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Navigating the tax accounting impacts of UAE Corporate Tax Law

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Speaker

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Today’s agenda

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2 – Basic Concepts

3 – Measurement of Deferred Taxes

4 – Recognition of Deferred Taxes

5 – Financial Statement Presentation

6 – Financial Statement Disclosure

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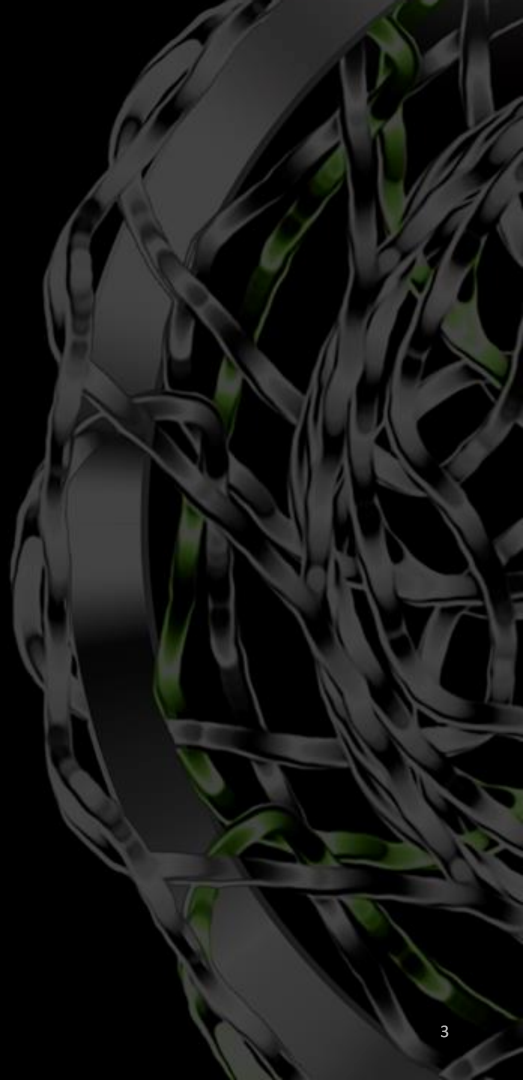


Objective of IAS 12

IAS 12 | Objective

Objective

- To prescribe the accounting treatment for **income taxes**

- Main issue: 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 entity’s statement of financial position; and

    b. transactions and other events of the current period that are recognised in an entity’s financial statements.

IAS 12 | Objective

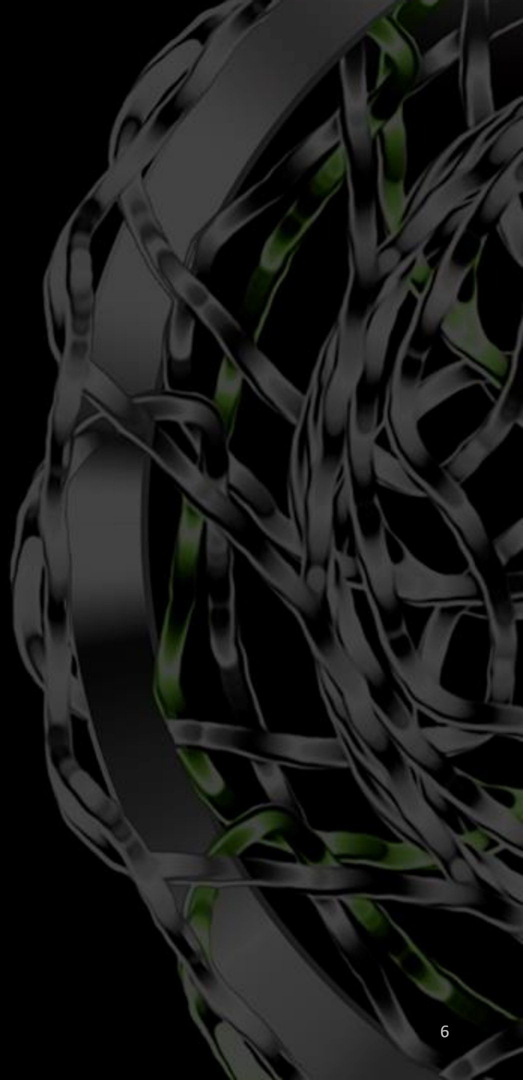
Accounting for Income Taxes

- The main area of complexity in tax accounting arises from the fact that **taxable profit often differs** from **accounting profit.**

- Some differences are **permanent** in nature and will not impact future taxable profits **(permanent differences)** => Generally P&L items arising in a period which are not taxable or not deductible under tax law.

- Most transactions recognized in the financial statements of one period will have consequences on the tax liability of later periods **(temporary differences).**

IAS 12 is designed to recognize the current or future tax consequences of transactions that are recognized in the financial statements, or transactions recognized for income tax purposes but have not yet been recognized in the financial statements.



Basic Concepts

IAS 12 | Basic Concepts

Current Tax Expense/Recovery

- Amount of income tax a company will pay for the current period

Deferred Tax Expense/Recovery

- Amount of income tax allocated during the period to cover taxes in/from a difference period

Income Tax Receivable/Payable

- Amount of income tax payable to or refundable by the tax authorities in respect of the current and previous periods.

Deferred Tax Asset/Liability

- The amounts of income taxes payable/recoverable in future periods

IAS 12 | Basic Concepts

Permanent Difference

- Difference between the financial accounting treatment and tax treatment of an item that will not reverse in time

Temporary Difference

- Difference between the carrying amount of an asset or liability in the statement of financial position and its tax bases

IAS 12 | Basic Concepts

Tax Return

A. Net accounting profit/ (loss) before tax

B. Deduct: Non-taxable income

- Unrealized gains on capital items
- Unrealized gains on revenue items (depending on election)
- Participation exemption (Dividend / Capital Gains)
- Foreign PE exemption
- Gain from transfers within a Qualifying Group
- Gain from qualified business restructuring

C. Add: Non-deductible expenses

- Unrealized loss on capital items
- Unrealized loss on revenue items (depending on election)
- Expenses incurred in relation to an exempt income
- Net interest expense (capping at 30% of EBITDA)
- Entertainment expenses (50% disallowed)
- Penalties and fines, taxes settled in foreign jurisdictions, recoverable VAT, and donations paid to unapproved organizations
- Dividends, profit distributions or benefits of a similar nature paid to the owner
- Adjustments for transactions with Related Parties and Connected Persons
- *Expenditures that may be prescribed in a Cabinet decision to be issued*

Taxable Income

Tax Accounting

A. Net accounting profit/ (loss) before tax

B. Permanent Differences

- Participation exemption (Dividend / Capital Gains)
- Foreign PE exemption
- Expenses incurred in relation to an exempt income
- Entertainment expenses (50% disallowed)
- Penalties and fines, taxes settled in foreign jurisdictions, recoverable VAT, and donations paid to unapproved organizations
- Dividends, profit distributions or benefits of a similar nature paid to the owner
- Adjustments for transactions with Related Parties and Connected Persons

C. Temporary Differences

- Unrealized gain/loss on capital items
- Unrealized gain/loss on revenue items (depending on election)
- Gain from transfers within a Qualifying Group
- Gain from qualified business restructuring
- Net interest expense (capping at 30% of EBITDA)
- *Expenditures that may be prescribed in a Cabinet decision to be issued*

Taxable Income

Measurement of Deferred Taxes

IAS 12 | Measurement of Deferred Taxes

Deferred Tax

The **future tax consequences** of recovering or settling the carrying amount of an asset or liability

Deferred taxes arising from temporary differences

$$\boxed{\text{Carrying amount}} - \boxed{\text{Tax base}} = \boxed{\text{Temporary difference}}$$

$$\boxed{\text{Temporary difference}} \times \boxed{\text{Tax rate}} = \boxed{\text{Deferred tax asset/liability}}$$

Deferred taxes arising from carryforward tax losses/tax credits

$$\boxed{\text{Unused tax losses/credits}} \times \boxed{\text{Tax rate}} = \boxed{\text{Deferred tax asset}}$$

IAS 12 | Measurement of Deferred Taxes

Tax Rate

- As per IAS12:47 - Deferred tax balances are calculated using the tax rates that are **expected** to apply to the reporting period or periods when the temporary differences reverse, based on tax rates and tax laws **enacted or substantively enacted** at the end of the reporting period.

Taxpayer	Applicable CT rate
Individuals and juridical persons	0% for taxable income up to and including AED 375,000
	9% for taxable income exceeding AED 375,000
Qualifying Free Zone Persons	0% on Qualifying Income
	9% on taxable income form immovable property

Timing

3 October 2022

Issuance of the Decree-Law

10 October 2022

Publication of the Decree-Law in the Official Gazette

26 October 2022

Effective date of application of the Decree-Law

(15 days after the publication)

1 June 2023

1 January 2024

First tax period for calendar year taxpayer

Pillar 2 to apply to MNEs exceeding the thresholds from 2024

31 December 2024

30 September 2025

Deadline for filing the return and settling the tax due

Recognition of Deferred Taxes

IAS 12 | Recognition of Deferred Taxes

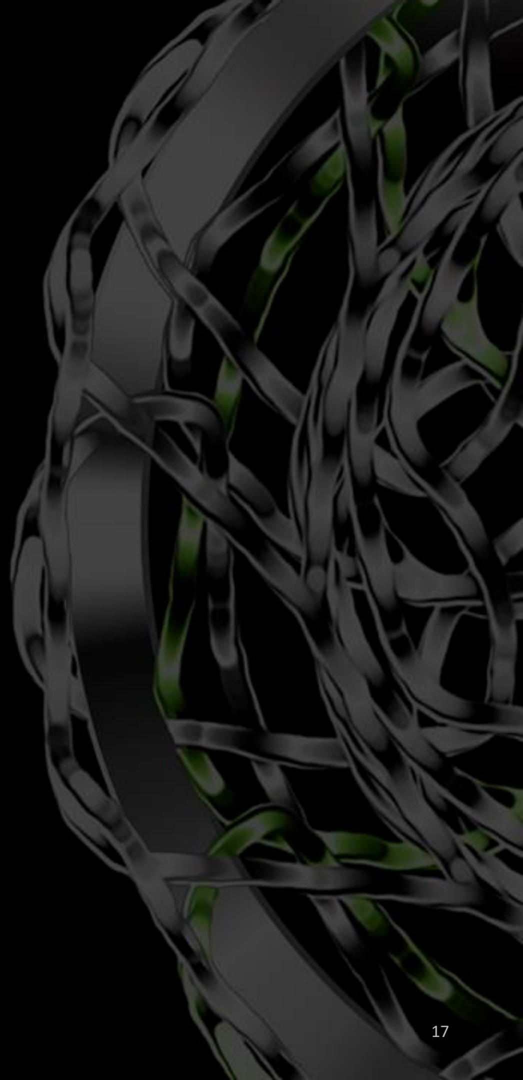
Recognition of Deferred Tax Liability

- A deferred tax liability is generally recognized for all taxable temporary differences
- Three exceptions apply – most common one is upon the initial recognition of goodwill arising in a business combination under IFRS 3

Recognition of Deferred Tax Asset

- A deferred tax asset is recognized for deductible temporary differences, unused tax losses and unused tax credits to the extent that it is **probable** that taxable profit will be available against which the deductible temporary differences can be utilized.
- A deferred tax asset is recognized for an unused tax loss carryforward or unused tax credit if, and only if, it is considered **probable** that there will be sufficient future taxable profit against which the loss or credit carryforward can be utilized.

IAS 12 | Recognition of Deferred Taxes



Initial Recognition Exception – Difference in point of views

Assume a business combination occurred in 2020 resulting in Goodwill of $1,000

Point of view #1

Book Goodwill = $1,000
Tax Goodwill = $0
Taxable Temporary Difference = $1,000
Tax Rate of 0%
Deferred Tax Liability on day 1 = $1,000 x 0% = $0

Point of view #2

Book Goodwill = $1,000
Tax Goodwill = $1,000
Taxable Temporary Difference = $0
Tax Rate of 0%
Deferred Tax Liability on day 1 = $0 x 0% = $0

IAS 12 | Recognition of Deferred Taxes

Post enactment of the UAE Corporate Tax Law

Point of view #1

Book Goodwill = $1,000
Tax Goodwill = $0
Taxable Temporary Difference = $1,000
Tax Rate of ~~0%~~ 9%
Deferred Tax Liability on day 1 = $1,000 x 9% = **$0 Due to Exception**

Point of view #2

Book Goodwill = $1,000
Tax Goodwill = ~~$1,000~~ $0
Taxable Temporary Difference = ~~$0~~ $1,000
Tax Rate of ~~0%~~ 9%
Deferred Tax Liability on day 1 = $1,000 x 9% = **$90**

Financial Statement Presentation

IAS 12 | Financial Statement Presentation

Current Tax Assets & Current Tax Liabilities

- Can only be offset in the statement of financial position if the entity has the legal right and the intention to settle on a net basis.

Deferred Tax Assets & Deferred Tax Liabilities

- Presented as a **non-current item**, they can only be offset in the statement of financial position if the entity has the legal right to settle current tax amounts on a net basis and the deferred tax amounts are levied by the same taxing authority on the same entity or different entities that intend to realize the asset and settle the liability at the same time.

Income Tax Expense / Recovery

- Presented in the statement(s) of profit or loss and other comprehensive income to the extent related to profit or loss.

Financial Statement Disclosure

IAS 12 | Financial Statement Disclosure

Mandatory Disclosures include:

- Major components of income tax expense/recover including:
    - Current tax expense/recovery
    - Deferred tax expense/recovery related to origination and reversal of temporary difference
    - Deferred tax expense/recovery related changes in tax rates or **the imposition of new taxes**
- Rate reconciliation
- Changes in tax rates
- Amounts and other details of deductible temporary differences, unused tax losses, and unused tax credits
- Details of deferred tax assets

Uncertain Tax Positions

IAS 12 | Uncertain Tax Positions

What is an uncertain tax position?

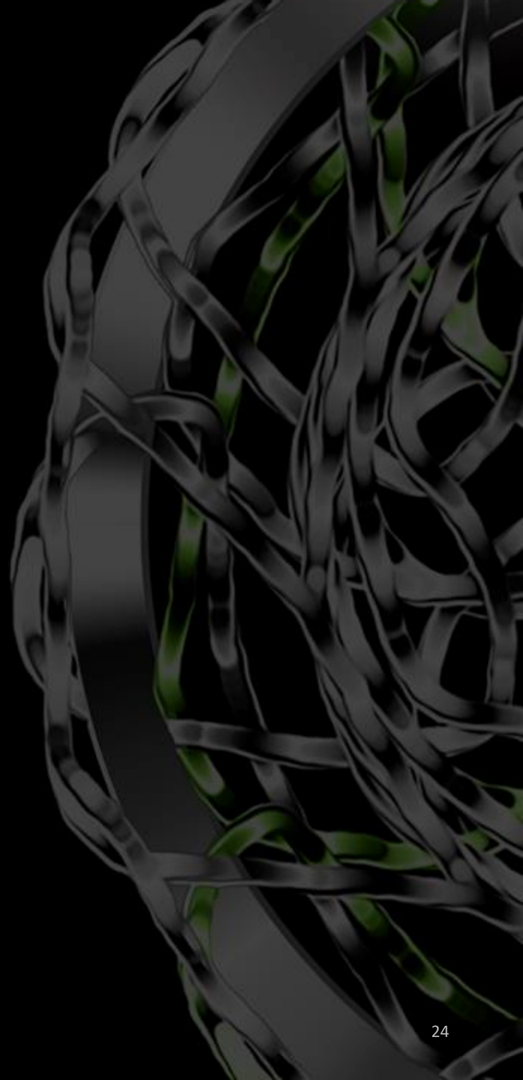
- Uncertainty with respect to a tax position taken in a previously filed return or expected to be taken in a future tax return.

- Examples of tax positions:

  - An allocation or a shift of income between jurisdictions (e.g., Transfer Pricing)

  - A decision to classify an entity as an exempt entity or a Qualifying Free Zone Person

  - The characterization of income or a decision to exclude reporting taxable income in a tax return



IAS 12 | Uncertain Tax Positions

IFRIC Interpretation 23

- An entity has to consider whether it is **probable** that the relevant tax authority will accept each tax treatment that is used or plans to use in its income tax filing.
- If probable, tax accounting must be prepared on the basis of treatment included in the tax return
- If **not** probable, tax accounting must be prepared on the basis of **the most likely amount** or **expected value** of the appropriate tax treatment.
- In conducting this assessment, Taxpayer must assume that tax authority has a full knowledge of all relevant facts and has authority to examine all values reported to it.
- Assessment is done based on technical merits of the position and the amount shown on the tax return.

IAS 12 | Uncertain Tax Positions

Definition of "probable"

- IFRIC 23 does not define the term "probable"
- IAS 37 defines "probable" as "more likely than not"

The Most Likely Amount

- The single most likely amount in a range of possible outcomes

The Expected Value

- The sum of the probability-weighted amounts in a range of possible outcomes

IAS 12 | Uncertain Tax Positions

Example

Assume an entity takes a deduction of $1,000 that is not a timing item (resulting in a $250 reduction in the income tax payable on the basis of a tax rate of 25%) on its tax return

Possible Estimated Outcome (A)	Individual Probability of Occurring (B)	Cumulative Probability of Occurring (C)	Estimate of Expected Value (D) = (A) × (B)
$ 250	22%	22%	$ 55
200	30%	52%	60
150	20%	72%	30
100	20%	92%	20
0	8%	100%	0
			$ 165

Most Likely Amount: $50 (being $250 - $200)
Expected Value Amount: $85 (being $250 - $165)

Areas of Concern

IAS 12 | Areas of Concern

FY2023 Financial Statements

- What impact does UAE Corporate Taxes have on the FY2023 financials?
- Can companies benefit from the initial recognition exemption on Goodwill?
- What is the tax bases of assets and liabilities?
- Should the deferred tax impact be accounted for in the P&L or Equity?

FY2024 Financial Statements and onwards

- How will accounting provisions be treated for tax purposes?
- How will the corporate tax rules evolve with the potential enactment of Pillar 2 in the UAE?