

ALL MEMBERS OF THE INSTITUTE

Dear Member

1. ISSUANCE OF ACCOUNTING TECHNICAL RELEASE TR-30 – FINAL TAX ACCOUNTING

An accounting technical release (TR-27) 'Income Taxes' was issued on April 26, 1996, subsequently the same was revised in 2003, to provide guidance on the application of the requirements of IAS 12 (Income Taxes) in the case of companies which are subject to Final Tax Regime (FTR) as well as Normal Tax Regime, in the same "tax year", under the applicable provisions of the Income Tax Ordinance, 2001 (the Ordinance). The guidance emphasised that deferred tax accounting does not apply to those companies which are entirely covered under FTR since such companies, it was argued, do not have a temporary difference which is a fundamental basis on which inter-period tax allocation is done through deferred tax accounting

Guidance was sought from the Institute with regard to the above TR that in a situation where an entity is taxed under FTR at import stage under the Ordinance and a portion of the imported goods remain unsold at the balance sheet date (held and carried forward as inventory), how the said final tax should be accounted for in the financial statements prepared under the approved accounting standards as applicable in Pakistan.

As there are varying accounting practices being followed in the above matter therefore in order to establish a uniform accounting practice the Council on the recommendation of the Professional Standards and Technical Advisory Committee (PS&TAC) has approved for issuance to the members the enclosed TR-30 in its 196th meeting held on May 6, 2008.

2. WITHDRAWAL OF TR-19 'EXCISE DUTY – ACCOUNTING TREATMENT (REFORMATTED – 2000)'

Further on the recommendation of the PS&TAC, the Council in the aforesaid meeting has also decided to withdraw TR-19 'Excise Duty - Accounting Treatment' (Reformatted - 2000) since it is felt that appropriate guidance is available in IAS 2 'Inventories' on the matter.

The revised Sectional Index is enclosed which is to be filed in Section C of Part I of Members' Handbook Volume II.

Yours truly

Shahid Hussain
Director Technical Services

Encl.: As above

SECTIONAL INDEX

PART I

SECTION C TECHNICAL RELEASES

- TR-1 **Withdrawn**-(Capitalization of Interest on Loan)
- TR-2 **Withdrawn**-(Financial Statement Presentation – Credit Cards)
- TR-3 **Withdrawn**-(Depreciation Treatment in Tax Holiday Companies)
- TR-4 **Withdrawn**-(Gratuity – Provision in the Accounts of Company)
- TR-5 IASB Standards-Council's Statement on Applicability
(Revised - 2006)
- TR-6 Fixed Assets Inventory and Records (Reformatted - 2004)
- TR-7 **Withdrawn**-(Revaluation of Fixed Assets)
- TR-8 Clarification Regarding Basis of Calculation of Workers' Profit
Participation Fund (Reformatted 2004)
- TR-9 **Withdrawn**-(Treatment of Post-dated Cheques or
Promissory Notes)
- TR-10 **Withdrawn**-(Deferred Taxation)
- TR-11 Depreciation on Idle Property, Plant and equipment
(Reformatted - 2004)
- TR-12 **Withdrawn**-(Debt Extinguishment)
- TR-13 **Withdrawn**-(Accounting for Compensated Absences)
- TR-14 **Withdrawn**-(Revaluation of Fixed Assets – Accounting
Treatment)
- TR-15 Bonus Shares-Accounting Treatment (Reformatted 2004)
- TR-16 **Withdrawn**-(Pending Litigation Settled in Favour of Client
After the Balance Sheet date).
- TR-17 **Withdrawn**-(Finished Pieces of Equipment held by Manufacturer
for Customers)

- TR-18 **Withdrawn**-(Good Accounting Software)
- TR-19 **Withdrawn** - Excise Duty-Accounting Treatment (Reformatted-2000)
- TR-20 **Withdrawn** - Accounting for Expenditure During Construction Period
- TR-21 Date of Commencement of Commercial Production (Reformatted–2000)
- TR-22 Book Value per Share (Revised - 2002)
- TR-23 **Withdrawn**-(Investments Valuation –Application of Lower of Cost and Market Value)
- TR-24 Exchange Risk Fee-Accounting Treatment (Reformatted - 2000)
- TR-25 **Withdrawn**-(Prudential Regulations for Banks)
- TR-26 **Withdrawn**-(Export Quota – Accounting Treatment)
- TR-27 IAS 12, Income Taxes (Revised 2003)
- TR-28 **Withdrawn**-(Golden Handshake – Accounting For)
- TR-29 Carry-Over-Transactions (COT)
- TR-30 Final Tax Accounting

FINAL TAX ACCOUNTING**THE ISSUE**

- 1.1 The Technical Advisory Committee (TAC) issued an accounting technical release (TR-27) on April 26, 1996, subsequently revised the same in 2003, to provide guidance on the application of the requirements of IAS – 12 (Income Taxes) in the case of companies which are subject to Final Tax Regime (FTR) as well as Normal Tax Regime (NTR), in the same “tax year”, under the applicable provisions of the Income Tax Ordinance, 2001 (ITO 2001). The guidance emphasised that deferred tax accounting does not apply to those companies which are entirely covered under FTR since such companies, it was argued, do not have a temporary difference which is a fundamental basis on which inter-period tax allocation is done through deferred tax accounting.
- 1.2 A member has sought guidance from the Institute with regard to the above TR that in a situation where an entity is taxed under FTR at import stage under the Ordinance and a portion of the imported goods remains unsold at the balance sheet date (held and carried forward as inventory), how should the said final tax be accounted for in the financial statements prepared under the approved accounting standards as applicable in Pakistan i.e. whether:
- a) The entire amount of final tax paid at import stage be recognised as expense in the period in which goods were imported; or
 - b) The final tax paid at import stage be recognized as expense as and when the goods are sold and the related profits are earned.

TECHNICAL COMMITTEE RECOMMENDATIONS

- 2.1 IAS – 12 ‘Income Taxes’ is applicable to income taxes which as per its paragraph ‘2’ are based on taxable profits. Taxable profit / (tax loss) has been defined as the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).
- 2.2 Section 148 (7) of ITO 2001 (the relevant section for the income tax in case of imports) inter alia states “The tax collected under this section shall be a final tax on the **income** of the importer arising from the imports”. Hence it is clear that the final tax on imports is actually on the income of the importer arising from imports such that the total amount of tax is a percentage of the import value. In other words, it may be seen as a variable tax rate being applicable on the income of the importer from imports that equates the tax on income to a certain percentage of assessed value.
- 2.3 ITO 2001 gives the timing of the payment of tax on income from imports. However, it is established that whatever be the timing, the tax is on the income of the importer from imports and hence, till the time the income does not so arise, it merely is a pre-payment of tax in relation to such income albeit being final is not refundable but entails future economic benefit that will flow to the tax payer as a

direct consequence of import stage taxation in the period when the imported goods are sold.

- 2.4 Para 12 of IAS 12 states “Current tax for current and prior periods shall, 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 shall be recognised as an asset.” The Committee is of the view that the word ‘due’ is used in this para with respect to taxable profit (tax loss).
- 2.5 Based on above, the Committee is of the view that in substance the tax paid at import stage entitles the tax payer to future tax benefit or relief in the shape of no further outflow in the form of taxation of profits that maybe earned from the selling of imported goods. Accordingly, any tax paid at import stage in relation to the goods in the inventory at year end should not be recognised as income tax expense rather treated as a pre-payment of tax to be expensed in the period in which such income arises from the sale of these imported goods.
- 2.6 Further, the Committee is of the opinion that the practice of treating final tax as a “period cost” in isolation without undertaking a matching process to determine whether the goods on the value whereof such income tax has been imposed, have been sold or carried over to the next accounting period as inventory negates the very foundation of tax accounting that income taxes are considered to be an expense incurred by the company as a consequence of income earned and therefore, are accrued in the same period as the income to which they relate.
- 2.7 In view of the aforesaid, the Committee is of the considered opinion that the tax paid at import stage under FTR should be recognised as a tax expense in the period in which the related goods are sold. Accordingly, the portion of the tax paid that pertains to the unsold inventory should be carried forward in the balance sheet as pre-paid tax, subject to the following conditions:
- a) it is probable that the sale of imported goods would result in sufficient future taxable profits;
 - b) the carry forward of tax shall not relate to the inventories written down to net realisable value in accordance with IAS 2 “ Inventories”;
 - c) the tax to be carried forward as explained above shall not constitute value of inventories; and

If the above conditions are not met, the tax paid under FTR at import stage shall be fully recognised as a tax expense in the period in which the goods are imported and such tax is paid.

- 2.8 The Committee further recommends that TR – 27 shall be read in conjunction with this TR.

(196th meeting of the Council – May 6, 2008)