STAFF PAPER

13–14 March 2012

IFRS Interpretations Committee Meeting

Project	**IAS 12 *Income taxes***		
Paper topic	Supplement—Updates on outreach activity for the issue of accounting for market value uplifts on assets that are to be introduced by a new tax regime		
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Objective and introduction

1. The objective of this Agenda Paper is to provide the IFRS Interpretations Committee (the Committee) with an update on our outreach activity relating to the issue of accounting for market value uplifts on assets, which is discussed in Agenda Paper 9. This paper also includes a staff recommendation to the Committee, which has been updated on the basis of the staff's analysis of the result of the outreach activity.
2. This Agenda Paper includes:

    (a) staff analysis on the result of the outreach;

    (b) agenda criteria and staff recommendation; and

    (c) questions for the Committee.

Updates on the result of outreach

1. As stated in Agenda Paper 9, we asked the following questions in our request for information to the National Standard-Setters Group:

    (a) In your jurisdiction, do you have a similar tax regime with those described above? If similar, but not identical, please tell us about the differences.

(b) *If there is a similar tax regime, what is the prevalent accounting for such type of changes in the tax base of an asset or liability, in particular, the part of the uplift?*

(c) *Based on your response to question (b), would your view be that there is diversity in practice for these types of tax allowances?*

2. The views expressed below are informal feedback from the National Standard-Setters Group. They do not reflect the formal views of the boards of those organisations. The geographical breakdown for the responses is as follows:

Geographical area	**Number of respondents**
South America	0
Asia/Oceania	5
Africa	1
Europe	4
North America	2
Total respondents	**12**

3. Two respondents answered that they are aware of tax regimes in their jurisdictions that might be relevant to this issue.

Case 1

4. One respondent stated that there was a similar issue in its jurisdiction. In the early 1990s, there was a change in tax legislation by which not-for-profit real estate entities in the jurisdiction became subject to an obligation for taxes for the fiscal years of the year of change and thereafter. As compensation for the additional tax burden, the entities affected were allowed to revalue the tax base of the real estate assets at fair value without paying taxes for the tax base adjustments. This tax revaluation generally resulted in deductible temporary differences on the real estate assets.

5. Under the local GAAP of the jurisdiction, those entities had an option not to recognise deferred tax assets for the deductible temporary differences. Under IFRSs, which those entities adopted in 2005, the prevalent accounting policy for

the change in the tax legislation was by applying SIC Interpretation 25 *Income Taxes—Changes in the Tax Status of an Entity or its Shareholders,* under which deferred tax assets were recognised to the extent that they meet the recognition criteria under IAS 12 *Income Taxes*.

Case 2

6. The other respondent informed us of a relevant tax regime in its jurisdiction that allows entities in the mining industry to increase the tax base of certain mining assets by a fixed rate until a specified cut-off point. The increase of the tax base gives rise to deductible temporary differences, even though the situation in this case is not similar to that in the submissions, because the temporary differences do not arise from a change in the tax legislation.
7. The respondent stated that the prevalent accounting for the increase of the tax base is by applying the requirement in paragraph 65 of IAS 12, which results in recognising deferred tax assets to the extent they meet the recognition criteria. Paragraph 65 of IAS 12 states (emphasis added):

    65 When an asset is revalued for tax purposes and that revaluation is related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects of both the asset revaluation and the adjustment of the tax base are recognised in other comprehensive income in the periods in which they occur. <u>However, if the revaluation for tax purposes is not related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects of the adjustment of the tax base are recognised in profit or loss.</u>

Agenda criteria and staff recommendation

8. In this section, we assesses the submission against the agenda criteria of the Committee as follows:

    (a) *The issue is widespread and has practical relevance.*

(b) *The issue indicates that there are significant divergent interpretations (either emerging or existing in practice).*

(c) *Financial reporting would be improved through the elimination of the diverse reporting methods.*

(d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.*

(e) *It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.*

(f) *If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?*

9. As indicated in the outreach result, this issue is relevant in at least three jurisdictions, including Australia. Even though the situation reported in Case 2 is not similar to the situation in the submissions, we think that we should consider the issue in Case 2 to be a related issue, in that the change in future tax reductions arises from tax revaluations of assets permitted or required by a tax regime. In this regard, the issue related to the recognition of deferred tax assets for an increase in future tax benefits stemming from tax revaluations, which will arise from recovering the carrying amount of the assets, is widespread and relevant regardless of whether the increase in future tax benefits arises from a change in a tax regime. Consequently, we think that this issue meets criterion (a).
10. With regard to criterion (b), the two cases refer to different accounting standards to determine whether an entity needs to recognise deferred tax assets for the changes in future tax benefits. Nevertheless, we do not think that significant divergence in the accounting for a change in future tax benefits arising from tax rules exists or is expected to emerge in the future.
11. SIC-25 is an interpretation of IAS 12 that addresses the specific situation under which there are changes in the tax status of an entity or its shareholders under a tax regime. Under SIC-25, if a change in the tax status of an entity or its shareholders has an effect on the future tax benefits that will arise from recovering the carrying amount of assets, the entity is required to recognise changes in the amount of the deferred tax assets. We think that SIC-25 bases its interpretation on

a principle that the effect of the change in tax status should be treated as adjustments to the tax base of the related assets, which is defined as "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" (paragraph 7 of IAS 12). Consequently, the underlying principle in SIC-25, which relates to the accounting for a change in future tax benefits, is consistent with the principle in IAS 12.

12. We do not expect significant divergent accounting practices in this area to emerge in the future because, in our view, the principle and the scope of exceptions to the principle in the existing IFRSs relating to the accounting for the effect of a change in future tax benefits that will arise from recovering the carrying amount of assets are clear and are employed consistently in the existing IFRSs. This is supported by the results of the outreach, which indicated that those entities in both jurisdictions accounted for the changes in future tax consequences in the same manner, which is consistent with the principle under IAS 12.
13. In addition, whether an entity applies SIC-25 to changes in future tax benefits requires judgement, taking into account all facts and circumstances available to the entity. The information provided by the respondents indicates that the facts and circumstances in the two cases are different. Thus, we think that the fact that the standard applied in Case 1 is different from the standard applied in Case 2 does not necessarily mean that there is significant divergence in accounting policies employed by entities.
14. Accordingly, we are of the view that this issue does not meet the Committee agenda criteria because criterion (b) is not met.
15. On the basis of the analysis above, if the Committee agrees with our technical analysis as shown in paragraph 23-38 of Agenda Paper 9, we recommend that the Committee should not take this issue onto its agenda because this issue does not meet the Committee agenda criteria. We have included draft rejection wording in Appendix A to this paper.

Questions for the Committee

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1. Does the Committee agree with the staff recommendation not to take this issue onto its agenda? 2. If the Committee agrees with the staff recommendation, does the Committee agree with the proposed rejection wording in Appendix A?

Appendix A—Proposed wording for tentative agenda decision

The staff propose the following wording for the tentative agenda decision:

IAS 12 Income Taxes—Accounting for market value uplifts on assets that are to be introduced by a new tax regime

The IFRS Interpretations Committee (the Committee) received a request to clarify the accounting for market value uplifts on certain assets that are to be introduced in the same proposed tax regime as the one described in *IAS 1 Presentation of Financial Statements and IAS 12 Income Taxes— Presentation of payments of non-income taxes*.

In calculating taxable profit for income taxes under the proposed tax regime, entities are allowed to deduct 'starting base allowance' against taxable profit, which represents the annual tax depreciation of the underlying assets of a mining project. The entities have an option to revalue the assets at market value for the calculation of the amount of the starting base allowance (ie, annual tax depreciation).

The Committee deliberated three alternative views for the accounting for the market value uplifts which are proposed in the submissions:

- View 1: Adjustment to the tax base
- View 2: Tax holiday
- View 3: Initial recognition exception.

The Committee noted that the amount of the starting base allowance, including the part that is attributable to market value uplifts, is attributed to the related asset under the tax regime and will become the basis for depreciation expense for tax purposes; and therefore, the market value uplifts meet the definition of 'tax base' in IAS 12. Accordingly the Committee noted that deferred tax should be recognised in respect of the temporary difference that arises as a result of the adjustment to the tax base. The Committee observed that the accounting under View 2 would result in neglecting the fact that the future tax benefits depend on taxable profit of the entity in future periods. With regard to View 3, the Committee noted that the situation under which the initial recognition exception is allowed in paragraph 24 of IAS 12 is not similar to the situation in this issue. Accordingly, it is inappropriate to apply the exception, by analogy, to the market value uplifts in this issue.

On the basis of the above, the Committee noted that existing IFRSs have sufficient guidance on this issue and does not expect significant diversity to arise in practice. Consequently, the Committee [decided] not to add this issue to its agenda.

Appendix B—Extract from SIC 25

Issue

1 A change in the tax status of an entity or of its shareholders may have consequences for an entity by increasing or decreasing its tax liabilities or assets. This may, for example, occur upon the public listing of an entity's equity instruments or upon the restructuring of an entity's equity. It may also occur upon a controlling shareholder's move to a foreign country. As a result of such an event, an entity may be taxed differently; it may for example gain or lose tax incentives or become subject to a different rate of tax in the future.

2 A change in the tax status of an entity or its shareholders may have an immediate effect on the entity's current tax liabilities or assets. The change may also increase or decrease the deferred tax liabilities and assets recognised by the entity, depending on the effect the change in tax status has on the tax consequences that will arise from recovering or settling the carrying amount of the entity's assets and liabilities.

3 The issue is how an entity should account for the tax consequences of a change in its tax status or that of its shareholders.

Consensus

4 A change in the tax status of an entity or its shareholders does not give rise to increases or decreases in amounts recognised outside profit or loss. The current and deferred tax consequences of a change in tax status shall be included in profit or loss for the period, unless those consequences relate to transactions and events that result, in the same or a different period, in a direct credit or charge to the recognised amount of equity or in amounts recognised in other comprehensive income. Those tax consequences that relate to changes in the recognised amount of equity, in the same or a different period (not included in profit or loss), shall be charged or credited directly to equity. Those tax consequences that relate to amounts recognised in other comprehensive income shall be recognised in other comprehensive income.

Date of consensus

August 1999

Effective date

This consensus becomes effective on 15 July 2000. Changes in accounting policies shall be accounted for in accordance with IAS 8.

IAS 1 (as revised in 2007) amended the terminology used throughout IFRSs. In addition it amended paragraph 4. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies IAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.