Recognising a deferred tax asset for unused STC credits in compliance with international financial reporting standards – Is the consensus in AC 501 correct?

E.R. Venter & M. Stiglingh

ABSTRACT

In the past, South African companies did not recognise an asset for unused STC credits. AC 501, *Accounting for* 'Secondary Tax on Companies (STC)', which is effective for annual accounting periods beginning on or after 1 January 2004, now requires South African companies to recognise a deferred tax asset for unused STC credits to the extent that it is probable that an entity will declare dividends of its own against which the unused STC credits can be utilised. This change in the accounting treatment for unused STC credits has come in for some criticism, as accounting commentators do not all agree on the treatment enforced by AC 501. The objective of this study is to consider the soundness of this requirement in AC 501 by comparison with the International Financial Reporting Standard on income taxes, IAS 12, *Income Taxes.* The results of the conceptual analysis of AC 501 and IAS 12 were tested with reference to expert opinions of academics and practitioners in the field. This study concludes that recognising a deferred tax asset for unused STC credits contradicts IAS 12, which requires deferred tax assets and liabilities to be measured at the undistributed rate.

Key words: AC 501, AC 303, deferred tax, dividends, distributed rate of tax, IAS 12, secondary tax on companies, taxation, undistributed rate of tax, unused STC credits

BACKGROUND AND FORMULATION OF THE RESEARCH PROBLEM

Background

The introduction of a dual tax system for companies in South Africa, in order to encourage growth in new and fast-growing companies without at the same time

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Mr E.R. Venter is a senior lecturer in the Department of Accounting, University of Pretoria. Prof. M. Stiglingh is head of the Department of Taxation, University of Pretoria. E-mail: elmarventer@lantic.net

prejudicing the fiscus to any great extent, has been described as one of the more interesting developments of the 1993 budget (Old Mutual 1993: 3). The announcement of this dual tax system for companies and close corporations in South Africa resulted in a reduction of the corporate tax rate, at that stage from 48% to 40%, and introduced a new Secondary Tax on Companies (STC) at a rate of 15% on net dividends declared by a company on or after 17 March 1993 (*Business Day* 1993: 2). The corporate tax rate for years of assessment ending from 1 April 2005 is 29% (National Treasury 2005: 26), and the STC rate was reduced to 12.5% as of 13 March 1996 (Department of Finance 1996: 5.6).

The levy and recovery of STC is included in Section 64B of the Income Tax Act (Act No. 58 of 1962) (hereafter referred to as 'the Act'). It is calculated on the 'net amount' as defined in the Act (Section 64B(2)). The net amount is the amount by which the dividends declared (which are not exempt from STC in terms of Section 64B(5) of the Act) exceed the sum of certain dividends that accrued to the company during a particular dividend cycle (Section 64B(3) of the Act). Where the sum of dividends accrued exceeds the dividends declared, the excess (which is generally referred to as 'unused STC credits') must be carried forward and deemed to be a dividend that accrued to the company during the succeeding dividend cycle of the company (Section 64B(3)(a) of the Act). A company could thus legally incur a possible STC liability in future on its retained earnings to the extent that these are distributed by way of dividends to its shareholders. This future legal obligation will, however, decrease as a result of the current unused STC credits and to the extent that future dividends accrue to the company.

The introduction of STC has had a number of accounting implications. These created a need for guidance on the accounting treatment of STC. It is therefore important to understand what accounting principles are appropriate and applicable to accounting for STC. The revised Listing Requirements of the JSE Securities Exchange require listed companies to comply with the International Financial Reporting Standards (IFRSs) for financial periods commencing on or after 1 January 2005 (SAICA 2003a: §03). A number of convergence projects resulted in South African Statements of Generally Accepted Accounting Practice (SA GAAP) now being an exact replica of the relevant IFRSs. To indicate this, a dual numbering system is used in South Africa to reflect both to the relevant IFRS and the SA GAAP number (SAICA 2004: §06). Entities that prepare financial statements in terms of SA GAAP therefore have to account for STC in terms of IAS 12 (AC 102), *Income Taxes*, which is an exact replica of IAS 12. The Accounting Practices Board (APB) in South Africa has decided to issue the international text of any IFRS in South Africa without any amendments in future (SAICA 2003b: 1). This means that SA GAAP will continue to be an exact replica of the corresponding IFRSs in future.

Although the APB is committed to issuing IFRSs in South Africa without any amendments, in certain instances, a particular IFRS does need to be interpreted for

specific aspects, transactions or other issues that only occur in the South African environment, if such aspects, transactions or other issues are not specifically or clearly addressed in the IFRS concerned, as acknowledged in AC 500 (SAICA 2003b: §02). The AC 500-series is therefore used in South Africa to address matters specific to South Africa that are not addressed in an IFRS (SAICA 2003a: §07). Now that SA GAAP is fully aligned with the international standards, the only difference between SA GAAP and the IFRSs is the AC 500-series, for which there is no IFRS equivalent. The first AC 500 statement in South Africa is AC 501, *Accounting for Secondary Tax on Companies (STC)* (AC 501), which is an interpretation of the accounting for STC in South Africa based on the principles contained in IAS 12 (SAICA 2003c: §21). The accounting treatment of STC is not specifically or clearly addressed in IAS 12, so AC 501 regulates the accounting treatment of the future legal obligation to pay STC on retained earnings, as well as the future legal benefit that the entity might have in the form of accrued dividend income which may be used to reduce the future obligation. Some accounting commentators have already questioned whether AC 501 is fully in line with IFRS (Basson 2002: 2; KPMG 2004: 2; SAICA 2004: 19).

Defining the problem

Paragraph 52B of IAS 12 provides that the income tax consequences of dividends may not be recognised until a dividend has been declared. Consequently, in terms of AC 501, the liability for STC is only recognised once a dividend declaration has occurred (SAICA 2003c: §09). In a recent empirical study by Venter & Stiglingh (2005: 32), the majority of the respondents in a survey regarding the accounting treatment for the liability for STC agreed that the liability for STC should not be recognised until the declaration of a dividend has occurred, because, prior to this date, there is no obligating event on the part of the entity to distribute the profits.

Prior to AC 501, South African companies did not recognise a deferred tax asset for unused STC credits prior to the declaration of a dividend, as a local accounting opinion, AC 303, *Accounting for Secondary Tax on Companies,* considered these credits to be contingent assets, which should only be disclosed in the notes to the financial statements (SAICA 1999: §09). AC 501 (SAICA 2003c: §14) now requires South African companies to recognise a deferred tax asset for unused STC credits to the extent that it is probable that the entity with the STC credit will declare dividends of its own against which unused STC credits can be used. In other words, a deferred tax asset for unused STC credits is recognised prior to the declaration of a dividend, while no liability is recognised for the STC that would become payable on the future profits that need to be distributed in order to use the STC credit.

This change to the accounting treatment for unused STC credits has received mixed reactions. Some believe that it is anomalous to recognise a deferred tax asset in respect of unused STC credits while no liability is recognised for the STC that would

be payable on the future distribution of retained earnings (KPMG 2004: 3). Vorster, Koornhof, Oberholster & Koppeschaar (2004: 68) also believe that recognising a deferred tax **asset** for unused STC credits, while no deferred tax liability is recognised, may be "somewhat confusing".

Objective of the study

The objective of this study is to consider the soundness of the conclusion reached in AC 501 with regard to the recognition of a deferred tax asset for unused STC credits. As the AC 500 series of interpretations contains interpretations of IFRSs, the soundness of AC 501 in this regard is evaluated against the provisions of IAS 12, which is the relevant international standard dealing with the recognition and measurement of all types of income taxes.

Research methodology

A conceptual analysis was done, followed by an empirical study based on the findings of the analysis. The conceptual analysis focused on the requirements of IAS 12 to determine whether it is appropriate to recognise a deferred tax asset for unused STC credits in terms of the IFRS. Problems identified in the course of the conceptual analysis were then tested using an appropriate questionnaire administered to the partners specialising in technical accounting matters and the leading tax partners of the eight largest auditing firms in South Africa, accounting lecturers teaching at postgraduate level at various South African universities and other relevant accounting specialists. The conclusions reached in this study on the basis of the findings are set out in the final section of the article.

CONCEPTUAL ANALYSIS

Identifying the concept

In this study, the conceptual soundness of the following consensus reached by AC 501 was considered in relation to the requirements of IAS 12. In this regard, AC 501 states the following:

> To the extent that it is probable that the entity with the STC credit will declare dividends of its own against which unused STC credits can be utilised, a deferred tax asset should be recognised for such STC credits. (SAICA 2003c: §14)

In terms of the 'basis of conclusion' of AC 501, this consensus is based on paragraph 34 of IAS 12, which states:

> A deferred tax asset shall be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised. (IASB 2000: §34)

Paragraph 52A of IAS 12 also states:

> In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In some other jurisdictions, income taxes may be refundable or payable if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In these circumstances, current and deferred tax assets and liabilities are measured at the rate applicable to undistributed profits. (IASB 2000: §52A)

In order to recognise a deferred tax asset for unused tax losses and unused tax credits, the following requirements must therefore be met in terms of paragraphs 34 and 52A of IAS 12:

- An unused tax loss or unused tax credit must exist (first requirement)
- It must be probable that the benefit of the unused tax loss or unused tax credit will be realised through a set-off against future taxable profit (second requirement)
- The related deferred tax asset must be measured at the rate applicable to undistributed profits (third requirement).

The requirements of IAS 12 are considered in more detail in the following sections in order to determine whether the consensus in AC 501, namely that it is appropriate to recognise a deferred tax asset for unused STC credits prior to the declaration of a dividend, is an accurate interpretation of IAS 12.

First requirement: an unused tax loss or unused tax credit must exist

In order to determine whether unused STC credits are 'unused tax losses' or 'unused tax credits' for the purposes of IAS 12, it is necessary to determine the distinguishing features of 'unused tax losses' and 'unused STC credits', and whether unused STC credits share these distinguishing features.

Are unused STC credits the same as 'unused tax losses' in terms of IAS 12?

IAS 12 (IASB 2000) does not define '*unused* tax losses'. However, IAS 12 (2000: ½05) contains a definition of a 'tax loss', namely, the loss for the period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are recoverable. Hence, one could argue that an 'unused tax loss' would mean a

'tax loss' that has not been used against the taxable income. As a 'tax loss' is determined in accordance with the rules established by the taxation authorities, an 'unused tax loss' must also be determined in accordance with the rules established by the taxation authorities, that is, in South Africa those rules which are contained in the Act.

In the South African context, an example of an unused tax loss is an assessed loss, as envisaged by Section 20 of the Act. An assessed loss is defined in Section 20(2) of the Act as any amount by which the deductions admissible under Sections 11 to 19, inclusive, exceeded the income in respect of which they are so admissible. In this context, 'income' refers to the amount remaining of the gross income after deducting exempt income (the definition of 'income' in terms of Section 1 of the Act). If an entity's 'taxable income', as defined in Section 1 of the Act, is negative, this represents a balance of an assessed loss that is carried forward to the next year of assessment and that is offset against the taxable income derived in the next year of assessment (Section 20(a) of the Act).

From a tax perspective, an assessed loss therefore has the following characteristics:

- Any unused balance is carried forward to the next year of assessment
- Any balance carried forward to the next year of assessment may be offset against the 'taxable income' in that year.

From a tax perspective, an unused STC credit may share the listed characteristics of an unused tax loss, for the following reasons:

- Because unused STC credits are carried forward to the next dividend cycle and deemed to be a dividend that accrued to the company (which would therefore be available to reduce the net amount) (Section 64B(3)(a) of the Act), they may share the first characteristic of an assessed loss, namely that unused balances are carried forward to the next tax period.
- In the case of normal income tax, any unused assessed loss is offset against 'taxable income'. In other words, it is deducted in the calculation of the taxable amount for that year. STC is considered to be an income tax, that is, a tax on the profits of a company (De Koker 2003: §13.10; SAICA 2003c: §15; Venter & Stiglingh 2005: 31). IAS 12 defines a 'taxable profit' as the profit for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (IASB 2000: §05). In the case of normal income tax, a 'taxable profit' in terms of IAS 12 has the same meaning as a 'taxable income' in terms of the Act. If an analogy is drawn between normal income tax and STC, the 'net amount' for STC is 'taxable income' for the purposes of the Act, and also 'taxable profit' for the purposes of IAS 12. As with an assessed loss, unused STC credits are deducted in the calculation of the 'taxable income' of the succeeding dividend cycle (in the case of STC, the Act refers to the 'net amount') (Section

64B(3)(a) of the Act; SARS 2006: 2). One may therefore argue that unused STC credits might share the second characteristic of an assessed loss, namely that it is deducted in the calculation of 'taxable income'.

It should be noted that IAS 12 does not distinguish between a normal company tax loss that has accrued to the company (by means of any allowable expenditure actually incurred that exceeds income accrued to the company) and a tax loss that has been assessed by the South African Revenue Service (SARS). One might argue that the tax loss legally only comes into existence once SARS has assessed the loss, which might be several months after the balance sheet date, but, in substance, the benefit of the tax loss has already accrued to the entity. The only matter that needs to be clarified by SARS is whether the tax position taken by the entity in its calculation of the tax loss is legally justifiable in terms of the Act. If the entity has calculated the assessed loss on sound tax principles, SARS should not dispute the existence of the tax loss. From an accounting perspective, this distinction is therefore not important for recognition purposes. However, based on the opinion of the International Accounting Standard Board (IASB) (the standard-setting authority for any IFRS) (IASB & FASB 2005: 3), it is important for measurement purposes.

By analogy, the same principles apply to an unused STC credit that has not yet been assessed by SARS. This is, for example, relevant where dividends contemplated in Section 64B(3) of the Act have accrued to an entity since the previous dividend cycle and are available for future offsetting against dividends declared. If the dividend cycle has not ended by the balance sheet date, the accrued STC credit will not have been confirmed in any assessment made by SARS. A position would therefore have been taken that SARS would allow the dividends accrued as a deduction against the amount of dividends declared, or to be declared in future. From an accounting perspective, whether or not the credit has been assessed by SARS is therefore not relevant for recognition purposes, but it might be relevant for measurement purposes. In the following example, the similarities between an unused assessed loss and unused STC credit are investigated from an accounting perspective.

Example 1

A: A start-up company has earned revenue of R100 000 (all gross/taxable income in terms of the Act) during its first accounting period and has incurred expenditure of R120 000, which is deductible in terms of Section 11(a) of the Act. Assume that future taxable profits are probable.

B: A start-up company has earned dividend income (which is exempt in terms of Section 10(1)(k) of the Act) of R100 000 during its first accounting period. The company did not have any other income or expense items for the period under review. Future dividend declarations are probable.

Table 1: Example 1

Income Statement	**Company A** R	**Company B** R
Revenue / Other income	100 000	100 000
Expenses	(120 000)	—
(Loss)/Profit before tax	(20 000)	100 000
Taxation	5 800	12 500
Current	0	0
Deferred	5 800[1]	12 500[2]
(Loss)/Profit for the period	(14 200)	112 500
Effective tax rate	29%	(12.5%)

Notes:

1. Deferred tax asset on assessed loss (unused tax loss) recognised in terms of IAS 12 (IASB 2000: §34) is R20 000 x 29%.
2. Deferred tax asset on unused STC credits in terms of AC 501 (SAICA 2003c: §14) is R100 000 x 12.5%.

Von Well (2004: 1) states that there are very distinct similarities between an assessed loss and an unused STC credit from an accounting perspective (which is also evident from the foregoing example). Von Well (2004) presents the following four arguments in this regard:

- The benefits of both an unused assessed loss and an unused STC credit only materialise upon the occurrence of a future event – the earning of taxable income in the case of an assessed loss and the declaration of a dividend in the case of an unused STC credit.
- The recognition of a deferred tax asset in respect of an unused assessed loss results in matching between losses incurred by an entity during a specific period and the related tax benefit of these losses (which will only materialise in future periods); while the recognition of a deferred tax asset in respect of an unused STC credit results in matching between dividends received during a specific period and their related STC benefit (which will only materialise in future periods).
- Assuming that there are no 'permanent differences', the effect of the deferred tax asset in respect of the unused assessed loss is that the income tax expense in the income statement would be exactly 29% of the company's accounting loss for the year, while the effect of the deferred tax asset in respect of the unused STC credit is that the STC income reported would be exactly 12.5% of the undistributed dividends received during the period.
- Providing for a deferred tax asset in respect of an unused assessed loss results in a situation in which the future tax effect of the loss for the current year is reflected in the income statement for the current period; while the provision of a deferred tax

asset in respect of an unused STC credit results in a situation in which the future STC effect of the dividend received in the current year is reflected in the income statement for the current period.

The foregoing arguments, both from a tax and from an accounting perspective, might indicate that an unused STC credit is an 'unused tax loss' for the purposes of IAS 12. Van Blerck (2003: 2), however, holds an opposing view and states that the normal income tax base is determined, in broad terms, by commencing with gross receipts and accruals, then including special inclusions, then excluding exempt income, and then reducing the resultant sum (defined as 'income') by allowable expenditure deductions (whether these are general or special deductions). Since exempt income is an exclusion, rather than a deduction, it does not form part of the tax base under any circumstances (Van Blerck 2003: 2). Because STC is considered to be an income tax, Van Blerck (2003: 1) is of the opinion that the STC tax base is analogous to the normal income tax base. In terms of Section 20(2) of the Act, an assessed loss arises in the case of normal income tax when the admissible deductions exceed 'income', in other words, the remaining gross income after deducting exempt income (see the definition of 'income' in terms of Section 1 of the Act). Van Blerck (2003: 3) argues that (certain) dividend income is the equivalent of exempt income in the STC tax base, rather than a tax expenditure deduction (Van Blerck 2003: 3). Van Blerck's contention is thus that unused STC credits are deducted from the dividends declared (which could be considered 'gross income' in the STC tax base), because they represent amounts distributed that are not subject to STC, in other words, 'exempt income'. Silke, De Koker, Kolitz & Arendse (2001: §13.10) state that, in general, 'incoming dividends', that is, dividends earned by a company, would already have borne STC when they were distributed, and that they are therefore effectively offset against outgoing dividends in the computation of the liability of the distributing company, and so take the form of a tax shelter. This argument might support the view that dividend income is 'exempt income' in the STC tax base. Van Blerck (2003: 3) is therefore of the opinion that dividend income is not part of the STC tax base and that it cannot generate a deferred tax asset.

The following example investigates whether dividends that accrued to an entity could be regarded as 'exempt income' for the purposes of STC.

Example 2

A start-up company earned dividend income (which is exempt in terms of Section 10 (1)(k) of the Act) of R100 000 during its first accounting period. The company did not have any other income or expense items for the period under review. Future dividend declarations are probable. The income statement of the company, which accounts for STC in terms of AC 501, is examined in Table 2.

Table 2: Example 2

Income statement	**R**
Other income	100 000
Expenses	—
(Loss)/Profit before tax	100 000
Taxation	12 500
Current	0
Deferred	12 500[1]
(Loss)/Profit for the period	112 500

Note:

1. The deferred tax asset on unused STC credits in terms of AC 501 (SAICA 2003c) is R100 000 x 12.5%.

On the first day after the balance sheet date, the company declares a dividend of R100 000. The STC charge for the dividend declaration will be Rnil ((R100 000 – R100 000) × 12.5%), while an asset of R12 500 is reflected on the balance sheet.

The results in this example suggest that dividend income that is exempt for normal tax in terms of Section 10(1)(k) of the Act is, in fact, 'exempt income' for STC purposes, as it will never result in an STC expense. In essence, Van Blerck (2003: 1) states that normal income tax is a tax on the income that a company generates itself, as opposed to income distributed to it by other companies in the form of dividends. Similarly, it could be argued that STC is a tax on the distribution of the income that a company generates itself, as opposed to the income that has been distributed to it by other companies in the form of dividends (Van Blerck 2003: 1).

In terms of IAS 12, are unused STC credits the same as 'unused tax credits'?

AC 501 (SAICA 2003c: §21) uses the following wording: "...where an entity received a dividend without utilising the related tax credit in that period...". AC 501 therefore seems to take the view that unused STC credits are 'unused tax credits' as envisaged by paragraph 34 of IAS 12. Although IAS 12 does not define 'unused tax credits', it prescribes a similar treatment for unused tax credits as for unused tax losses (IASB 2000: §34). This suggests that for the purposes of IAS 12 (IASB 2000), an 'unused tax credit' is a credit that is determined in accordance with the rules established by the local taxation authority.

The Act does not contain a definition of a tax credit. However, Clegg & Stretch (2005: §18.17.1) interpret a foreign tax credit as an amount that the taxpayer is allowed to offset against the local tax due. In terms of Section 6*quat* of the Act, the rebate in respect of foreign taxes paid is a tax credit that is deductible from the normal tax payable. In its 2005 guide, *Information on Income Tax*, SARS has included a

section on income tax credits. The credits mentioned in this section are Pay As You Earn, Standard Income Tax on Employees and foreign tax credits (SARS 2005: 5). In the same guide, a template is provided for the calculation of the tax liability. In this template, the credits referred to are deducted from the total tax payable to calculate the tax liability (SARS 2005: 36). It therefore appears that a critical characteristic of a tax credit is that it is used as an offset against the tax payable. In order to determine whether unused STC credits are 'unused tax credits' for the purposes of IAS 12, it is necessary to establish whether unused STC credits are offset against the STC payable.

Where an entity has unused STC credits, the credits are deemed to be a dividend that accrues to the company during the succeeding dividend cycle of the company (Section 64B(3)(a) of the Act). As dividends accrued to the company are deducted in the calculation of the net amount (Section 64B(3) of the Act), the unused STC credits are taken into account in the calculation of the STC payable, and they are not necessarily offset against the STC payable. This analysis is also confirmed by IT 56 (SARS 2006: 2), which is the return for the payment of STC. In this return, it is clear that the 'excess dividend accrued brought forward from previous cycle' (which is the unused STC credit) is deducted in the calculation of the net amount and is not offset against the STC payable. It therefore appears that unused STC credits are not unused tax credits for the purposes of paragraph 34 of IAS 12.

Findings on the first requirement

The conceptual analysis indicates that unused STC credits might not be 'unused tax credits' for the purposes of IAS 12. Two opposing opinions exist as to whether unused STC credits are 'unused tax losses' for the purposes of IAS 12. These opposing arguments indicate that there is some uncertainty as to whether unused STC credits are 'unused tax losses'. This matter is addressed in the empirical study.

Second requirement: the benefit must realise through a set-off against future taxable profit

'Taxable profit' is defined in IAS 12 (IASB 2000: §05) as the profit for the period (determined in accordance with the rules established by the taxation authorities) upon which income taxes are payable. As has been established in a previous section of this article, it appears that STC is levied on 'taxable profits' (that is, the distributed profits included in the 'net amount' as determined by Section 64B(2) of the Act), as defined by IAS 12. Therefore, because unused STC credits are deducted in the calculation of the net amount (Section 64B(2) of the Act), they are considered to be realised by being offset against future 'taxable profit'.

Third requirement: deferred tax assets must be measured at the rate applicable to undistributed profits

IAS 12 provides the following example to illustrate paragraph 52A (IASB 2000: §52B):

> The following example deals with the measurement of current and deferred tax assets and liabilities for an enterprise in a jurisdiction where income taxes are payable at a higher rate on undistributed profits (50%), with an amount being refundable when profits are distributed. The tax rate on distributed profits is 35%. At the balance sheet date, 31 December 20x1, the enterprise does not recognise a liability for dividends proposed or declared after the balance sheet date. As a result, no dividends are recognised in the year 20x1. Taxable income for 20x1 is 100 000. The enterprise recognises a current tax liability and a current tax expense of 50 000. Subsequently, on 15 March 20x2, the enterprise recognises dividends of 10 000 from previous operating profits as a liability. On 15 March 20x2, the enterprise recognises the recovery of income taxes of 1 500 (15% of dividends recognised as a liability) as a current tax asset and as a reduction of current income tax expense for 20x2.

The example provided in IAS 12 is very similar to the situation in South Africa. The only difference is that, in the example, the distributed tax rate of 35% is lower than the undistributed tax rate of 50%, while in South Africa, the distributed tax rate is higher than the undistributed tax rate, because STC is levied when profits are distributed.

Table 3 indicates the difference between the undistributed and the distributed rates in South Africa.

Table 3: : Undistributed rate versus distributed rate

	Undistributed	**Distributed**
Normal income tax	29%	29%[1]
STC	0%[2]	11.11%[3] or 12.5%[3]
Total (normal income tax and STC)	29%	36.89%[4]

Notes:

1. The calculation of normal income tax is not affected by the distribution of profits.
2. STC is only triggered once a dividend is declared (Section 64B(2) of the Act).
3. $12.5 / 112.5 \times 100 = 11.11\%$. This rate will apply to distributable income (100% distribution policy) other than dividend income that qualifies to be deducted in the calculation of STC in terms of Section 64B(3)(a) of the Act. The 12.5% rate will apply to distributable dividend income that qualifies to be deducted in the calculation of STC in terms of Section 64B(3)(a) of the Act.
4. $29 + (100 \times 0.71 \times 12.5 / 112.5) = 36.89\%$, based on the assumption that profits are fully distributed. With a more conventional distribution of 50%, the effective rate reduces to 33.44% [$29 + (100 \times 0.71 \times 0.5 \times 12.5 / 100)$].

Hence, if a company has an unused assessed loss of R20 000, a deferred tax asset of R5 800 (R20 000 × 29%) will be recognised, based on the undistributed rate of 29%. If a company has an unused STC credit of R20 000, a deferred tax asset of Rnil (R20 000 × 0%) should be recognised, based on the undistributed rate of 0%.

Even if one concludes that unused STC credits are 'unused tax losses' for the purposes of IAS 12 (in other words, they are not 'exempt income'), the value of the deferred tax asset should be measured based on the undistributed rate of 0%, and, consequently, the asset should have a value of Rnil in the balance sheet.

Findings in the conceptual analysis

The conceptual analysis has indicated that three requirements should be met before it can be concluded that the requirement of AC 501 to recognise a deferred tax asset for unused STC credits is an accurate interpretation of IAS 12. There is some uncertainty as to whether the first requirement (namely, that an unused tax loss or unused tax credit must exist) is complied with in the case of unused STC credits. The second requirement (namely, that the benefit must be realised by offsetting it against the taxable profit) is satisfied, as STC is considered to be a tax levied on the profits of a company when they are distributed. The third element appears to be the most significant, as it appears that it would be inappropriate to recognise a deferred tax asset for unused STC credits at a rate of 12.5%, as this represents the distributed, and not the undistributed, rate as required by IAS 12 (IASB 2000: §52A). Based on the requirements of IAS 12 (IASB 2000: §52A), it appears that the deferred tax asset for unused STC credits should be measured at the undistributed rate of 0%, which means that no asset will be recognised in the balance sheet. As it seems that all three requirements for the recognition of a deferred tax asset have not been satisfied, it appears to be inappropriate to recognise a deferred tax asset for unused STC credits.

These critical areas were tested by an empirical study, discussed in the following sections.

RESULTS OF THE EMPIRICAL STUDY

Background to the questionnaire

The purpose of the empirical study was to test the problems identified in the conceptual analysis by means of a survey of the opinions of accounting and tax specialists in South Africa.

The questionnaire was distributed to the 'defined population', comprising accounting lecturers teaching students at postgraduate level at South African universities, the partners specialising in technical accounting matters at the eight largest auditing firms in South Africa and the leading tax partners at the eight largest auditing firms in South Africa. Accounting lecturers and accounting technical

partners were chosen, as they are usually actively involved with accounting standards on a day-to-day basis and should therefore have an in-depth knowledge of accounting requirements. The leading tax partners were chosen, as they should have an in-depth knowledge of STC. All three of the target groups should be aware of STC and accounting for STC, and they should be competent to answer the questionnaire, although it was expected that the tax partners might have some difficulty in answering detailed accounting questions. In the interpretation of the results, a limitation associated with questionnaires should be borne in mind, namely that the responses are based mainly on the opinions and perceptions of the respondents.

The accounting lecturers teaching at postgraduate level at South African universities were identified either from information contained on the websites of the universities concerned or from a telephone call made directly to the universities concerned to obtain information on and contact details of the individuals to be surveyed.

The eight largest auditing firms in South Africa were chosen based on fee income, as contained in a survey done by the *International Accounting Bulletin* (Dayasena 2003: 12). A questionnaire was sent to the lead corporate tax partner of each of the eight firms and to all the partners specialising in technical accounting matters at each firm. These individuals were identified by means of a telephone call to the firms. Where a firm did not have a specialist accounting and/or tax department, the questionnaire was sent to the contact partner listed in the *International Accounting Bulletin* (Dayasena 2003: 15) with a request to forward it to the most appropriate individual in the firm. The questionnaires were distributed to the participants via e-mail.

The first part of the questionnaire provided a general background on the topic and the questionnaire. The second part consisted of general questions concerning the profile of the respondent. The third part contained five questions on the comparison of an unused STC credit with an assessed loss. The fourth part contained two questions relating to the argument that dividend income cannot create a tax credit. The final part contained one question relating to the appropriate tax rate that should be used to measure a deferred tax asset for unused STC credits.

Response rate

A total of 64 questionnaires were distributed – 33 to accounting lecturers teaching at postgraduate level, 18 to accounting technical partners at the eight largest auditing firms in South Africa, seven to leading tax partners at the eight largest auditing firms in South Africa and six to other relevant accounting specialists.

The response rates in the various categories are set out in Table 4.

Questionnaires that were not completed by the deadline date were followed up with additional e-mails and/or telephone calls.

Table 4: Response rate

	Response rate %
Accounting lecturers	48
Technical accounting partners	67
Tax partners	29
Other	33
Total response rate	**50**

In addition, the questionnaire was forwarded to SAICA with a request to send it to all members of the Accounting Practices Board and Accounting Practices Committee (APC). An additional two responses were obtained through this process.

For the purposes of the analysis, the responses of the 'other' category and the additional two responses were grouped with the responses of the technical accounting partners, as these responses represented those of accounting specialists.

Profile of respondents

The profile of respondents to the questionnaire is as follows:

- 38% had less than five years' experience in their particular field, 38% had between five and ten years' experience, and 24% had more than ten years' experience
- 29% considered their knowledge of Section 64B of the Act to be 'good', 50% considered it to be 'fair', and 21% considered their knowledge to be 'poor'
- 76% considered their knowledge of AC 501 to be 'good', 18% considered it to be 'fair', and 6% considered their knowledge to be 'poor'
- 79% considered their knowledge of IAS 12 to be 'good', 15% considered it to be 'fair', and 6% considered their knowledge to be 'poor'
- Only 18% of the respondents provided SAICA with comments on ED 153, while 24% of the respondents commented on ED 159. (ED 153 and ED 159 were the exposure drafts issued by SAICA in the development of AC 501.)

Statistical summary of results

Question 1: The benefit of both an unused assessed loss and an unused STC credit will only materialise upon occurrence of a future event – the earning of taxable income in the case of an assessed loss and the declaration of a dividend in the case of an unused STC credit. Do you agree with this statement? (Table 5).

Of the respondents, 91% either agreed or totally agreed with the results derived from the conceptual analysis.

Table 5: Results of question 1

	Lecturers %	Technical %	Tax partners %	Total %
Totally disagree	0	0	0	0
Disagree	12	0	0	6
Neutral	0	6	0	3
Agree	69	50	100	62
Totally agree	19	44	0	29
Total	**100**	**100**	**100**	**100**

Question 2: The recognition of a deferred tax asset in respect of an unused assessed loss results in matching between losses incurred by an entity during a specific period and the related tax benefit of these losses (which will only materialise in future periods), while the recognition of a deferred tax asset in respect of an unused STC credit results in matching between dividends received during a specific period and their related STC benefit (which will only materialise in future periods). Do you agree with this statement? (Table 6).

Table 6: Results of question 2

	Lecturers %	Technical %	Tax partners %	Total %
Totally disagree	0	0	0	0
Disagree	0	0	0	0
Neutral	0	0	0	0
Agree	75	88	100	82
Totally agree	25	12	0	18
Total	**100**	**100**	**100**	**100**

All respondents either agreed or totally agreed with the results obtained from the conceptual analysis.

Question 3: Assuming that there are no 'permanent differences', the effect of the deferred tax asset in respect of the unused assessed loss is that the income tax expense in the income statement would be exactly 29% of the company's accounting loss for the year, while the effect of the deferred tax asset in respect of the unused STC credit is that the STC income reported would be exactly 12.5% of the net dividends received during the period. Do you agree with this statement? (Table 7).

Table 7: Results of question 3

	Lecturers %	Technical %	Tax partners %	Total %
Totally disagree	0	0	0	0
Disagree	0	12	0	5
Neutral	18	0	50	12
Agree	69	69	50	68
Totally agree	13	19	0	15
Total	**100**	**100**	**100**	**100**

Of the respondents, 83% agreed or totally agreed with the results obtained from the conceptual analysis.

Question 4: Providing for a deferred tax asset in respect of an unused assessed loss results in the future tax effect of the current year's loss being reflected in the current period's income statement, while the provision of a deferred tax asset in respect of an unused STC credit results in the future STC benefit of the dividend received in the current year being reflected in the current period's income statement. Do you agree with this statement? (Table 8).

Table 8: : Results of question 4

	Lecturers %	Technical %	Tax partners %	Total %
Totally disagree	0	6	0	2
Disagree	0	6	0	3
Neutral	0	13	0	6
Agree	75	56	100	68
Totally agree	25	19	0	21
Total	**100**	**100**	**100**	**100**

Of the respondents, 89% either agreed or totally agreed with the results obtained from the conceptual analysis.

Question 5: Do you believe that the STC tax base is analogous to the income tax base – that is, in broad terms determined by gross receipts/accruals, then including special inclusions, then excluding exempt income, and then reducing the resultant sum by allowable deductions? (Table 9).

Of the respondents, 41% totally disagreed or disagreed with Van Blerck's argument that the STC tax base is analogous to the income tax base, while a high percentage of

Table 9: Results of question 5

	Lecturers %	Technical %	Tax partners %	Total %
Totally disagree	6	5	0	6
Disagree	25	38	100	35
Neutral	38	13	0	24
Agree	31	38	0	32
Totally agree	0	0	0	0
Question not answered by respondent	0	6	0	3
Total	**100**	**100**	**100**	**100**

respondents (24%) were neutral with respect to the question, and 32% agreed with Van Blerck. This indicates that there is some uncertainty as to whether Van Blerck's argument is valid.

Question 6: Based on the assumption that the STC tax base is analogous to the income tax base, do you believe that dividend income in the STC tax base is the equivalent of exempt income in the income tax base? (Table 10).

Table 10: : Results of question 6

	Lecturers %	Technical %	Tax partners %	Total %
Totally disagree	6	0	0	3
Disagree	25	56	0	38
Neutral	31	13	50	24
Agree	38	25	50	32
Totally agree	0	0	0	0
Question not answered by respondent	0	6	0	3
Total	**100**	**100**	**100**	**100**

A total of 41% of the respondents totally disagreed or disagreed with Van Blerck's argument that dividend income in the STC tax base is the equivalent of exempt income in the income tax base, while a high percentage of respondents (24%) were neutral with respect to the question, and 32% agreed with Van Blerck. This again indicates that there is some uncertainty as to whether Van Blerck's argument is valid.

Question 7: IAS 12 (2000: §52A) requires deferred tax liabilities to be measured at the tax rate applicable to undistributed profits. In the case of an unused STC credit, the deferred tax asset will be provided at a rate of 12.5% of the unused STC credit, and this imputes a distribution effect on the tax rate. Do you agree with this statement (Table 11).

Table 11: : Results of question 7

	Lecturers %	**Technical %**	**Tax partners %**	**Total %**
Totally disagree	0	12	0	5
Disagree	0	13	0	6
Neutral	37	6	50	24
Agree	44	56	50	50
Totally agree	6	13	0	9
Question not answered by respondent	13	0	0	6
Total	**100**	**100**	**100**	**100**

A very high percentage (24%) of the respondents were neutral with respect to the statement that providing for a deferred tax asset on unused STC credits at a rate of 12.5% imputes a distribution effect on the tax rate, while 59% of respondents agreed or totally agreed with this statement. This appears to indicate that the recognition of a deferred tax asset for unused STC credits is not in accordance with the principles of IAS 12 §52A (that is, that deferred tax assets should be measured at the rate applicable to undistributed profits).

Findings of the empirical study

Most of the respondents agreed that unused STC credits are similar to unused assessed losses, but they were divided with regard to the argument by Van Blerck that dividend income can never generate a tax credit. The results of these two questions cast some doubt on whether an unused STC credit is an 'unused tax loss' or an 'unused tax credit' for the purposes of IAS 12. Most respondents believed that the recognition of a deferred tax asset for unused STC credits at 12.5% imputes a distribution effect on the tax rate at which the asset is recognised. The percentage of technical accounting partners at the eight largest auditing firms in South Africa and other accounting professionals that agreed or totally agreed with this statement was 69%. This could mean that in terms of IAS 12 (IASB 2000: §52A), the recognition of a deferred tax asset for unused STC credits is not appropriate, as IAS 12 requires that deferred tax assets should be measured at the rate applicable to undistributed profits.

CONCLUSION

This study considered whether the consensus in AC 501 (SAICA 2003c: §14) that a deferred tax asset should be recognised for unused STC credits to the extent that it is probable that the entity will realise the benefit in future periods is an accurate interpretation of the requirements of IAS 12.

Although most respondents to the empirical study agreed with the view that unused STC credits are similar to unused assessed losses, most of the respondents also agreed with the conclusions from the conceptual analysis that it is inappropriate to measure a deferred tax asset for unused STC credits at a rate of 12.5%. Even if one concludes that unused STC credits are 'unused tax losses' for the purposes of IAS 12, the value of the deferred tax asset should be measured based on the undistributed rate of 0%, and, consequently, the asset should have a value of Rnil in the balance sheet. This is due to the requirement of IAS 12 (IASB 2000: §52A) that deferred tax assets should be measured at the rate applicable to undistributed profits. In the case of unused STC credits, the undistributed rate is 0%, because, until a dividend has been declared, undistributed profits do not incur any STC.

It could be held that, if IAS 12 were amended to provide that deferred tax assets and liabilities should be measured at the distributed rate, there could be a case to provide for deferred tax on unused STC credits. Under United States Generally Accepted Accounting Practice (US GAAP), deferred taxes are measured at the distributed rate (FASB 2004: 2). The difference between IFRS and US GAAP on the tax rate (distributed or undistributed) at which deferred taxes should be measured has recently been discussed as part of the joint short-term convergence project by the IASB and the Financial Accounting Standards Board (FASB) (the standard-setting authority for US GAAP). At an FASB Board meeting held on 23 March 2005, the FASB agreed to concur with the IASB, namely that deferred tax assets and liabilities should be measured at the undistributed rate (FASB 2005: 2). It was noted from the minutes of this meeting that a majority of FASB Board members gave preference to the use of the distributed rate over the undistributed rate (FASB 2005: 4). Although it was felt that the distributed rate is 'conceptually superior' to the undistributed rate, FASB Board members felt that this issue should be revisited as part of the Conceptual Framework Project (FASB 2005: 2). FASB Board members believed that the principal issue relates to the definition of the obligating event (FASB 2005: 2) and, as such, this matter accords better with the Conceptual Framework Project. The decision of the IASB and the FASB to measure deferred tax assets and liabilities at the undistributed rate will now be exposed for public comment before the necessary amendments are made to US GAAP (FASB 2005: 4).

Van Blerck (2003: 4), however, believes that even if IAS 12 were to be amended to require that deferred taxes should be measured at the distributed rate, it would still be inappropriate to recognise a deferred tax asset for unused STC credits, as he believes

that dividend income can never create a tax credit. Van Blerck's argument has been tested in this empirical study, and the opinions of the respondents were divided as to whether they agree or disagree with him. This indicates that, even if IAS 12 were to be amended to require deferred taxes to be measured at the distributed rate, there is still some uncertainty as to whether it would be appropriate to recognise a deferred tax asset for unused STC credits. If an entity is required to measure deferred tax assets and liabilities at the distributed rate, the effect of unused STC credits would, however, be reflected in the measurement of the liability for STC, as the entity is taxed on the 'net amount' (Section 64B(2) of the Act).

Based on the results of this study, however, it appears that the consensus in AC 501 with regard to the recognition of a deferred tax asset for unused STC credits is not an accurate interpretation of the current principles of IAS 12. Even though AC 501 has been approved by the Accounting Practices Board following a process of drafting and exposure by the Accounting Practices Committee of SAICA and was exposed for public comment for a period of approximately 60 days (SAICA 2003c: §07) (refer to the section on the profile of respondents for the percentage of respondents to the empirical study that provided comments to SAICA on the exposure draft for AC 501), this study may indicate that SAICA should reconsider the consensus in AC 501 with regard to the recognition of a deferred tax asset for unused STC credits based on the current IAS 12. In the light of the international convergence project between the IASB and FASB, this matter should be reconsidered, taking into account the outcome of the Conceptual Framework Project.

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