

IAS 12 *Income Taxes*

Deferred tax – tax base of assets and liabilities
Possible narrow-scope standard-setting (slides)

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Recognition of deferred taxes

IAS 12 requires entities to recognise deferred taxes for all **temporary differences**, with few exceptions.

Initial recognition exemption

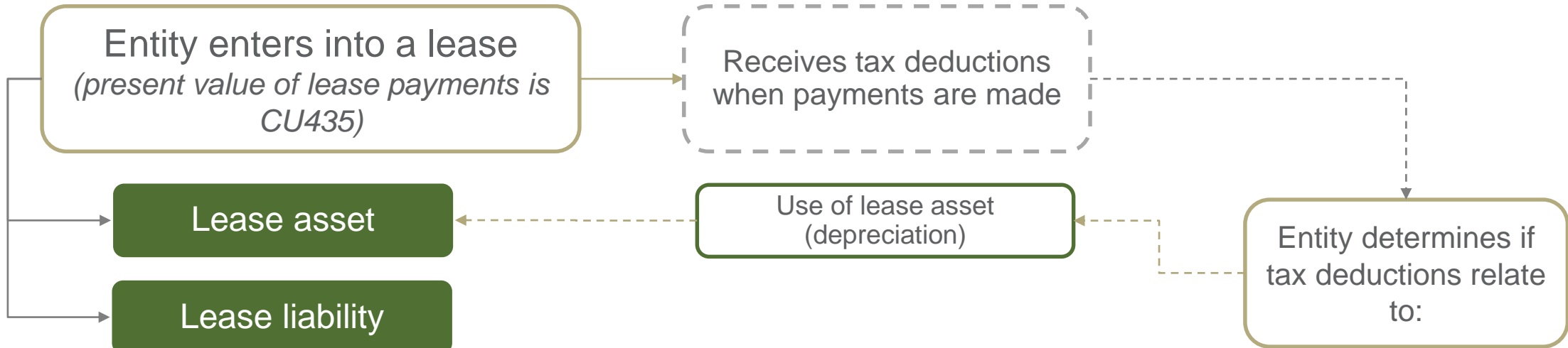
Deferred taxes are not recognised on the initial recognition of an asset (liability) in a transaction which:

- is not a business combination; and
- at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

Temporary differences are calculated by comparing the carrying amount of assets and liabilities with their **tax bases**.

The **tax base** of an asset or liability is the amount attributed to that asset or liability for tax purposes.

Do temporary differences arise?



	Lease asset		Lease liability	
	Carrying amount	Tax Base	Carrying amount	Tax Base
Tax deductions allocated to the lease asset	435	435	435	435

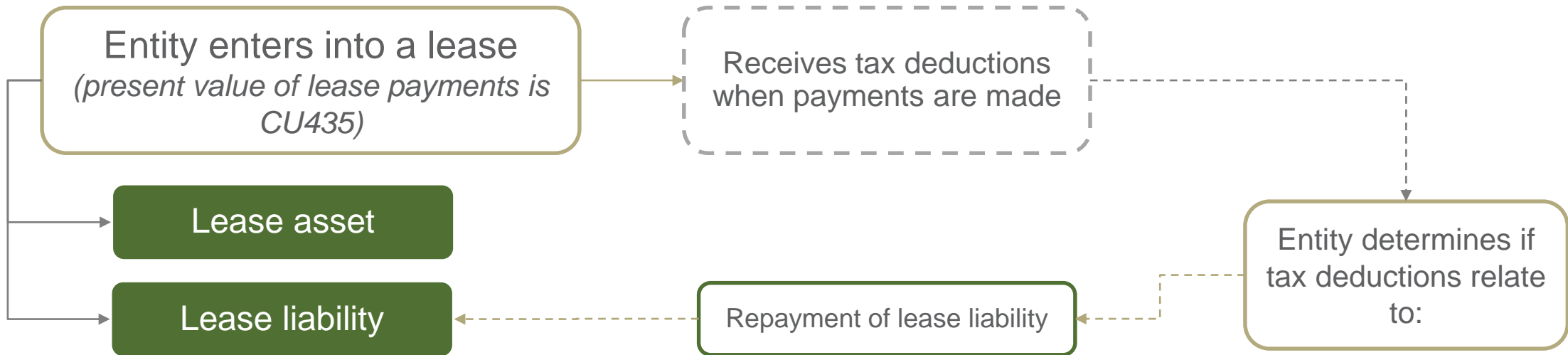
No temporary differences arise

IAS 12, paragraphs 7 and 8

'The tax base of an asset is **the amount that will be deductible for tax purposes** against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset.'

'The tax base of a liability is **its carrying amount, less any amount that will be deductible** for tax purposes in respect of that liability in future periods.'

Do temporary differences arise?



IAS 12, paragraphs 7 and 8

'The tax base of an asset is **the amount that will be deductible for tax purposes** against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset.'

'The tax base of a liability is **its carrying amount, less any amount that will be deductible** for tax purposes in respect of that liability in future periods.'

	Lease asset		Lease liability	
	Carrying amount	Tax Base	Carrying amount	Tax Base
Tax deductions allocated to the lease liability	435	—	435	—

Equal and offsetting temporary differences arise

Should deferred taxes be recognised?

IAS 12, paragraphs 15 and 24

“A deferred tax liability **shall be recognised for all taxable temporary differences**, except to the extent that the deferred tax liability arises from:

- (a) the initial recognition of goodwill; or
- (b) **the initial recognition of an asset or liability in a transaction which:**
 - (i) is not a business combination; and
 - (ii) **at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).**”

(paragraph 24 has similar requirements in relation to deferred tax assets)

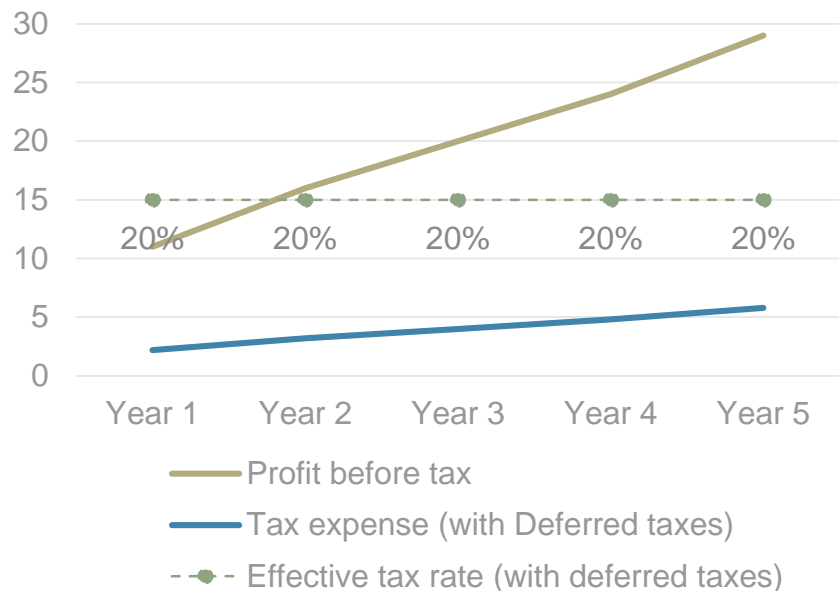
Equal and offsetting temporary differences arise when entities attribute tax deductions to the lease liability.

Initial recognition exemption **applies** to each temporary difference arising on lease commencement.

Therefore, an entity **does not recognise deferred taxes** either on initial recognition or subsequently.

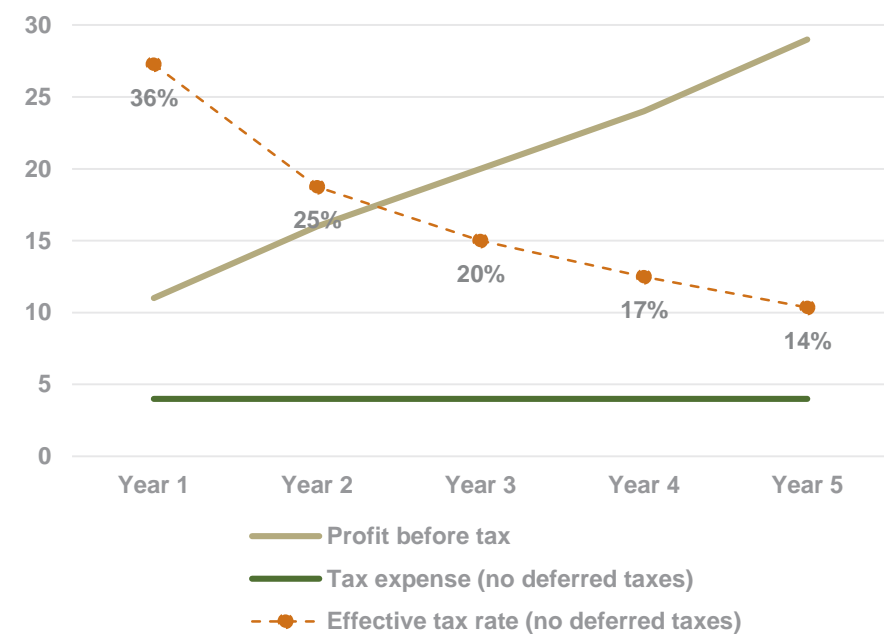
Effects of applying the initial recognition exemption

Deferred taxes are recognised



Reflects tax effects in profit or loss **in line** with the **recovery of the asset** and the **accrual of interest over the lease liability**.

Deferred taxes are not recognised



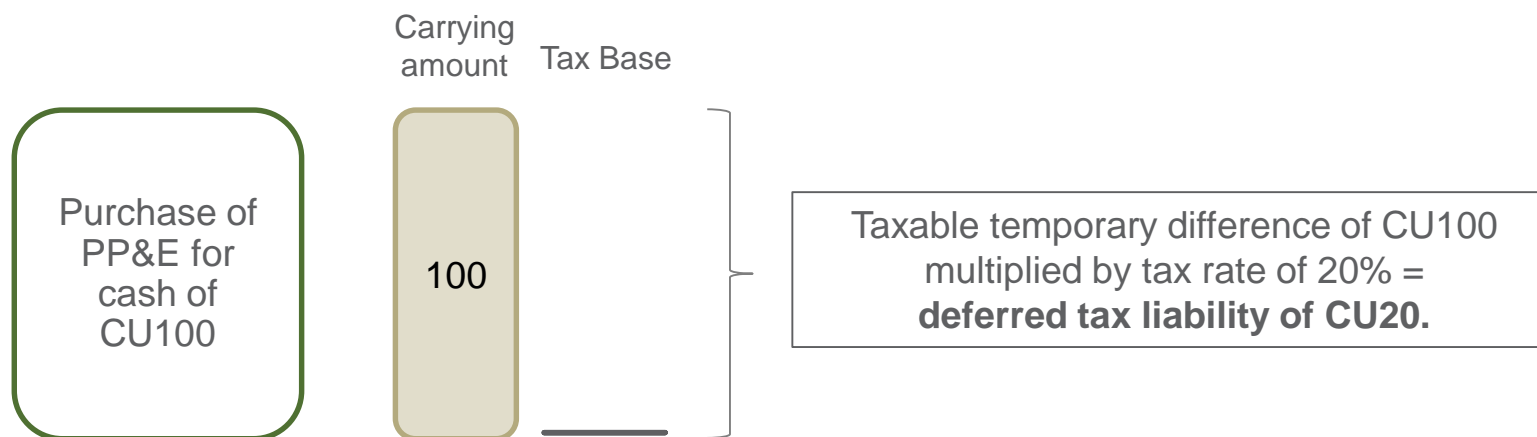
Reflects the tax effects of the transaction in profit or loss as the **tax deductions become available for tax purposes**.

Purpose of the initial recognition exemption

IAS 12, paragraphs 22(c)

“(...) if the transaction is not a business combination, and affects neither accounting profit nor taxable profit, an entity would, in the absence of the exemption provided by paragraphs 15 and 24, recognise the resulting deferred tax liability or asset and **adjust the carrying amount of the asset or liability by the same amount. Such adjustments would make the financial statements less transparent.** Therefore, this Standard does not permit an entity to recognise the resulting deferred tax liability or asset, either on initial recognition or subsequently (see example below).

Example – Purchase of non-deductible PP&E for cash (tax rate 20%)



Journal entries

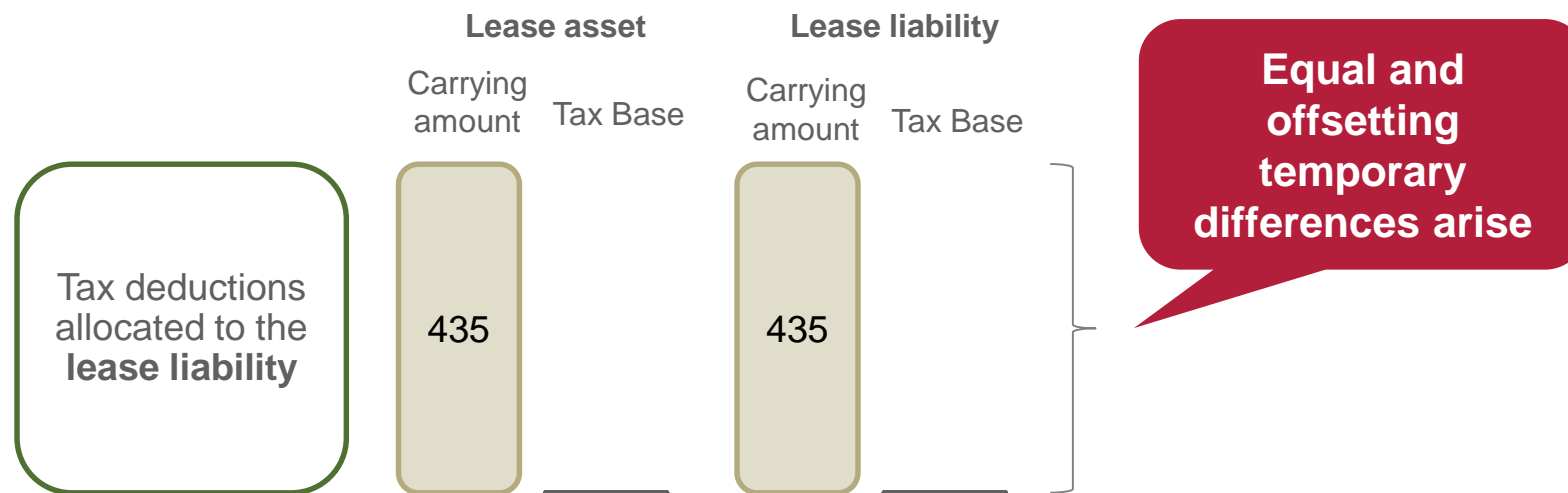
Dr PP&E 100
Cr Cash 100

Dr ???
Cr Deferred tax liability 20



Initial recognition exemption **does not allow** an entity to recognise deferred tax liability.

Is the exemption necessary for leases?



Journal entries

(if deferred taxes were recognised)

Dr	Lease asset	435	
	Cr		Lease liability
			435

Dr	Deferred tax asset	87	
	Cr		Deferred tax income
			87

Dr	Deferred tax expense	87	
	Cr		Deferred tax liability
			87

Journal entries offset. **No effect in profit or loss**, nor it is necessary to adjust carrying amount of related asset or liability.

Deferred tax assets and liabilities would also generally be offset for balance sheet presentation purposes.

The initial recognition exemption **would not apply** to transactions that give rise to **both taxable and deductible temporary differences to the extent** the amounts recognised for the temporary differences **are the same**.

This would result in an entity recognising deferred tax assets and liabilities:

- of the **same amount**; and
- only ***to the extent*** (ie up to the point) the entity would otherwise **recognise deferred tax asset considering the recoverability requirement**.

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