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Qualified Investment Projects
CIAS12: deferred tax considerations

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22 September 2020

Accounting for deferred tax under CIAS 12: Considerations in the context of tax incentives available to Qualified Investment Projects in Cambodia.

Cambodia has experienced enviable GDP growth in recent years. Indeed, in its November 2019 Cambodia Economic Update, the World Bank Group (WBG) reports real economic growth rates ranging between 7.0% - 7.4% in 2011 – 2017, peaking at 7.5% in 2018; of course, the unprecedented global impact of the COVID-19 pandemic has slewed this growth trajectory during the first quarters of 2020.

This impressive economic progress has, in part, been driven by the Cambodian government's offering of some of the most attractive tax incentive schemes – for investors in prescribed industries – in South East Asia. For example, one of the main tax incentives available to QIPs - under the Law on Investment - is up to nine years' tax holiday. This tax holiday is made up of three distinct periods: "trigger period", "three-year period", and "priority period", during which the tax on income rate is bolstered at 0%.

"Cambodia's economy continues to show signs of robust growth, underpinned by solid export performance and strong domestic demand"

World Bank Group, 2019.

Accounting implications: deferred tax

With certain exceptions, CIAS 12 requires the recognition of deferred tax liabilities and – to the extent they are expected to be recoverable – deferred tax assets in relation to taxable temporary differences and deductible temporary differences respectively. Temporary differences arise when the tax base of an asset/liability differs from that at which it is carried in statement of financial position. As with any accrual or prepayment, this is to reflect the effects of tax in the periods in which the underlying expenses/income are recognised, as opposed to the periods in which they are subject to tax.

A QIP, during its tax holiday, is of course still required to apply the applicable accounting standards, of which CIAS 12 is mandatory. That is to say, it should be recognising deferred tax assets and liabilities in respect of qualifying temporary differences in line with CIAS 12.47: 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 the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

For a registered QIP in which financial year 2019 represents the first, of six, years' tax holiday the enacted rates of tax on income would be as follows:

2019-2024	2025+
0%	20%

When future years' tax rates are expected to vary, as is the case for QIPs during the tax holiday, it is necessary to anticipate the year in which the temporary differences will reverse so that the deferred tax asset or liability can be calculated at the appropriate rate.

Example

As at its reporting date of 31 December 2019, ABC Co., Ltd. (a QIP), had temporary differences as shown in the below table:

Financial Statement Line	Carrying value CU	Tax base CU	(Taxable)/ Deductible temporary difference CU
Interest expense[1]	0	500,000	500,000
Fixed assets[2]	1,000,000	400,000	(600,000)

Because the enacted future landscape varies in terms of applicable tax rates, the entity is required to estimate the period in which these temporary differences will reverse, in order to correctly value the underlying deferred tax assets and liabilities in compliance with the requirement in CIAS 12.47.

[1] Assume ABC Co., Ltd. operates in a jurisdiction where tax deductions for interest expense are capped via a formula, with any excess expense being available to carry forward against future tax profits for 5 years. For the year ended 31 December 2019, the entity incurred CU 500,000 more interest expense than tax relief available for that year.

[2] The entity had charged CU 600,000 less depreciation than it had taken tax depreciation as at 31 December 2019.

Interest expense

Based on its latest forecasts, ABC Co., Ltd. expects to: (a) make sufficient taxable profits in order to recover the brought forward deductible temporary differences during financial year 2020 and, (b) expects to incur no interest expense during financial year 2020 as the loan to which they relate was fully repaid during financial year 2019. Therefore, the tax rate - as enacted as at the balance sheet date 31 December 2019 - expected to prevail when the deductible temporary differences in relation to 2019's interest expense will reverse, is 0%. The value of the deferred tax asset to be recognised as at 31 December 2019 is, therefore, calculated as follows:

CU 500,000 * 0% = CU 0.

Fixed assets

In relation to the taxable temporary differences for fixed asset depreciation, the entity's profile of accounting depreciation over the next 5 years vs. tax depreciation has been analysed as follows:

Financial year	Accounting depreciation	Tax depreciation	(Taxable)/ deductible temporary difference CU
2020	100,000	110,000	(10,000)
2021	100,000	64,000	36,000
2022	100,000	51,200	48,000
2023	100,000	40,960	59,040
2024	100,000	32,768	67,232

For the purposes of allocating the reversal of temporary differences to future years, there are two methodologies:

1. Considering future deferred tax asset/liability originations

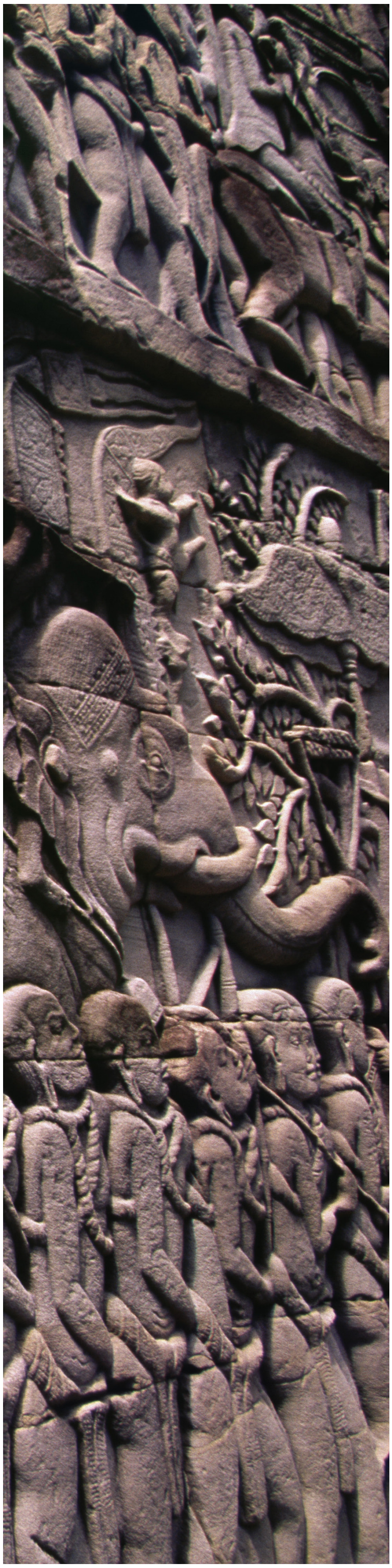
The CU 600,000 taxable temporary difference as at 31 December 2019 would be scheduled to reverse as per the following table:

Financial year	Reversal of temporary difference
2020	(10,000)
2021	36,000
2022	48,800
2023	59,040
2024	67,232
2025+	398,928

2. Not considering future deferred tax asset/liability originations

Allocating the reversals on a FIFO basis is appropriate:

Financial year	Reversal of temporary difference
2020	-
2021	36,000
2022	48,800
2023	59,040
2024	67,232
2025+	388,928



Using the two methods described above, as at 31 December 2019, a deferred tax liability would be recognised of CU 398,928 * 20% = CU 79,786 under method 1 and, CU 388,928 * 20% = CU 77,786 under method 2.

Assuming method 1 was chosen, and no deferred tax balances exist on the opening balance sheet, ABC Co., Ltd. should process the following journal entry in financial year 2019:

Dr deferred tax expense CU 79,786

Cr deferred tax liability (non-current) CU 79,786

Consequences of not recognising deferred tax during QIP

It is clear in ABC Co., Ltd.'s case, if it does not comply with the deferred tax accounting requirements of CIAS 12 during years 2019-2024, its net asset position as at 31 December 2024 would be too high by the requisite deferred tax liability of CU 79,786. Consequently, the overall profits for the remaining years of the underlying fixed assets' lives would be too low by this same value.

Conclusion

The requirements to account for deferred tax are no different during the tax holiday periods offered to QIPs in Cambodia. To the extent that temporary differences accumulate during these periods, and are expected to be recoverable, then deferred tax should be accounted for at the tax on income rate(s), as enacted at the reporting date, for the periods in which these temporary differences are expected to reverse.

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