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IFRS in Focus
IASB issues Exposure Draft on Deferred Tax: Recovery of Underlying Assets

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The Bottom Line

- The ED proposes an exception to IAS 12, which would require the measurement of deferred tax assets and deferred tax liabilities arising from certain assets on the presumption that the carrying amount of the asset will be recovered entirely through sale. The presumption can be rebutted if there is clear evidence that the asset's economic benefits would be consumed throughout its economic life.
- The exception would apply to assets measured using the fair value model under IAS 40 or the revaluation model under IAS 16 and IAS 38. It would also apply to investment property, property, plant and equipment and intangible assets acquired in a business combination if the acquirer applies the fair value model in IAS 40 or the revaluation model in IAS 16 or IAS 38 subsequent to the business combination.
- Comments are due by 9 November 2010.

The proposal

On 10 September 2010, the International Accounting Standards Board (IASB) published ED/2010/11 *Deferred Tax: Recovery of Underlying Assets – Proposed amendments to IAS 12*. The ED would provide an exception to the general principle in IAS 12 that the measurement of deferred tax assets and deferred tax liabilities should reflect the tax consequences that would follow from the manner in which the entity expects to recover the carrying amount of an asset.

The ED was issued in response to concerns in certain jurisdictions where application of this principle can be difficult or subjective. For example, this principle is particularly difficult to apply to an investment property measured at fair value because it may be held by the entity to earn rental income as well as for capital appreciation, and the tax law may tax gains and losses from the recovery of an asset through sale at a different rate from that applicable to income earned from using the same asset. Additionally, tax law may also ascribe different tax bases to the same asset depending on the manner of recovery. For example, some jurisdictions may provide cost base plus an indexation allowance for inflation on disposal, but allow no deductions for depreciation, or allow depreciation only on the original cost. This has resulted in confusion and potential inconsistency in applying this principle in practice.

In response, the Board is proposing to provide an exception to the principle when deferred tax assets or deferred tax liabilities arise from:

- investment property measured using the fair value model in IAS 40;
- property, plant and equipment or intangible assets measured using the revaluation model in IAS 16 or IAS 38; and
- investment property, property, plant and equipment or intangible assets acquired in a business combination if they are subsequently measured using the fair value or revaluation models.

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

For these assets, the ED proposes a rebuttable presumption that the measurement of a deferred tax asset or deferred tax liability should reflect the tax consequences of recovering the carrying amount of the asset entirely through sale, unless there is clear evidence that the entity will consume the asset's economic benefits throughout its economic life.

Observation

The proposed amendments replace the current requirement in IAS 12 to determine the expected manner in which an asset's carrying amount would be recovered with a rebuttable presumption that, for the assets specified, the carrying amount would be recovered entirely through sale.

Currently, in some cases an asset is judged to be recovered partially through use and partially through sale. The proposed amendments imply that for assets which are fair valued, recovery will be assumed to be entirely through use or sale.

Entities holding investment property (accounted for using the fair value model in accordance with IAS 40) in jurisdictions where no tax is imposed on the sale would no longer recognise deferred tax on any temporary differences arising from fair value gains or losses. This is because there would be no tax consequences arising from the recovery entirely through sale, regardless as to whether the entity intends to use the property to generate rental income for a period of time prior to sale.

Transition

The ED proposes that the amendments to IAS 12 should apply retrospectively. This would include the retrospective restatement of all deferred tax assets or deferred tax liabilities within the scope of the proposed amendments, including those that were initially recognised in a business combination.

The proposed amendments would supersede SIC Interpretation *21 Income Taxes – Recovery of Revalued Non-Depreciable Assets* when it becomes effective.

Effective date

The comment period ends on 9 November 2010. The ED does not specify an effective date. The IASB will determine the effective date after considering the comments received on the ED.

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