

Opinion Issued by the Accounting Standards Board

Deferred Tax on Export Business consequent to Finance Bill 2024

Brief facts of the enquiry:

The Accounting Standards Board received an enquiry which contained following question:

Since last many years and till tax year 2024, income from export business was taxable under Final Tax Regime (FTR). Consequent to promulgation of Finance Act, 2025, income from export business is chargeable to normal tax regime (NTR) subject to minimum tax effective from July 1, 2024. This raises the query whether deferred tax should be computed and recorded in respect of export business in the financial statements for the year ended June 30, 2024 considering the fact that Finance Act, 2024 was enacted prior to year-end but is effective from July 1, 2024.

The brief facts of the matter are stated as follows:

- As per Income Tax Ordinance (amended upto Finance Act, 2023), Export business is subject to income tax under Final Tax Regime till tax year 2024 (relevant to accounting year ended June 30, 2024).
- Finance Act, 2024 was enacted on June 29, 2024 (after approval by President of Pakistan) which brought certain amendments to the Income Tax Ordinance, 2001. Such amendments included change in section 154 that income from export business is chargeable to tax under Normal Tax Regime (NTR) subject to any taxes withheld on realization of export proceeds which shall be considered as Minimum Tax in relation to Income from exports.

From above arise following questions:

- whether deferred tax should be computed in respect of export business as at June 30, 2024 and recorded in financial statements for the year ended June 30, 2024, considering the fact that changes brought to the Income Tax Ordinance, 2001 through Finance Act, 2024 are effective from July 1, 2024.
- If deferred tax is required to be recorded, then, whether Tax WDV of fixed assets have to be computed assuming that such exporters have forgone the benefit of tax depreciation (including initial allowance) for all previous years under FTR and we have to compare it with Accounting WDV of fixed assets.

Opinion:

This opinion is issued in context of entities obligated to use accounting and reporting standards as applicable in Pakistan other than those which apply AFRS for SSEs, and which undertake export business.

In this respect, the important definitions as per IAS 12 Income Taxes, are as follows:

‘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 carryforward of unused tax losses; and
- (c) the carryforward 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:

- (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.’

Certain relevant paragraphs of IAS 12 are reproduced below for ease of reference:

Paragraphs 15, 22A, and 24 of IAS 12 state as follows:

“15. A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:

(a) *the initial recognition of goodwill; or [Refer: paragraphs 21–21B and 66–68 IFRS 3 paragraph 32]*

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

(i) *is not a business combination;*

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

(iii) *at the time of the transaction, does not give rise to equal taxable and deductible temporary differences. [Refer: paragraph 22A]*

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax liability shall be recognised in accordance with paragraph 39.”

“22A. A transaction that is not a business combination may lead to the initial recognition of an asset and a liability and, at the time of the transaction, affect neither accounting profit nor taxable profit. For example, at the commencement date of a lease, a lessee typically recognises a lease liability and the corresponding amount as part of the cost of a right-of-use asset. Depending on the applicable tax law, equal taxable and deductible temporary differences may arise on initial recognition of the asset and liability in such a transaction. The exemption provided by paragraphs 15 and 24 does not apply to such temporary differences and an entity recognises any resulting deferred tax liability and asset.”

“24. A deferred tax asset shall 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 the initial recognition of an asset or liability in a transaction that:

(a) *is not a business combination;*

(b) *at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); and*

(c) *at the time of the transaction, does not give rise to equal taxable and deductible temporary differences.*

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However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44.”

Paragraph 47 of IAS 12 states as follows:

‘47. Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or liability is settled, based on tax rates / laws that have been enacted or substantively enacted by the end of the reporting period.’

Paragraph 51 of IAS 12 further explains as follows:

‘51. The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.’

2. Determination of whether it is required to record deferred tax at June 30, 2024

Paragraph 47 of IAS 12 states as follows:

‘47. Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or liability is settled, based on tax rates / laws that have been enacted or substantively enacted by the end of the reporting period.’ (Italic and underlying ours)

In view of paragraph 47 (read with paragraphs 15 and 24) of IAS 12, it is required to measure and record deferred tax at June 30, 2024 using the tax rates that have been enacted or substantively enacted by the end of the reporting period i.e. June 30, 2024.

Accordingly, since the Finance Act, 2024 was enacted on June 29, 2024, it is required to consider tax laws and tax rates (as amended through Finance Act, 2024) to measure deferred tax on June 30, 2024.

In essence, a deferred tax liability or asset (so recorded) represents difference in accounting and tax base of assets and liabilities at the reporting date. Hence, a deferred tax liability or asset for temporary differences would be recorded in line with the requirements of IAS 12, regardless of the fact that the present tax year (2024) still falls within the FTR regime.

3. Determination of appropriate tax base of assets and liabilities and tax rates for determination of deferred tax at June 30, 2024

For determination of deferred tax at June 30, 2024, accounting base and tax base of assets **(including fixed assets)** and liabilities shall be computed (considering requirements of Income Tax Ordinance, 2001) at June 30, 2024, to determine taxable and deductible temporary differences and deferred tax thereon.

Another important aspect in this regard, is use of appropriate tax rate for determination of deferred tax. For this purpose, as stated in paragraph 47 of IAS 12 as referred above, appropriate tax rate(s) to be applied to taxable / deductible temporary differences relating to assets and liabilities, are tax rates **that are expected to apply to the period when the related asset is realised or liability is settled, based on tax rates / laws that have been enacted or substantively enacted by the end of the reporting period.**

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For above purposes, detailed guidance may be obtained from tax experts with respect to the following:

- Allowability or taxability of items of income / expenses relating to individual assets and liabilities (including tax losses and tax credits etc.) in future periods to determine appropriate taxable / deductible temporary differences on June 30, 2024.
- tax rates that are expected to apply to the period when the related asset is realised or liability is settled, based on tax rates / laws that have been enacted or substantively enacted by the end of the reporting period.

4. Conclusion

It is pertinent to mention here that since Income from Export Business, post Finance Act, 2024, is taxable under Minimum Tax regime, hence, entities (obligated to use accounting and reporting standards as applicable in Pakistan other than those which apply AFRS for SSEs) should follow guidance contained in ICAP's guidance 'IAS 12 Application Guidance on Accounting for Minimum Taxes and Final Taxes' issued through circular no. 7 dated May 15, 2024.

Board's conclusion covering accounting aspects arising from the instant case are explained as follows:

- In view of requirements of paragraph 47 (read with paragraphs 15 and 24) of IAS 12 as more fully discussed in paragraph 2 above, the deferred tax asset / liability (as the case may be) should be measured and recognized in the financial statements (based on tax rates / laws that have been enacted or substantively enacted by the end of the reporting period) as at and for the year ended June 30, 2024;

Accordingly, in this case, the change in tax regime from FTR to NTR has enacted as of June 30, 2024 and therefore, deferred taxation should be accounted for on temporary differences existing on June 30, 2024 between tax and accounting bases of assets and liabilities, and measured at the applicable tax rate; and

With respect to financial statements of 'export business' for the year ended June 30, 2024, the taxation charge for the year shall be determined based on FTR basis (because as per provisions contained in Income Tax Ordinance, 2001, the income from export business for tax year 2024 is taxable under FTR regime). Such charge should be categorized as 'levy' in terms of requirements of IFRIC 21 as more fully explained in our Guidance 'IAS 12 Application Guidance on Accounting for Minimum Taxes and Final Taxes' issued via circular no. 7 dated May 15, 2024. Accordingly, the accounting policy in this regard should be changed retrospectively in the light of above-referred Guidance in the same financial statements.

(Issued on August 13, 2024)

Disclaimer

An opinion is based on the facts, circumstances, assumptions and quantitative analyzes provided by the enquirer. The opinions, accordingly, do not provide a judgment about the adequacy of the data provided to us by the enquirers. An opinion may change if the facts and the circumstances change. In addition, an opinion may also change due to subsequent change in law, pronouncements, and other relevant changes, made by the regulators, the International Accounting Standards Board, the International Auditing & Assurance Standards Board, the Institute, the Board/ Committee or any other body. The opinions are not legal advice. The Institute and Board/ Committee believes that the enquired matters, transactions or arrangements have been or will be made considering the legal, ethical and moral requirements. The Institute, the Board/ Committee and staff will have no liability in connection with opinions.