

IFRS Project Insights

Income Taxes

20 December 2010

The IASB's efforts related to accounting for income taxes have been ongoing. Accounting for income taxes was identified as a short-term convergence project of the IASB and the FASB as part of the 2006 Memorandum of Understanding. However, in 2008 the FASB decided to indefinitely defer its income tax project, while the IASB moved forward with its project.

In March 2009, the IASB issued an ED, Income Tax (ED/2009/2), containing proposals for an IFRS that would replace the current guidance under IAS 12 and its related interpretations. The IASB received a considerable amount of criticism from constituents on the ED, leading the Boards to defer undertaking a fundamental review of the accounting for income taxes until sometime in the future. As an alternative to the proposals contained in the ED, the IASB decided to limit the scope of this project to specific, less controversial practice issues, as outlined below.

Deferred tax on property revaluation

The IASB published ED/2010/11 *Deferred Tax: Recovery of Underlying Assets – Proposed amendments to IAS 12* during September 2010. The ED proposed 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 proposed that the measurement of deferred tax assets and deferred tax liabilities arising from certain assets should reflect the presumption that the carrying amount of the asset will be recovered entirely through sale. The presumption could be rebutted if there is clear evidence that the asset's economic benefits would be consumed throughout its economic life. It was proposed that 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.

At the December 2010 meeting, the Board decided to limit the scope of the exception to investment property measured at fair value. As a result of this limited scope exception, SIC Interpretation 21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets* would be retained, however the scope of the interpretation would be amended to exclude investment property measured at fair value.

The amendment to IAS 12 would be applied retrospectively for annual periods beginning on or after 1 January 2012 with early application permitted. The IASB issued the amendment on 20 December 2010.

Summary of project objectives

The limited project's objective is to address current practice issues that (1) do not require fundamental changes to the current approach on accounting for income taxes under IAS 12 or (2) increase divergence with U.S. GAAP. The staff proposed that the limited project focus, in addition to the deferred tax on property revaluation issue discussed above, on the following areas:

Practice Issues

1. Uncertain tax positions.

Improvements Proposed in the 2009 Exposure Draft

2. Introduction of an initial step to consider whether recovery of an asset or settlement of a liability will affect taxable profit.
3. Recognizing a deferred tax asset in full and an offsetting valuation allowance to the extent necessary.
4. Guidance on assessing the need for a valuation allowance.
5. Guidance on substantive enactment.
6. Allocation of current and deferred taxes within a group that files a consolidated tax return.

In addition to the areas proposed by the staff, the Board suggested adding to the project the issue of what tax rate should be applied (distributed rate versus undistributed rate) for entities such as real estate investment trusts (REITs). This issue was addressed in the March 2009 ED and was generally supported; however, it was not originally recommended by the staff for inclusion in this project because of the operational challenges noted in the comment letters on the ED.

Next Steps

The IASB is expected to wait until after June 2011 to discuss the remaining issues.

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