Project	**Income Tax**
Topic	**Comments received on the pre-ballot draft *Deferred Taxes: Recovery of Underlying Asset***

Purpose of this paper

1. The purpose of this agenda paper is to provide a summary of comments received on the pre-ballot draft of the exposure draft *Deferred Taxes: Recovery of Underlying Asset*.

Summary of staff recommendations

2. The below table summarises the:

   (a) major issues that the staff identified in the feedback received on the pre-ballot draft;

   (b) the approach to these issues in the pre-ballot draft; and

   (c) how the staff recommend these issues are addressed in the ballot draft.

Major issues identified in the feedback	**Proposal in the pre-ballot draft**	**Staff recommendation for ballot draft**
• Shall the exception be applied to deferred tax assets in addition to deferred tax liabilities?	• No.	• Yes.
• What are the implications for SIC 21 *Income taxes – Recovery of Revalued Non-Depreciable Assets* after the amendment?	• Amended to exclude deferred tax liabilities from its scope.	• Superseded by the amendment.
• What shall be the unit of account to apply the exception?	• The temporary difference created by the revaluation of the underlying asset.	• All temporary differences relating to the underlying asset, including those not directly relating to the revaluation.
• How shall deferred taxes be measured when the exception applies?	• Based on the lower tax consequences of sale or use.	• Based on the tax consequence of sale.
• Shall the exception be required?	• Required regardless of entity's intent to use, or sell, the underlying asset.	• Required **unless** an entity will consume the asset's future economic benefit entirely throughout its economic life.

Background information

3. At the July 2010 IASB meeting, the Board discussed deferred taxes on the remeasurement of investment properties at fair value, and tentatively decided to introduce an exception to the measurement principle in paragraph 52 of IAS 12 *Income Taxes*. That principle requires an entity to measure deferred tax consistently with the expected manner of recovery of the underlying asset that generates the deferred tax. When this exception applies, an entity would measure any deferred tax liability in a manner that reflects the tax that the entity will pay if it sells the underlying asset or, if lower, the tax that it will pay if it uses the underlying asset.

4. The Board tentatively decided that the exception should apply for investment properties, property, plant and equipment or intangible assets measured at fair value, using the fair value model in IAS 40 *Investment Property* or the revaluation model in IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*. The exception would also apply for investment properties, property, plant or equipment or intangible assets measured at fair value in a business combination in accordance with IFRS 3 *Business Combinations*.

5. The Board also instructed the staff to prepare an exposure draft addressing this exception described above, so that other issues within the scope of this project do not delay the resolution of this issue.

6. The staff circulated the pre-ballot draft to international accounting firms and national standard setters on 10 August 2010 at the same time when they circulated it to the Board members for their comments. The staff asked for feedback on the proposals in the pre-ballot draft, including any unintended consequences that may occur if the exception is introduced. The staff received feedback on the pre-ballot draft from 11 national standard setters and 7 international accounting firms.

7. Please note that, because the feedback period was short, respondents stated that their feedback might not reflect formal views of the organisation they represented, and might not identify all relevant matters.

8. This paper contains:

   (a) an overview of the major issues raised by constituents including the:

      (i) proposal in the pre-ballot draft;

      (ii) related concerns raised by constituents; and

      (iii) staff recommendations for addressing these concerns.

   (b) the staff recommendations for the next steps in the project;

   (c) questions to the Board;

   (d) Appendix A - an overview of other issues raised by constituents; and

   (e) Appendix B – an alternative approach.

Major issues raised by constituents

Issue 1 – Shall the exception be applied to deferred tax assets in addition to deferred tax liabilities?

Proposals in the pre-ballot draft

9. In the pre-ballot draft, the Board proposed to apply the exception only to taxable temporary differences (deferred tax liabilities) and **not** to deductible temporary differences (deferred tax assets).

Related concerns raised by constituents

10. Constituents noted that it is inconsistent to measure a deferred tax liability based on the proposed exception, and to measure a deferred tax asset based on the expected manner of recovery (in accordance with existing IAS 12 principles).

11. For example, what accounting should be applied when a taxable temporary difference arises if the underlying asset is recovered through sale (eg tax law permits no tax deductions from the sale proceeds), but a deductible temporary difference arises if the underlying asset is recovered through use (eg tax law permits tax depreciation that is greater than depreciation recognised for accounting purposes)?

Staff recommendations for addressing these concerns

12. The staff recommends updating the exposure draft to state that the exception **should apply equally** to taxable temporary differences, (deferred tax liabilities) and deductible temporary differences, (deferred tax assets).

Issue 2 – What are the implications for SIC 21 after the amendment?

Proposals in the pre-ballot draft

13. In the pre-ballot draft, the Board proposed consequential amendments to the scope of SIC 21, proposing that it should apply only to deferred tax assets, and not to deferred tax liabilities, relating to non-depreciable assets that are revalued, or fair valued.

14. As a result, SIC 21 would continue to apply to deferred tax assets relating to revalued, or fair valued, non-depreciable assets, even if the tax consequences of using the underlying asset are lower than the tax consequence of selling the underlying asset.

Related concerns raised by constituents

15. Constituents expressed views that **SIC 21 should continue to be applied consistently** to non-depreciable assets, regardless of whether a deferred tax asset, or a deferred tax liability, arises in relation to the non-depreciable asset.

16. For example, it is inconsistent for a non-depreciable asset to be measured based on recovery through sale, in accordance with SIC 21, in one reporting period, and then to be measured based on recovery through use, in accordance with the proposed exception, in a different reporting period.

Staff recommendations for addressing these concerns

17. The staff recommends updating the exposure draft to reflect the withdrawal of SIC 21 entirely. This is because the scope and consensus in SIC 21 can be incorporated into IAS 12 as part of the proposed amendment (please also see the staff recommendation in Issue 4 to use the ‘presumed sale’ approach rather than the ‘lower’ approach) .

Issue 3 – What shall be the unit of account to apply the exception?

Proposals in the pre-ballot draft

18. In the pre-ballot draft, the Board proposed that the exception should apply only to a temporary difference **created by the revaluation or fair value** of the underlying asset.

Related concerns raised by constituents

19. Constituents suggested that the exception should apply to **all temporary differences relating to the underlying asset,** not just those temporary differences that are created by the revaluation.

20. This is because the unit of account applied in determining the manner of recovery is the underlying asset, not the individual temporary difference.

21. For example, one temporary difference may arise as a result of revaluing an underlying asset at fair value, and a second temporary difference may arise in relation to the same underlying asset as a result of claiming tax depreciation that is different from accounting depreciation.

Staff recommendations for addressing these concerns

22. The staff recommends updating the exposure draft to reflect that the exception should apply to **all temporary differences relating to the underlying asset**, not just those temporary differences that are created by the revaluation.

23. This is because the unit of account applied in determining the manner of recovery in accordance with the principles of IAS 12 is the underlying asset, not the individual temporary difference. The staff also believe this approach is more practical to apply.

Issue 4 – How shall deferred taxes be measured when the exception applies?

Proposal in the pre-ballot draft

24. In the pre-ballot draft, the Board proposed to apply the exception, based on the **lower** tax consequences of sale or use of the underlying asset.

Related concerns raised by constituents

25. Constituents were concerned that the Basis for Conclusions in the pre-ballot draft does not sufficiently explain the Board's **rationale for using the 'lower' approach** rather than an alternative approach.

26. For example, why was a 'lower' rather than 'higher' or 'average' approach proposed?

27. Alternatively, why did the Board preclude the alternative measurement approach, when the entity's expectations of the manner of recovery of the underlying asset are unclear, of the exception requiring an assumption that the underlying asset would be recovered either:

    (a) entirely through sale (consistent with SIC 21); or

    (b) entirely through use?

Staff recommendations for addressing these concerns

28. The staff recommend updating the exposure draft to require that, when the exception is applied, the measurement of deferred tax assets and deferred tax liabilities should reflect the tax consequence that follows if the underlying asset would be recovered **entirely through sale**.

29. This is because measurement based on the tax consequences of sale of the underlying asset:

    (a) can be equally applied when measuring a deferred tax asset or a deferred tax liability.

This is because it avoids concerns of applying a 'lower' of approach to deferred tax assets. For example, should a deferred tax asset be measured based upon the 'lower' of, or 'higher' tax consequences of sale or use in applying the measurement approach included in the pre-ballot draft?

(b) is a practical approach to measuring the deferred taxes than the 'lower' approach (only one calculation is required);

(c) is consistent with the measurement approach applied in SIC 21 and

(d) reflects at least one of the entities' dual intentions (generally sale and use).

Issue 5 – Shall the exception be required?

Proposals in the pre-ballot draft

30. In the pre-ballot draft, the Board proposed to **require** the exception to be applied if a taxable temporary difference relates to an underlying asset that is fair valued or revalued.

Related concerns raised by constituents

31. Constituents raised concerns that the exception **should not be required** to be applied when an entity's intention to sell the underlying asset, or use the underlying asset, is clear.

32. Furthermore, some reviewers noted that in some jurisdictions, practice has developed to measure deferred tax assets and liabilities in these situations using approaches that are different from that proposed in the pre-ballot draft. Consequently, some constituents are concerned that the proposed exception will prohibit entities in those jurisdictions from continuing to use those approaches.

Staff recommendations for addressing these concerns

33. The staff recommend updating the exposure draft to reflect the following approaches to addressing these concerns raised:

(a) The exception should be required based on a **rebuttable presumption** of recovery by sale when an entity chooses its accounting policy to use the fair value model in IAS 40 or the revaluation model in IAS 16 or IAS 38 regardless of how the entity expects to recover the carrying amount of the underlying asset.

(b) Entities may rebut the assumption and measure a deferred tax asset or liability based on a tax consequence of using the asset if an entity has clear evidence to prove that it will consume the asset's future economic benefit entirely throughout its economic life.

(c) The Board should address in the Basis for Conclusions that;

  (i) the Board assumes the recovery of sale when assets are revalued or remeasured because entities choose to use the fair value model in IAS 40 or the revaluation model in IAS 16 or IAS 38 generally when there is a market in which they can sell the asset, and also a possibility that they will sell the asset sometime in the future; however

  (ii) the Board has made this assumption rebuttable because it is aware that sometimes there are other reasons for entities to choose the fair value model or the revaluation model in IAS 40, IAS 16 or IAS 38.

Next steps

34. The staff propose reflecting the Board decisions in a ballot draft and to circulate the revised draft for balloting at the end of August.

Questions to the Board

Questions 1 and 2 for the Board
1. Does the Board agree with the staff recommendations for addressing the major concerns raised by constituents included in this agenda paper? 2. If not, would the Board prefer to apply the alternative approach described by the staff in Appendix B?

Question 3 for the Board
3. Does the Board have any comments on the staff's responses to the other issues included in Appendix A?

Question 4 for the Board
4. Does the Board agree with the next steps to circulate a ballot draft at the end of August?