

Recognition of Deferred Tax

S.M. Ifthikar & C.R. Thilakarathne
m91ifthi@gmail.com & chamindat@kln.ac.lk

Introduction:

PQR (Lanka) Limited is a company whose preliminary engagement is to manufacture and sell Paints. It leverages its worldwide experience to deliver products of International quality & assortment to the consumers with complete range of decorative, wood finishes and industrial coatings. When considering about the supply chain of the company, distributors play a vital role which ultimately decide the reachability of products all around the country without any exertion.

The rapid change of customer behaviors and innovative technologies led the company to think differently and be wise in the situation where opportunities can explore and execute. Therefore with considering those facts company has been decided to go one step ahead from the manufacturing process on conventional paints. So they introduced “Luxury Paints” as a new product range for the company. Hence dealers need to be attracted to sell new product. Company introduces “Gold Coin Awards” for distributors who achieved more sales on “luxury paints” as a “promotional campaign”. This will be conducted in subsequent financial year based on the performance of current financial year for selected distributors.

Since “this is a present obligation and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation”, company has been provided a monthly provision for this gold coin awards.

Discussion of the Issue:

This issue is related to the recognition of “Deferred Tax” based on the provision made for the “Gold Coin Awards” of the company. Even though main intention of conducting such gold coin awards for distributors is boosting revenue of the company, the recognition of deferred tax assets/liability should have to be decided based on the implications provided by the relevant accounting standards (LKAS 12) and other regulatory requirements prevailing in the country (Inland Revenue Act, No. 10 of 2006).

Since pure intention of conducting such gold coin award is directly attract distributors to sell more paints under the category of “Luxury Paints” of the company, client had identified those provisions made for such gold coin awards can be deduct as a “deferred tax assets” when preparing the financial statements of the company. But when considering to the Inland Revenue Act, No. 10 of 2006, there are no sections specifically mention whether these kind of expenses can be allowed or disallowed to deduct from taxable profit of the company. Therefore company *has not recognized deferred tax on these provisions*.

Implication of the Issue

According to LKAS 12,

“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

“Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. Temporary differences may be either”:

“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.”

(Paragraph 5 – LKAS 12)

Therefore a deferred tax asset shall be recognized for total provision made for the “Gold Coin Awards” to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized.

When analyzing the Inland Revenue requirements even though there are no any specific guidelines mentioned about the business promotion expenses in the Inland Revenue Act, No. 10 of 2006. General recognition criteria of “Deductions Allowed in Ascertaining profits and income” (Sec. 25 of Inland Revenue Act, No. 10 of 2006) under same Act has led to recognize “Deferred Tax Assets” on provisions of “Gold Coin Awards”.

Following is the sub section mentioned in Inland Revenue Act, No. 10 of 2006

“Subject to the provisions of subsections (2) and (4), there shall be deducted for the purpose of ascertaining the profits or income of any person from any source, all outgoings and expenses incurred by such person in the production”

[Inland Revenue Act, No. 10 of 2006, Sec 25 (1)]

Conclusion and Recommendation:

When critically evaluating the guidelines provided by the Inland Revenue Department of Sri Lanka, expense on gold coin award has been considered as a “Business Promotion Expenses” (as per general recognition criteria under deduction allowed) and therefore it can be deducted from the taxable income of the company. Due to this, there will be a temporary difference arrived on

monthly provisions made by the company and deferred tax asset also be recognized in the financial statements of the company.

Accounting Adjustment

“Recognized Deferred Tax Assets”

Deferred Tax Payable/Receivable A/c (Dr) ***

Profit and Loss A/c (Cr) ***

(Being recognized deferred tax asset on provisions of “Gold Coin Awards”)