South Africa: Deferred tax at 27% or 28%?

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The South African National Treasury announced on 23 February 2022 that the corporate tax rate is reduced from 28% to 27% for years of assessment that end on or after 31 March 2023. From an accounting perspective, this raises the question at what rate a company's deferred tax assets or liabilities should be measured. This article sets out the core principles and briefly reviews guidance to be gleaned from educational material recently published by the South African Institute of Chartered Accountants on this topic.

The South African National Treasury announced on 23 February 2022 that the corporate tax rate is reduced from 28% to 27% for years of assessment that end on or after 31 March 2023. One of the accounting questions that stem from this announcement is how companies should reflect the rate change in their deferred tax accounts. This article revisits the core principle and considers recently published guidance on this topic.

Principle

Deferred tax represents the future tax consequences for an entity if it recovers the carrying amounts of its assets and settles the carrying amounts of its liabilities. Changes in tax rates or tax laws that take effect in future affect this measurement. The relevant principle for the measurement of deferred tax is set out in paragraph 47 of IAS 12:

> 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.

The standard alludes to the fact that 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. It states that in such cases, tax assets and liabilities must be measured at the announced rates.

South African context

The Department of Trade and Industry in South Africa issued Financial Reporting Pronouncement 1 (FRP1) in 2018. It deals with the question when changes in tax rates and law are regarded as substantively enacted in South Africa. FRP1 was based on Financial Reporting Guide 1 published by the South African Institute of Chartered Accountants (SAICA). The consensus in FRP1 is that 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. In this context, FRP1 indicates that changes in tax rates should be regarded as substantively enacted from the time that they are announced in the Minister of Finance's Budget Statement. If, however, the change in rate is inextricably linked to other changes in the tax laws, it should only be regarded as substantively enacted when approved by Parliament and signed by the President.

Analysis

The rate reduction is complicated by its linkage with base-broadening measures to counterbalance the effect of the rate change for the fiscus. The base broadening measures were enacted into the Income Tax Act as part of the 2021 legislative cycle. They however only become effective once the reduced corporate tax rate applies.

SAICA's Accounting Practices Committee recently published educational material on the announced rate change. This material indicates that the rate change announced by the Minister of Finance in 2021 was not considered substantively enacted in light of it being inextricably linked to base-broadening changes that were not known at the date of the announcement. The base broadening measures were however enacted in January 2022 and the uncertainty regarding the rate change was clarified in the 2022 budget speech. The position is therefore taken in the material that the rate change is now expected to be promulgated in an unchanged manner. It appears as if the position taken is that although the rate change is still inextricably linked to the base-broadening measures, these measures are no longer considered changes in the tax laws, as contemplated in FRP1, since they have been enacted.

Practically this means that South African entities whose reporting periods end after 23 February 2022 should measure deferred tax to reflect the announcement of the rate change. Entities with February or March year-ends may find themselves in the peculiar position of having to measure deferred tax in respect of some temporary differences at 28%, being the rate that still applies to their financial years ending 2023, and other at 27%, being the rate that applies to any subsequent financial years, depending on when the temporary difference is expected to reverse.