FINANCIAL REPORTING

GUIDE 1

SUBSTANTIVELY ENACTED TAX RATES AND TAX LAWS

Issued December 2012
## CONTENTS

<table>
<thead>
<tr>
<th>Paragraphs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preface</td>
</tr>
<tr>
<td>References</td>
</tr>
</tbody>
</table>
| Background       | 1. – 3.  
| Issue            | 4.  
| Consensus        | 5. – 8.  
| Illustrative examples and disclosure guidance | IE1 – IE6  
| Basis for Conclusions | BC1 – BC9  

GUIDE ON SUBSTANTIVELY ENACTED TAX RATES AND TAX LAWS

PREFACE

This guide has been issued by The South African Institute of Chartered Accountants’ (SAICA’s) Accounting Practices Committee (APC). In terms of paragraphs 46 and 47 of IAS 12 – Income Taxes, both current and deferred tax assets and liabilities are to be measured using the tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period.

This Guide seeks to address the issue of when are changes in tax rates and tax laws that are announced by the Minister of Finance during the annual Budget Statement regarded as substantively enacted, in a South African context?

Although accounting guides do not have the authority of IFRS or IFRS for SMEs, in the event of significant deviation from the guidance given, and should the member’s actions be questioned, the member may be required to demonstrate that such deviation was justified.

![Every effort has been made to ensure that the advice given in this guide is correct. Nevertheless, that advice is given purely as guidance to members of SAICA to assist them with particular problems relating to the subject matter of the guide, and SAICA will have no responsibility to any person for any claim of any nature whatsoever that may arise out of, or relate to, the contents of this guide.](image)
GUIDE ON SUBSTANTIVELY ENACTED TAX RATES AND TAX LAWS

SUBSTANTIVELY ENACTED TAX RATES AND TAX LAWS

Paragraph .16 of the Statement of Generally Accepted Accounting Practice (GAAP) on Presentation of Financial Statements requires an entity whose financial statements comply with IFRSs to make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with IFRSs unless they comply with all the requirements of IFRSs. Paragraph .7 states that assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users.

References
IAS 12– Income Taxes
IAS 10 – Events after the Balance Sheet Date

Background
1. Following the withdrawal of Statements of Generally Accepted Accounting Practice (GAAP) for years beginning on/after 1 December 2012, the Accounting Practices Committee (APC) has issued the relevant AC 500 – series of Statement of Generally Accepted Accounting Practice (GAAP) as a Financial Reporting Guide (FRG). This Financial Reporting Guide 1 replaces AC 502 – Substantively Enacted Tax Rates and Tax Laws, issued initially by the Accounting Practices Board (APB) in 2006. The only changes made from AC 502 to this Guide of the same name are to delete references to Statements of GAAP, replacing the wording of “Interpretation” with “Guide” and deleting the effective date and transition sections.

2. The Minister of Finance may announce changes in tax rates and tax laws during the annual Budget Statement.

3. In terms of paragraphs 46 and 47 of IAS 12, both current and deferred tax assets and liabilities are to be measured using the tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period.

Issue
4. In a South African context, the issue is: when should changes in tax rates and tax laws that are announced by the Minister of Finance during the annual Budget Statement be regarded as substantively enacted?

Consensus
5. Changes in tax rates should be regarded as substantively enacted from the time that they are announced in terms of the Minister of Finance’s Budget Statement. However, this only applies where the change in tax rates is not inextricably linked to other changes in the tax laws. To be regarded as substantively enacted there should be the required degree of certainty that the announced changes would be promulgated in a substantially unchanged manner.
GUIDE ON SUBSTANTIVELY ENACTED TAX RATES AND TAX LAWS

6. When changes in the tax rates are inextricably linked to other changes in the tax laws, they should be regarded as being substantively enacted when they have been approved by Parliament and signed by the President.

7. Changes in tax laws other than those covered in paragraphs 5 and 6 above, should be regarded as being substantively enacted when they have been approved by Parliament and signed by the President.

8. The changes in tax rates and tax laws should be applied to the period to which they relate. For example, a change in tax rates could be announced during a tax year as being applicable to the following year, in which case the current tax balances in the balance sheet would be based on the previous tax rate, whereas the deferred tax balance in the balance sheet would be based on the new tax rate.
GUIDE ON SUBSTANTIVELY ENACTED TAX RATES AND TAX LAWS

Illustrative examples and disclosure guidance

These examples accompany, but are not part of this Guide.

IE1 Assume that on 23 February 20X5 the Minister of Finance in the Budget Statement announces a change in the corporate tax rate from 30% to 29%. This change is effective for entities with a year of assessment ending on or after 1 April 20X5. No other significant changes in tax laws are announced in the Budget Statement.

IE2 On the basis of the Guide, the date of substantive enactment for the tax rate change is 23 February 20X5, this being the date of the Budget Statement. However, for entities with a year end of 31 March 20X5 or earlier, the rate of tax to be used for current tax is 30%, seeing as the change applies to entities with years ending after 31 March 20X5.

IE3 In terms of paragraph 28 of IAS 34 – Interim Financial Reporting, an entity is to apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, which means that current and deferred tax balances in interim financial statements are to be measured using tax rates and tax laws that have been enacted or substantively enacted by the date of the interim balance sheet.

IE4 In keeping with the previous paragraphs, the current and deferred tax amounts in the balance sheet should be dealt with as outlined below.

Entity’s year end is before 23 February 20X5

4.1 Current tax balances are measured at 30%. The deferred tax balance disclosed on the balance sheet at year end will be based on a tax rate of 30%. Where these financial statements are approved for issue after 23 February 20X5, the entity should include a subsequent event note in the financial statements to the effect that any deferred tax balance will reduce in the future as a result of the change in corporate tax rate from 30% to 29%. For these entities the change in tax rate will be reflected in the following year’s financial statements.

Entity’s year end is between 23 February and 31 March 20X5

4.2 Current tax balances are measured at 30%. The deferred tax balance shown on the balance sheet at year end should be measured at 29%.

Entity’s year end is after 31 March 20X5

4.3 Current tax balances are measured at 29%. As above, the deferred tax balance shown on the balance sheet at year end should be measured at 29%.

Entity’s interim results are for a period ending before 23 February 20X5 for an entity with a year ending after 31 March 20X5, with the results being published after 22 February 20X5

4.4 The current and deferred tax balances should be measured using a 30% tax rate with a subsequent event note commenting that the results for the full year will measure current and deferred tax balances at 29%.

Entity’s interim results are for a period ending on or after 23 February 20X5 for a entity with a year ending after 31 March 20X5
GUIDE ON SUBSTANTIVELY ENACTED TAX RATES AND TAX LAWS

4.5 The current and deferred tax balances should be measured using a 29% tax rate.

IE5 In terms of IAS 12, paragraphs 80 and 81, the following, amongst other things, should be disclosed:

5.1 The amount of deferred tax income/expense that relates to a change in tax rates or to the imposition of new taxes.

5.2 A reconciliation between the effective tax rate and the applicable tax rate.

5.3 An explanation of the change in the applicable tax rate compared to the previous accounting period.

IE6 In terms of IAS 10 paragraph 21, an entity shall disclose the following for each material category of non-adjusting events after the reporting period:

6.1 the nature of the event, and

6.2 an estimate of its financial effect, or a statement that such an estimate cannot be made.
GUIDE ON SUBSTANTIALLY ENACTED TAX RATES AND TAX LAWS

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of the Guide.

BC1 IAS 12 states the following:

1.1 “Current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.” (paragraph 12.46)

1.2 “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 the liability is settled, based on the rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.” (paragraph 12.47)

1.3 “Current and deferred tax assets and liabilities are usually measured using the tax rates (and tax laws) that have been enacted. However, in some jurisdictions, announcements of tax rates (and tax laws) by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. In these circumstances, tax assets and liabilities are measured using the announced tax rate (and tax laws).” (paragraph 12.48)

BC2 In order to interpret the meaning of substantive enactment and the required degree of certainty that the announced changes would be promulgated in a substantially unchanged manner, it would be appropriate to regard a tax rate or tax law as substantively enacted where there is persuasive evidence that:

2.1 the government is able to enact and is committed to enacting the proposed change in the foreseeable future; and

2.2 the entity expects to be assessed on the basis of the announced rates/laws, where the change relates to the current year.

In addition, the requirements of this paragraph would usually exist only when the proposed change is specified in sufficient detail to be understood and applied in practice, and once the change has been tabled in Parliament.

BC3 In South Africa, the change in tax rates is only actually enacted when the necessary legislation is passed by Parliament, which occurs some months after the Budget Statement. However, the Income Tax Act provides, in paragraph 17(4) of the Fourth Schedule, that provisional tax should be based on the rate “in respect of that year foreshadowed by the Minister of Finance in his budget statement” if the rate for that year has not been fixed by Parliament. Accordingly, the rate as announced by the Minister of Finance is given legal standing in the Income Tax Act and is to be used for tax payment purposes.
GUIDE ON SUBSTANTIVELY ENACTED TAX RATES AND TAX LAWS

BC4 Furthermore, the budget is presented in Parliament by a member of the ruling party, which has a substantial majority, meaning that the ruling party is able to ensure that the revised tax rate will be passed by Parliament.

BC5 The factor in BC3, supplemented by that in BC4, is regarded as meeting the requirement in IAS 12, paragraph 48, that the announcement of the new rates has the substantive effect of actual enactment.

BC6 A change in tax rate, however, needs to be distinguished from other changes in tax legislation. Paragraphs 46 to 48 of IAS 12 not only refer to tax rates, but also to tax laws. Whilst the Minister of Finance might announce changes in tax laws in the Budget Statement, these changes are generally only drafted at a later stage. This means that the detail of the changes is only decided upon at this later stage, and could incorporate amendments made subsequent to the proposals announced in the Budget Statement. In addition, changes to the proposed legislation can be made as a result of debates in Parliament and in committees as well as in response to comments received when draft legislation is released for public comment. In this case, because the detail of the changes is generally only decided upon at a later date, substantive enactment would be regarded as occurring when the legislation is approved, seeing that prior to this date there is not sufficient certainty as to the details to be applied in practice when the changes are actually enacted. This is distinguished from a change in tax rates that only requires one amount to be changed and is therefore a change that can be made without interpretation issues arising, which are only resolved when the legislation is finally approved.

BC7 Where an announcement of a change in tax rates is inextricably linked to another change in tax laws, the change in tax rates should be regarded in the same way as a change in tax laws. This would apply, for example, if a change in tax rates were linked to a change in the basis of taxation (e.g. from a taxable income base to tax being based on a percentage of accounting profit). The same would apply if a new tax were introduced (e.g. capital gains tax) because the details of the legislation would only be enacted at a later date. Normally changes to tax laws, such as changes made to close perceived tax loopholes, are made independently of any changes in tax rates.

BC8 As noted above, the current and deferred tax balances are to be measured on the basis of the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. This means that, if the tax rates and tax laws are regarded as being enacted or substantively enacted after the balance sheet date, they are regarded as non-adjusting events after the balance sheet date, even when the changes to the tax rates and tax laws are applied retrospectively. In this case, the required disclosures in terms of IAS 10 are to be provided.

BC9 This Guide only addresses issues related to the selection of the tax rate to be used to calculate the deferred tax balance and the current tax expense. It does not address the subsequent implications relating to the recognition of any related income or expense, and therefore does not address the issue of whether the tax effect of the current year’s temporary differences should be calculated using the current or prior rate, and further whether the tax rate change should be made to the opening or closing balance of
deferred tax. As these issues are not addressed in IAS 12, it is not appropriate to address the issues in a Guide of that standard.