

## Exposure Draft of National Accounting Standard for Commercial Organisations (NASCO 4)

### DEFERRED TAXATION

#### General Provisions

1. This standard has been prepared on the base of Article 6 of the Accounting Law of the Republic of Azerbaijan in accordance with the International Accounting Standard 12 -Income Taxes.
2. This standard is intended to improve the quality of financial statements for Deferred Taxation
3. This standard should be implemented, taking into account additional provisions contained in the Rules of Bookkeeping and also in Explanations and Recommendations of its application.
4. In the case of contradictions between effective normative-legal acts and National Accounting Standard for Commercial Organizations 4 this standard will prevail.

#### Objective

5. The Objective of this standard is to prescribe the accounting treatment of the deferred tax, associated with the future consideration of the carrying amount of the assets, which are recognized in the balance sheet:

#### Scope

6. This standard applies to both the financial statements of commercial organisation and to the consolidated financial statements for a group, parent company (joint-stock associations) and their subsidiaries, presenting them as the single accounting subject.
7. Tax expense (tax income) comprises current tax expense (current tax income) and deferred tax expense (deferred tax income).

#### Definitions

8. The terms used in this standard have the following meanings:

**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.

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

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

- (a) deductible temporary differences;
- (b) the carry forward of unused tax losses; and
- (c) the carry forward of unused tax credits.

**Deferred Tax** – the estimated future tax consequences of transactions and events recognised in the financial statements of the current and previous periods.

**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.

#### Taxable Temporary Differences

9. A deferred tax liability should be recognised in respect of all taxable temporary differences that have originated but not reversed by the balance sheet date 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.

### **Deductible Temporary Differences**

10. Taxable temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, a deferred tax liability should be recognised in accordance with paragraph 15.
11. Deferred tax assets 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 difference 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.
12. Deductible temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, a deferred tax asset should be recognised in accordance with paragraph 16.

### **Permanent Differences**

13. Deferred tax should not be recognised on permanent differences.

### **Unused Tax Losses and Unused Tax Credits**

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

### **Investments in Subsidiaries, Branches and Associates and also Interests in Joint Ventures**

15. An enterprise should recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, except to the extent that both of the following conditions are satisfied:
  - (a) The parent, investor or venturer is able to control the timing of the reversal of the temporary difference; and
  - (b) It is probable that the temporary difference will not reverse in the foreseeable future.
16. An enterprise should recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint ventures, to the extent that, 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.

### **Business Combinations and Goodwill**

17. 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 19 and 20).
18. Similarly, deductible temporary differences result in deferred tax assets that are recognised in the balance sheet and are similarly reflected in the value of goodwill.

### **Goodwill**

19. Where the amortisation of goodwill is a non-deductible expense, 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.

20. 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.

### **Recognition of Deferred Tax Income and Expense**

21. Changes in the carrying amounts of deferred tax assets and liabilities should be recognised as income or 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; or
  - (b) a business combination as a result of the acquisition.
22. Deferred tax expenses (or income) should be charged (or credited) directly to equity if the tax relates to items credited or charged directly to equity in the same or different accounting periods.
23. As set out in paragraphs 15 and 16, temporary differences may arise in a business combination that is an acquisition. An enterprise recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria in paragraph 11) or deferred tax liabilities as identifiable assets and liabilities at the date of the acquisition.

Those deferred tax assets and liabilities are included in the value ascribed to goodwill or negative goodwill.

24. When, 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, the acquirer recognises a deferred tax asset and takes this into account in determining the goodwill or negative goodwill arising on the acquisition.
25. If 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.

### **Measurement**

#### **Measurement of Assets and Liabilities**

26. Deferred tax asset 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 effective by the balance sheet date in tax law.
27. 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.
28. Deferred tax assets and liabilities can not be discounted.

29. 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 to be utilised.
30. Any such reduction should be reversed to the extent that it becomes probable that sufficient taxable profit will become available.

### **Presentation**

31. Deferred tax assets and liabilities should be distinguished from current tax assets and liabilities.
32. 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).
33. Net deferred tax liabilities should be classified as estimated liabilities (provisions for liabilities and charges) in the balance sheet .
34. Net deferred tax assets should be classified as debtors, as a separate subheading of debtors where material.
35. Deferred tax assets and liabilities should only be offset in the following cases:
  - (a) The enterprise has a legal right to set off current tax assets against current tax liabilities; and
  - (b) The deferred tax assets and liabilities relate to income taxes levied by the same tax 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.

### **Disclosure**

36. The major components of the tax expense (income) attributable to deferred tax should be disclosed separately. The major components include:
  - (a) The amount of deferred tax expense (income) relating to the origination and cancellation of temporary differences;
  - (b) The amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;
  - (c) The amount of the benefit from a previously unrecognised tax loss or temporary difference of a prior period that is used to reduce deferred tax expense; and
  - (d) Deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset in accordance with paragraph 30.
37. The following should also be disclosed separately:
  - (a) The aggregate deferred tax relating to items that are charged or credited to equity;
  - (b) The deferred tax expense (income) relating to extraordinary items recognised during the period;
  - (c) An explanation of the relationship between the current tax expense (income) and the total tax expense in the form of a numerical reconciliation between the current tax expense (income) as reconciled under the provisions of NASCO 3 paragraph 21c and the total tax expense shown on the face of the income statement.
  - (d) An explanation of changes in the applicable tax rate compared to the previous accounting period;
  - (e) The amount (and expiry date, if any) of deductible temporary differences, unused tax losses for which no deferred tax asset is recognised in the balance sheet;
  - (f) The aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, for which deferred tax liabilities have not been recognised under the provisions of paragraph 15);
  - (g) In respect of each type of temporary difference, and in respect of each type of unused tax losses:

- 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;
  - iii. The amount of income tax consequences of dividends to shareholders of the enterprise that were proposed or declared before the financial statements were authorised for issue, but are not recognised as a liability in the financial statements.
38. 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 consolidation 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.

#### **Effective Date**

39. The accounting practices set out in this National Accounting Standard should be applied to financial statements relating to accounting periods ending on or after 31 December 2005.

#### **Compliance with International Accounting Standards**

40. The main differences between the two standards are:
- (a) IAS 12 requires the disclosure of deferred tax expenses (income) relating to discontinued activities; this standard does not.
  - (b) IAS 12 requires a reconciliation of the entities total tax charge or income (current and deferred) for the period to the tax that would be payable at the standard rate. NASCO 3 – Current Taxation requires a reconciliation of current taxation assessed for the period to a standard rate of tax and this standard requires a reconciliation of the current taxation and the total tax charge. With that taken together the information disclosed by the two National Accounting Standards meet the disclosure requirements of IAS 12.