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DEFERRED TAX: RECOVERY OF UNDERLYING ASSETS, PROPOSED AMENDMENTS TO IAS 12

STATUS
Exposure Draft

EFFECTIVE DATE
To be confirmed

ACCOUNTING IMPACT
Significant changes proposed to the measurement requirements of deferred tax assets/liabilities when investment properties, property, plant and equipment or intangible assets are subject to an accounting policy of revaluation.

Background

The International Accounting Standards Board has published an Exposure Draft (the ED) of proposed amendments to IAS 12 *Income Taxes*.

IAS 12 includes a principle that the measurement of deferred tax assets and liabilities should reflect whether the carrying values of the related assets and liabilities are expected to be recovered through use or sale. This can affect the tax deductible amount and/or the applicable tax rate.

The application of this principle can be difficult or judgemental for assets such as an investment property that is measured at fair value, and is held for the purposes of both earning rental income and capital appreciation. This is because of the subjectivity that often arises in estimating when an investment property is to be sold, which then affects the extent to which the carrying amount of the investment property will be recovered through use (rental income) and through sale (disposal proceeds). Because some tax jurisdictions treat rental income and disposal proceeds differently, there can be a significant effect on the deferred tax calculation.

The issue was addressed in a previous exposure draft issued by the IASB which proposed a replacement for IAS 12. However, there was little support from constituents for the overall proposals set out in that exposure draft and the IASB decided not to continue with them. Instead, it was announced that the IASB and FASB would ultimately carry out a fundamental review of accounting for income tax and in the meantime the IASB would address a number of specific and significant practice issues. The ED sets out proposals to address the first of those issues.

Proposals

Scope

The proposed amendment would apply to the following assets, when measured at fair value:

– Investment property;

– Property, plant and equipment; and

– Intangible assets.

The scope of the amendment has been limited, as the IASB understands that the most significant practice issues arise for those assets and there were concerns about the potential for unintended consequences of widening the scope to include other revalued assets.

The amendment would not apply to assets measured in accordance with an accounting policy of depreciated cost (even if these are measured initially at fair value by an acquirer in a business combination), as the depreciable amount of the assets can be presumed to be recovered through use and the residual value through sale.

Requirements

The proposals set out in the ED are intended to address the concerns set out above by proposing an exception to the principle in IAS 12 that the measurement of deferred tax assets and liabilities should reflect the manner of recovery of the related assets and liabilities. Instead, for those assets within the scope of the amendment, there would be a rebuttable presumption that the carrying amount at each reporting date will be recovered entirely through sale.

The presumption of recovery through sale would only be rebutted where an entity has clear evidence that it will recover the carrying value of the asset throughout its economic life. In such cases, additional disclosures would be required, setting out the reasons for the rebuttal.

Although the focus is on certain revalued assets only, the amendment would cover the measurement of any related deferred tax. This is because the uncertainty and subjectivity of measurement applies to the measurement of the related deferred tax, regardless of whether this is a deferred tax asset or liability.

IAS 12 currently includes guidance to be applied in determining the amount of a deferred tax asset that is to be recognised. This guidance requires an assessment to be carried out of both the extent to which an entity has sufficient taxable temporary differences or probable future taxable profits, and of whether tax planning opportunities are available that will create future taxable profit. This guidance would continue to apply unchanged.

Transition

It is proposed that the amendments would be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. This would include an assessment of the recoverability of previously recorded deferred tax assets, whether because of a reduction in deferred tax liabilities or restrictions on the set off of tax arising from trading profits and from the sale of assets.

The exception would also apply to a first-time adopter of IFRS at its date of transition to IFRS.

Withdrawal of other pronouncements

The amendments would supersede SIC 21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets*.

Comment period

The IASB has requested the submission of comments on its proposals by 9 November 2010.

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