IAS 12 – Income Taxes (March 2017)

Recognition of deferred taxes when acquiring a single-asset entity that is not a business

The Committee received a submission questioning how, in its consolidated financial statements, an entity accounts for a transaction in which it acquires all the shares of another entity that has an investment property as its only asset. In the fact pattern submitted, the acquiree had recognised in its statement of financial position a deferred tax liability arising from measuring the investment property at fair value. The amount paid for the shares is less than the fair value of the investment property because of the associated deferred tax liability. The transaction described in the submission does not meet the definition of a business combination in IFRS 3 Business Combinations because the acquired entity is not a business. The acquiring entity applies the fair value model in IAS 40 Investment Property.

The submitter asked whether the requirements in paragraph 15(b) of IAS 12 permit the acquiring entity to recognise a deferred tax liability on initial recognition of the transaction. If this is not the case, the submitter asked the Committee to consider whether the requirements in paragraph 15(b) of IAS 12 should be amended so that, in these circumstances, the acquiring entity would not recognise a gain on measuring the investment property at fair value immediately after initial recognition of the transaction.

The Committee noted that:

a. because the transaction is not a business combination, paragraph 2(b) of IFRS 3 requires the acquiring entity, in its consolidated financial statements, to allocate the purchase price to the assets acquired and liabilities assumed; and
b. paragraph 15(b) of IAS 12 says that an entity does not recognise a deferred tax liability for taxable temporary differences that arise from the initial recognition of an asset or liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting profit or loss nor taxable profit (tax loss).

Accordingly, on acquisition, the acquiring entity recognises only the investment property and not a deferred tax liability in its consolidated financial statements. The acquiring entity therefore allocates the entire purchase price to the investment property.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to determine how to account for the transaction. The Committee also concluded that any reconsideration of the initial recognition exception in paragraph 15(b) of IAS 12 is something that would require a Board-level project. Consequently, the Committee decided not to add this matter to its standard-setting agenda.

The Committee noted that the Board had recently considered whether to add a project on IAS 12 to the Board’s agenda but had decided not to do so. Consequently, the Committee did not recommend that the Board consider adding a project to its agenda on this topic.