000)	0	0	0	2,000
Current tax expense (income) at 30%	(600)	0	0	0	600

The enterprise recognises a current tax asset at the end of years 1 to 4 because it recovers the benefit of the tax loss against the future taxable profits.

The temporary differences associated with the equipment and the resulting deferred tax asset and liability and deferred tax expense and income are as follows:

	Year 1 RM	Year 2 RM	Year 3 RM	Year 4 RM	Year 5 RM
Carrying amount	8,000	6,000	4,000	2,000	0
Tax base	6,000	4,000	2,000	0	0
Taxable temporary difference	2,000	2,000	2,000	2,000	0
Opening deferred tax liability	0	600	600	600	600
Deferred tax expense (income)	600	0	0	0	(600)
Closing deferred tax liability	600	600	600	600	0

The enterprise recognises the deferred tax liability in years 1 to 4 because the reversal of the taxable temporary difference will create taxable income in subsequent year 5. The enterprise's income statement is as follows:

	Year 1 RM	Year 2 RM	Year 3 RM	Year 4 RM	Year 5 RM
Income	2,000	2,000	2,000	2,000	2,000
Depreciation	2,000	2,000	2,000	2,000	2,000
Profit before tax	0	0	0	0	0
Current tax expense (income)	(600)	(0)	(0)	(0)	600
Deferred tax expense (income)	600	0	0	0	(600)
Total tax expense (income)	0	0	0	0	0
Net profit for the period	0	0	0	0	0

Example 2 - Temporary Differences and Computation of Deferred Tax

The following items relate to the accounts of Mulia Sdn Bhd for the financial years ended 31 December 19x7 and 19x8:

(a) Net book value of fixed assets was RM7,600 and RM8,800 as at 31 December 19x7 and 19x8 respectively. Included in these amounts were net book values of land and building of RM2,000 in 19x7 and RM2,500 in 19x8. The residual expenditures of qualifying fixed assets as at 31 December 19x7 and 19x8 were RM3,100 and RM3,680 respectively.

(b) Mulia capitalises product development expenditures and amortises them over the expected useful lives of the products to which the expenditures relate. As at 31 December 19x7 and 19x8, the deferred expenditures in the accounts were RM4,000 and RM5,600 respectively. Product development expenditures are claimed for income tax purposes when incurred.

(c) The company maintains a provision for warranty costs in relation to warranties given for products sold. As at 31 December 19x7 and 19x8, the balances in the provision account were RM3,000 and RM3,600 respectively. Warranty costs are deductible for income tax purposes when incurred.

(d) As at 31 December 19x7 and 19x8, accrued interest expenses were RM800 and RM900 respectively. Interest expenses are allowable for income tax purposes when paid.

(e) Income tax rate was 30% in 19x7 and 28% in 19x8.

The computation of deferred tax is as follows:

19x7	Carrying Amount RM	Tax Base RM	Temporary Differences RM
Taxable temporary differences:			
Fixed assets:			
Non-qualifying land and building	2,000	-	2,000
Qualifying fixed assets	5,600	3,100	2,500
Deferred development expenditure	4,000	-	4,000
			8,500
Deductible temporary differences:			
Provision for warranty costs	(3,000)	-	(3,000)
Accrued interest expense	(800)	-	(800)
			(3,800)
No deferred tax should be recognised on the non-qualifying land and building			-
Deferred tax liability of other taxable temporary differences		30% x 6,500	1,950
Deferred tax asset of deductible temporary differences		30% x (3,800)	(1,140)
Net deferred tax liability			810
19x8			
Taxable temporary differences:			
Fixed assets			
Non-qualifying land and building	2,500	-	2,500
Qualifying fixed assets	6,300	3,680	2,620
Deferred development expenditure	5,600	-	5,600
			10,720
Deductible temporary differences:			
Provision for warranty costs	(3,600)	-	(3,600)
Accrued interest expense	(900)	-	(900)
			4,500
No deferred tax should be recognised on the non-qualifying land and building			-
Deferred tax liability of other taxable temporary differences		28% x 8,220	2,302
Deferred tax asset of deductible temporary differences		28% x (4,500)	(1,260)
Net deferred tax liability			1,042
Less: Opening deferred tax liability			(810)
Adjustment to opening deferred tax liability resulting from reduction in income tax rate		2% x (6,500-3,800)	54
Deferred tax expense related to the origination of temporary differences			286

Example 3 - Deferred Tax Assets and Liabilities

The example deals with an enterprise over the two year period, X5 and X6. In X5 the enacted income tax rate was 40% of taxable profit. In X6 the enacted income tax rate was 35% of taxable profit.

Donations to unapproved institutions are recognised as an expense when they are paid and are not deductible for tax purposes.

In X5, the enterprise was notified by the relevant authorities that they intend to pursue an action against the enterprise with respect to sulphur emissions. Although as at December X6 the actions had not yet come to court the enterprise recognised a liability of RM700 in X5 being its best estimate of the fine arising from the action. Fines are not deductible for tax purposes.

In X2, the enterprise incurred RM1,250 of costs in relation to the development of a new product. These costs were deducted for tax purposes in X2. For accounting purposes, the enterprise capitalised this expenditure and amortised it on the straight-line basis over five years. At 31/12/X4, the unamortised balance of these product development costs was RM500.

In X5, the enterprise entered into an agreement with its existing employees to provide retirement benefits to retirees. The enterprise recognises as an expense the cost of this plan as employees provide service. No payments to retirees were made for such benefits in X5 or X6. Retirement benefit costs are deductible for tax purposes when payments are made to retirees. The enterprise has determined that it is probable that taxable profit will be available against which any resulting deferred tax asset can be utilised.

Buildings are depreciated for accounting purposes at 5% a year on a straight-line basis and at 10% a year on a straight line basis for tax purposes. Motor vehicles are depreciated for accounting purposes at 20% a year on a straight line basis and at 25% a year on a straight line basis for tax purposes. A full year's depreciation is charged for accounting purposes in the year that an asset is acquired.

At 1/1/X6, the building was revalued to RM65,000 and the enterprise estimated that the remaining useful life of the building was 20 years from the date of the revaluation. The revaluation did not affect taxable profit in X6 and the taxation authorities did not adjust the tax base of the building to reflect the revaluation. In X6, the enterprise transferred RM1,033 from revaluation reserve to retained earnings. This represents the difference of RM1,590 between the actual depreciation on the building (RM3,250) and equivalent depreciation based on the cost of the building (RM1,660, which is the book value at 1/1/X6 of RM33,200 divided by the remaining useful life of 20 years), less the related deferred tax of RM557 (see paragraph 57 of the Standard).

Current Tax Expense

	X5	X6
	RM	RM
Accounting profit	8,775	8,740
Add		
Depreciation for accounting purposes	4,800	8,250
Donations to unapproved institutions	500	350
Fine for environmental pollution	700	-
Product development costs	250	250
Retirement benefits	2,000	1,000
	17,025	18,590
Deduct		
Capital allowances	(8,100)	(11,850)
Taxable Profit	8,925	6,740
Current tax expense @ 40%	3,570	
Current tax expense @ 35%		2,359

Carrying Amounts of Property, Plant and Equipment

	Building	Motor Vehicles	Total
	RM	RM	RM
Cost			
Balance at 31/12/X4	50,000	10,000	60,000
Additions X5	6,000	-	6,000
Balance at 31/12/X5	56,000	10,000	66,000
Elimination of accumulated depreciation on revaluation at 1/1/X6	(22,800)	-	(22,800)
Revaluation at 1/1/X6	31,800	-	31,800
Balance at 1/1/X6	65,000	10,000	75,000
Additions X6	-	15,000	15,000
	65,000	25,000	90,000

	5%	20%	
Accumulated Depreciation			
Balance at 31/12/X4	20,000	4,000	24,000
Depreciation X5	2,800	2,000	4,800
Balance at 31/12/X5	22,800	6,000	28,800
Revaluation at 1/1/X6	(22,800)	-	(22,800)
Balance at 1/1/X6	-	6,000	6,000
Depreciation X6	3,250	5,000	8,250
Balance at 31/12/X6	3,250	11,000	14,250
Carrying Amount			
31/12/X4	30,000	6,000	36,000
31/12/X5	33,200	4,000	37,200
31/12/X6	61,750	14,000	75,750

Tax Base of Property, Plant and Equipment

	Building	Motor Vehicles	Total
	RM	RM	RM
Cost			
Balance at 31/12/X4	50,000	10,000	60,000
Addition X5	6,000	-	6,000
Balance at 31/12/X5	56,000	10,000	66,000
Additions X6	-	15,000	15,000
Balance at 31/12/X6	56,000	25,000	81,000
	10%	25%	
Cumulative Capital Allowances			
Balance at 31/12/X4	40,000	5,000	45,000
Capital allowances X5	5,600	2,500	8,100
Balance at 31/12/X5	45,600	7,500	53,100
Capital allowances X6	5,600	6,250	11,850
Balance 31/12/X6	51,200	13,750	64,950
Tax Base			
31/12/X4	10,000	5,000	15,000
31/12/X5	10,400	2,500	12,900
31/12/X6	4,800	11,250	16,050

Deferred Tax Assets, Liabilities and Expense at 31/12/X4

	Carrying Amount RM	Tax Base RM	Temporary Differences RM
Accounts receivable	500	500	-
Inventory	2,000	2,000	-
Product development costs	500	-	500
Investments	33,000	33,000	-
Property, plant and equipment	36,000	15,000	21,000
TOTAL ASSETS	72,000	50,500	21,500
Current income taxes payable	3,000	3,000	-
Accounts payable	500	500	-
Fines payable	-	-	-
Liability for retirement benefits	-	-	-
Long term debt	20,000	20,000	-
Deferred income taxes	8,600	8,600	-
TOTAL LIABILITIES	32,100	32,100	
Share capital	5,000	5,000	-
Revaluation surplus	-	-	-
Retained earnings	34,900	13,400	
TOTAL LIABILITIES / EQUITY	72,000	50,500	
TEMPORARY DIFFERENCES			21,500
Deferred tax liability 21,500 at 40%			8,600
Deferred tax asset	-	-	-
Net deferred tax liability			8,600

Deferred Tax Assets, Liabilities and Expense at 31/12/X5

	Carrying Amount RM	Tax Base RM	Temporary Differences RM
Accounts receivable	500	500	-
Inventory	2,000	2,000	-
Product development costs	250	-	250
Investments	33,000	33,000	-
Property, plant & equipment	37,200	12,900	24,300
TOTAL ASSETS	72,950	48,400	24,550
Current income taxes payable	3,570	3,570	-
Accounts payable	500	500	-
Fines payable	700	700	-
Liability for retirement benefits	2,000	-	(2,000)
Long term debt	12,475	12,475	-
Deferred income taxes	9,020	9,020	-
TOTAL LIABILITIES	28,265	26,265	(2,000)
Share capital	5,000	5,000	-
Revaluation surplus	-	-	-
Retained earnings	39,685	17,135	
TOTAL LIABILITIES / EQUITY	72,950	48,400	
TEMPORARY DIFFERENCES			22,550
Deferred tax liability RM24,550 at 40%			9,820
Deferred tax asset (RM2,000) at 40%			(800)
Net deferred tax liability			9,020
Less:			
Opening deferred tax liability			(8,600)
Deferred tax expense (income) related to the origination and reversal of temporary differences			420

Deferred Tax Assets, Liabilities and Expense at 31/12/X6

		Carrying Amount RM	Tax Base RM	Temporary Differences RM
Accounts receivable		500	500	-
Inventory		2,000	2,000	-
Product development costs		-	-	-
Investments		33,000	33,000	-
Property, plant & equipment		75,750	16,050	59,700
TOTAL ASSETS		111,250	51,550	59,700
Current income taxes payable		2,359	2,359	-
Accounts payable		500	500	-
Fines payable		700	700	-
Liability for retirement benefits		3,000	-	(3,000)
Long term debt		12,805	12,805	-
Deferred income taxes		19,845	19,845	-
TOTAL LIABILITIES		39,209	36,209	(3,000)
Share capital		5,000	5,000	-
Revaluation surplus		19,637	-	-
Retained earnings		47,404	10,341	
TOTAL LIABILITIES / EQUITY		111,250	51,550	
TEMPORARY DIFFERENCES				56,700
Deferred tax liability	RM59,700 at 35%			20,895
Deferred tax asset	(RM3,000 at 35%)			(1,050)
Net deferred tax liability				19,845
Less:				
Opening deferred tax liability				(9,020)
Adjustment to opening deferred tax liability resulting from reduction in tax rate	RM22,550 at 5%			1,127
Deferred tax attributable to revaluation surplus	RM31,800 at 35%			(11,130)
Deferred tax expense (income) related to the origination and reversal of temporary differences				822

Illustrative Disclosure

The amounts to be disclosed in accordance with the Standard are as follows:

Major components of tax expense (income) [paragraph 77]

	X5 RM	X6 RM
Current tax expense	3,570	2,359
Deferred tax expense relating to the origination and reversal of temporary differences	420	822
Deferred tax expense (income) resulting from reduction in tax rate	-	(1,127)
Tax expense	3,990	2,054

Aggregate current and deferred tax relating to items charged or credited to equity [paragraph 79(a)]

Deferred tax relating to revaluation of building	-	(11,130)

In addition, deferred tax of RM557 was transferred in X6 from retained earnings to revaluation reserve. This relates to the difference between the actual depreciation on the building and equivalent depreciation based on the cost of the building.

Explanation of the relationship between tax expense and accounting profit [paragraph 79(c)]

The Standard permits two alternative methods of explaining the relationship between tax expense (income) and accounting profit. Both of these formats are illustrated as follows.

(i) *a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed*

	X5 RM	X6 RM
Accounting profit	8,775	8,740
Tax at the applicable tax rate of 35% (X5: 40%)	3,510	3,059
Tax effect of expenses that are not deductible in determining taxable profit:		
Charitable donations	200	122
Fines for environmental pollution	280	-
Reduction in opening deferred taxes resulting from reduction in tax rate	-	(1,127)
Tax expense	3,990	2,054

(ii) *a numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed*

	X5 %	X6 %
Applicable tax rate	40.0	35.0
Tax effect of expenses that are not deductible for tax purposes:		
Donations to unapproved institutions	2.3	1.4
Fines for environmental pollution	3.2	-
Effect on opening deferred taxes of reduction in tax rate	-	(12.9)
Average effective tax rate (tax expense divided by profit before tax)	45.5	23.5

An explanation of changes in the applicable tax rate(s) compared to the previous accounting period [paragraph 79(d)]

In X6, the government enacted a change in the national income tax rate from 40% to 35%.

In respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:

(i) **the amount of the deferred tax assets and liabilities recognised in the balance sheet for each period presented;**

(ii) **the amount of the deferred tax income or expense recognised in the income statement for each period presented, if this is not apparent from the changes in the amounts recognised in the balance sheet [paragraph 79(f)]**

	X5	X6
	RM	RM
Accelerated capital allowances	9,720	10,322
Liabilities for retirement benefits that are deducted for tax purposes only when paid	(800)	(1,050)
Product development costs deducted from taxable profit in earlier years	100	-
Revaluation, net of related depreciation	-	10,573
Deferred tax liability	9,020	19,845

(Note: The amount of the deferred tax income or expense recognised in the income statement for the current year is apparent from the changes in the amounts recognised in the balance sheet.)

Example 4 - Business Combinations

On 1 January X5 enterprise A acquired 100% of the shares of enterprise B at a cost of RM600. A amortises goodwill over 5 years. Goodwill amortisation is not deductible for tax purposes. The tax rate in A's tax jurisdiction is 30% and the tax rate in B's tax jurisdiction is 40%.

The fair value of the identifiable assets and liabilities (excluding deferred tax assets and liabilities) acquired by A is set out in the following table, together with their tax base in B's tax jurisdiction and the resulting temporary differences.

	Cost of Acquisition	Tax Base	Temporary Differences
	RM	RM	RM
Property, plant and equipment	270	155	115
Accounts receivable	210	210	-
Inventory	174	124	50
Retirement benefit obligations	(30)	-	(30)
Accounts payable	(120)	(120)	-
Fair value of the identifiable assets and liabilities acquired, excluding deferred tax	504	369	135

The deferred tax asset arising from the retirement benefit obligations is offset against the deferred tax liabilities arising from the property, plant and equipment and inventory (see paragraph 72 of the Standard).

No deduction is available in B's tax jurisdiction for the cost of the goodwill. Therefore, the tax base of the goodwill (in B's jurisdiction) is nil. However, in accordance with paragraph 14(a) of the Standard, A recognises no deferred tax liability for the taxable temporary difference associated, in B's tax jurisdiction, with the goodwill.

The carrying amount, in A's consolidated financial statements, of its investment in B is made up as follows:

	RM
Fair value of identifiable assets and liabilities acquired, excluding deferred tax	504
Deferred tax liability (RM135 at 40%)	(54)
Fair value of identifiable assets and liabilities acquired	450
Goodwill (net of amortisation of nil)	150
Carrying amount	600

At the date of acquisition, the tax base, in A's tax jurisdiction, of A's investment in B is RM600. Therefore, no temporary difference is associated, in A's jurisdiction, with the investment.

During X5, B's equity (incorporating the fair value adjustments made on acquisition) changed as follows:

	RM
At 1 January X5	450
Retained profit for X5 (net profit of RM150, less dividend payable of RM80)	70
At 31 December X5	520

A recognises a liability for any withholding tax or other taxes that it will suffer on the accrued dividend receivable of RM80.

At 31 December X5, the carrying amount of A's underlying investment in B, excluding the accrued dividend receivable, is as follows:

	RM
Net assets of B	520
Goodwill (net of amortisation of RM30)	120
Carrying amount	640

The temporary difference associated with A's underlying investment is RM40 as follows:

	RM
Cumulative retained profit since acquisition	70
Cumulative amortisation of goodwill	(30)
	40

If A has determined that it will not sell the investment in the foreseeable future and that B will not distribute its retained profits in the foreseeable future, no deferred tax liability is recognised in relation to A's investment in B (see paragraphs 41 and 42 of the Standard). Note that this exception would apply for an investment in an associate only if there is an agreement requiring that the profits of the associate will not be distributed in the foreseeable future. A is required to disclose the amount (RM40) of the temporary difference for which no deferred tax is recognised only if the distribution of the profits will attract additional income tax liability.

If A expects to sell the investment in B, or that B will distribute its retained profits in the foreseeable future, A recognises a deferred tax liability to the extent that the temporary difference is expected to reverse. The tax rate reflects the manner in which A expects to recover the carrying amount of its investment (see paragraph 49 of the Standard). A credits or charges the deferred tax to equity to the extent that the deferred tax results from foreign exchange translation differences which have been charged or credited directly to equity (paragraph 59 of the Standard). A discloses separately:

(a) the amount of deferred tax which has been charged or credited directly to equity (paragraph 79(a) of the Standard); and

(b) the amount of any remaining temporary difference which is not expected to reverse in the foreseeable future and for which, therefore, no deferred tax is recognised.

Example 5 - Compound Financial Instruments

An enterprise receives a non-interest-bearing convertible loan of RM1,000 on 31 December X4 repayable at par on 1 January X8. In accordance with MASB 24, Financial Instruments: Disclosure and Presentation, the enterprise classifies the instrument's liability component as a liability and the equity component as equity. The enterprise assigns an initial carrying amount of RM751 to the liability component of the convertible loan and RM249 to the equity component. Subsequently, the enterprise recognises imputed discount as interest expense at an annual rate of 10% on the carrying amount of the liability component at the beginning of the year. The tax authorities do not allow the enterprise to claim any deduction for the imputed discount on the liability component of the convertible loan. The tax rate is 40%.

The temporary differences associated with the liability component and the resulting deferred tax liability and deferred tax expense and income are as follows:

	Year			
	X4	X5	X6	X7
	RM	RM	RM	RM
Carrying amount of liability component	751	826	909	1,000
Tax base	1,000	1,000	1,000	1,000
Taxable temporary difference	249	174	91	-
Opening deferred tax liability at 40%	0	100	70	37
Deferred tax charged to equity	100	-	-	-
Deferred tax expense	-	(30)	(33)	(37)
Closing deferred tax liability at 40%	100	70	37	-

As explained in paragraph 25 of the Standard, at 31 December X4, the enterprise recognises the resulting deferred tax liability by adjusting the initial carrying amount of the equity component of the convertible liability. Therefore, the amounts recognised at that date are as follows:

	RM
Liability component	751
Deferred tax liability	100
Equity component (RM249 less RM100)	149
	1,000

Subsequent changes in the deferred tax liability are recognised in the income statement as tax income (see paragraph 25 of the Standard). Therefore, the enterprise's income statement is as follows:

	Year			
	X4	X5	X6	X7
	RM	RM	RM	RM
Interest expense (imputed discount)	-	75	83	91
Deferred tax (income)	-	(30)	(33)	(37)
	-	45	50	54