HONG KONG SOCIETY OF ACCOUNTANTS

Financial Accounting Standards Committee

Urgent Issues & Interpretations Sub-Committee

Interpretation 21 Income Taxes - Changes in the Tax Status of an Enterprise or its Shareholders

Interpretations are authoritative guidance on the application of Statements of Standard Accounting Practice with which enterprises should comply if their financial statements purport to give a true and fair view. Unless indicated otherwise, Interpretations have the same status as the background material and implementation guidance contained in Statements of Standard Accounting Practice. Interpretations are not intended to apply to immaterial items.

Reference: SSAP 12 (revised) *Income Taxes*

ISSUE

1. A change in the tax status of an enterprise or of its shareholders may have consequences for an enterprise by increasing or decreasing its tax liabilities or assets. This may, for example, occur upon the public listing of an enterprise's equity instruments or upon the restructuring of an enterprise's equity. It may also occur upon a controlling shareholder's move to a foreign country. As a result of such an event, an enterprise may be taxed differently; it may for example gain or lose tax incentives or become subject to a different rate of tax in the future.

2. A change in the tax status of an enterprise or its shareholders may have an immediate effect on the enterprise's current tax liabilities or assets. The change may also increase or decrease the deferred tax liabilities and assets recognised by the enterprise, depending on the effect the change in tax status has on the tax consequences that will arise from recovering or settling the carrying amount of the enterprise's assets and liabilities.

3. The issue is how an enterprise should account for the tax consequences of a change in its tax status or that of its shareholders.

CONCLUSIONS

4. A change in the tax status of an enterprise or its shareholders does not give rise to increases or decreases in amounts recognised directly in equity. The current and deferred tax consequences of a change in tax status should be included in net profit or loss for the period, unless those consequences relate to transactions and events that result, in the same or a different period, in a direct credit or charge to the recognised amount of equity. Those tax consequences that relate to changes in the recognised amount of equity, in the same or a different period (not included in net profit or loss), should be charged or credited directly to equity.

BASIS FOR CONCLUSIONS

5. SSAP 12 paragraph 58 requires current and deferred tax to be included in the net profit or loss for the period, except to the extent the tax arises from a transaction or event that is recognised directly in equity, in the same or a different period, (or arises from a business combination that is an acquisition). SSAP 12 paragraph 61 requires that current and deferred tax be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.

6. SSAP 12 paragraph 62 identifies examples of circumstances in which a transaction or event is recognised directly in equity as is permitted or required by another Statement of Standard Accounting Practice. All of these circumstances result in changes in the recognised amount of equity through recognition of a credit or charge directly to equity.

7. SSAP 12 paragraph 65 explains that where the tax base of a revalued asset changes, any tax consequence is recognised directly in equity only to the extent a related accounting revaluation was or is expected to be recognised directly in equity (revaluation surplus).

8. Because tax consequences recognised directly in equity must relate to a transaction or event recognised directly in equity in the same or a different period, the cumulative amount of tax charged or credited directly to equity can be expected to be the same amount that would have been charged or credited directly to equity if the new tax status had applied previously. SSAP 12 paragraph 63(b) acknowledges that determining the tax consequences of a change in the tax rate or other tax rules that affects a deferred tax asset or liability and relates to an item previously charged or credited to equity may prove to be difficult. Because of this, SSAP 12 paragraph 63 suggests that an allocation may be necessary.

DATE OF ISSUE: 30 July 2002

Effective Date: This Interpretation becomes effective for annual financial periods beginning on or after 1 January 2003. If an enterprise applies SSAP 12 (revised), Income Taxes, for periods beginning before 1 January 2003, it should also apply this Interpretation and Interpretation 20, Income Taxes - Recovery of Revalued Non-Depreciable Assets, for the same periods and disclose that fact.