IFRS® Foundation

IAS 12 *Income Taxes*

Deferred tax – tax base of assets and liabilities

Possible narrow-scope standard-setting (slides)

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Recap

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

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.

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).

Do temporary differences arise?

Entity enters into a lease
(present value of lease payments is CU435)

Receives tax deductions when payments are made

Lease asset

Lease liability

Use of lease asset (depreciation)

Entity determines if tax deductions relate to:

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 asset**	435	435	435	435

No temporary differences arise

Do temporary differences arise?

Entity enters into a lease
(present value of lease payments is CU435)

Receives tax deductions when payments are made

Lease asset

Lease liability

Repayment of lease liability

Entity determines if tax deductions relate to:

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.

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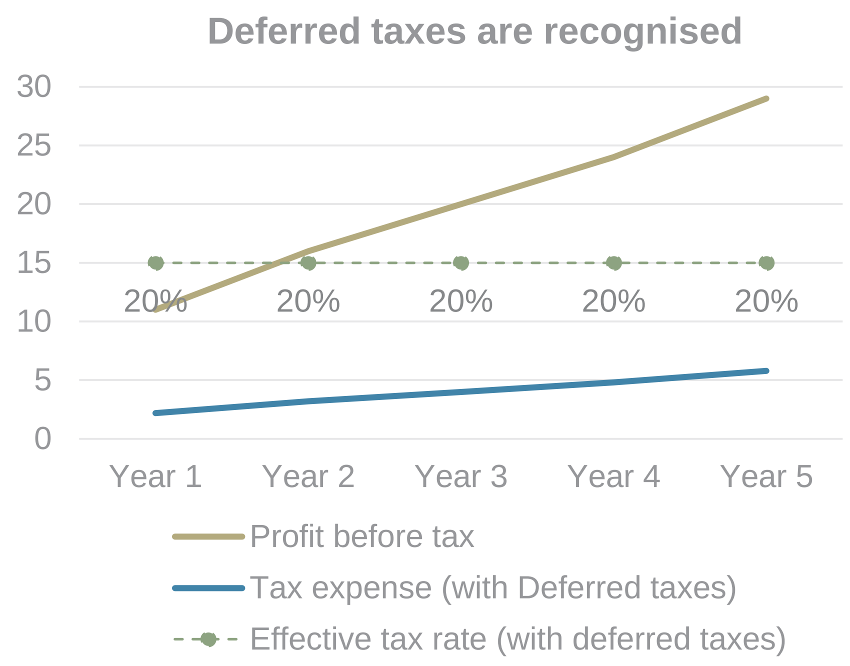
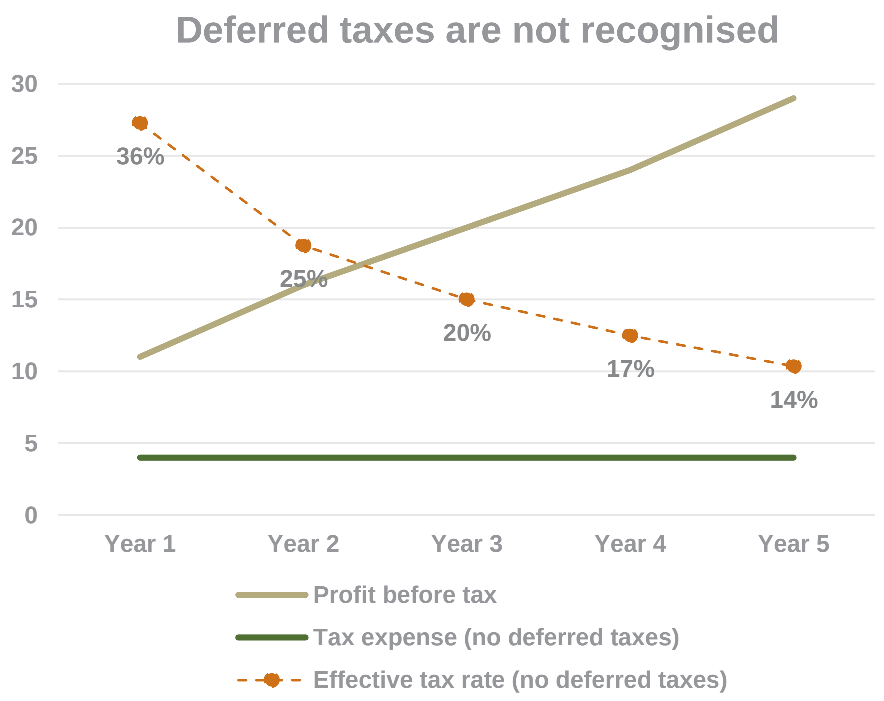
Therefore, an entity **does not recognise deferred taxes** either on initial recognition or subsequently.

Effects of applying the initial recognition exemption



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



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%)

Purchase of PP&E for cash of CU100

Carrying amount

Tax Base

100

Taxable temporary difference of CU100 multiplied by tax rate of 20% = **deferred tax liability of CU20.**

Journal entries

Dr PP&E 100
Cr Cash 100

Dr ???
Cr efer ta iability 20

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

Is the exemption necessary for leases?

	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

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.

Proposed amendment

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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