

STAFF PAPER

15–16 May 2012

IFRS Interpretations Committee Meeting

IFRS IC meetings: Sep and Nov 2011

Project	Annual Improvements—2011-2013 cycle
Paper topic	IAS 12 <i>Income Taxes</i> —Recognition of deferred tax for a single asset in a corporate entity
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*. The approval of a final Interpretation by the Board is reported in *IASB Update*.

Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to clarify the accounting for deferred tax in the consolidated financial statements of the parent, when the subsidiary has only one single asset within it (the asset inside) and the parent expects to recover the carrying amount of the asset inside by selling the shares in the subsidiary (the shares).
2. The Committee noted significant diversity in practice in accounting for deferred tax when tax law attributes separate tax bases to the asset inside and the parent's investment in the shares and each tax base is separately deductible for tax purposes (ie tax law considers the asset inside and the parent's investment in the shares to be two separate assets):
 - (a) some follow the tax perspective and recognise deferred tax related to both the asset inside and the shares;
 - (b) others recognise only the deferred tax related to the shares.
 - (c) A third group of preparers determines deferred tax by comparing the carrying amount (in the consolidated financial statements) of the asset inside with the tax base of the shares and using the tax rate that applies if the parent recovers the carrying amount of the shares.

3. The Committee discussed the issue in the November 2011 meeting and noted that the current IAS 12 requires the parent to recognise both the deferred tax related to the asset inside and the deferred tax related to the shares, if tax law considers the asset inside and the shares to be two separate assets.
4. Because there is significant diversity in practice, the Committee directed the staff to assess whether this issue could be clarified through an annual improvement.

Structure of this paper

5. The objective of the paper is not to re-analyse the issue. This analysis was done by the Committee in its meetings in September and November 2011. The objective of this paper is solely to work out the most straightforward amendment that clarifies the current requirements and thereby removes the current diversity in practice.
6. In order to do so, this paper considers the views that diverge from the Committee's view (divergent views) and analyses where some read current IAS 12 in a way that results in them not recognising the deferred tax both on the asset inside and on the shares.
7. Accordingly, we compare in the following paragraphs:
 - (a) the reading of current IAS 12 by proponents of divergent views (*Divergent reading of IAS 12 observed in practice*) (see paragraphs 11, 13, 14 and 18); and
 - (b) the requirements of current IAS 12 noted by the Committee in its meetings in September and November 2011 (*Current IAS 12*) (see paragraphs 12, 15-17 and 19).
8. Based on this comparison we develop in paragraphs 20-26 a recommendation for a proposed amendment to IAS 12 that clarifies current requirements, before we:
 - (a) address transition and consequential amendments of a proposed amendment to IAS 12 (see paragraphs 27-29);
 - (b) give an update on the comment letter analysis (see paragraphs 30-34);

- (c) assess the proposed amendment against the annual improvement criteria (see paragraphs 35-36); and
 - (d) make a recommendation to the Committee (see paragraph 37).
9. We reproduce for ease of reference in Appendix C the paragraphs from IAS 12 that we make reference to in our following analysis of the divergent views.

Analysis of divergent readings

10. We identified divergent readings of IAS 12 observed in practice on the following three issues:
- (a) Inside/outside perspective for single-asset entities;
 - (b) Expected manner of recovery;
 - (c) Faithful representation.

Inside/outside perspective for single-asset entities

Divergent reading of IAS 12 observed in practice

11. Paragraphs 11 and 38 of IAS 12 make a general distinction between temporary differences within the subsidiary related to its assets and liabilities (sometimes referred to as ‘inside temporary differences’) and temporary differences related to the parent’s investment in the shares of the subsidiary (sometimes referred to as ‘outside temporary differences’). Some understand from IAS 12 that this distinction is not applicable for a subsidiary that has only one single asset within it (a single-asset entity) because they think it is not appropriate in such cases for the following two reasons:
- (a) The general distinction between temporary differences within the subsidiary related to its assets and liabilities and temporary differences related to the parent’s investment in the shares of the subsidiary was written within the context of a ‘normal’ trading subsidiary, whose activity constitutes a business. For such subsidiaries, the general distinction fits because it is appropriate to assume that the carrying

amount of an asset held by a ‘normal’ trading subsidiary will be recovered directly by that subsidiary, rather than indirectly through the disposal of that subsidiary by the parent. However, proponents of this view believe it is not appropriate to make that assumption in the case of a single-asset entity whose main, if not sole, *raison d’être* is to allow the parent to make the asset inside transferable by disposing of the shares in the subsidiary rather than the asset itself.

- (b) The tax consequences of recovering the carrying amount of the shares in the subsidiary cannot, in most cases, be allocated to specific assets and liabilities in the subsidiary, if the subsidiary constitutes a business with several assets and liabilities. This is different for subsidiaries that are single-asset entities.

Current IAS 12

- 12. The current IAS 12 does not consider whether the distinction between inside temporary differences and outside temporary differences is appropriate for specific scenarios. Paragraphs 11 and 38 of IAS 12 require a one-size-fits-all approach, if tax law distinguishes between the assets and liabilities in the subsidiary and the shares in the subsidiary. This includes single-asset entities, even if it is market practice in a specific jurisdiction that specific assets are purchased and sold by transferring the shares in the subsidiary.

Expected manner of recovery

Divergent reading of IAS 12 observed in practice

- 13. Paragraphs 51 and 51A of IAS 12 require an entity to take into consideration the expected manner of recovery of the carrying amount of an asset when determining the applicable tax rate and the tax base of an asset.
- 14. On the basis of this principle, we observed the following two divergent readings of IAS 12 in practice:
 - (a) When the parent expects to recover the carrying amount of the asset inside by selling the shares in the single-asset entity, one divergent

reading of IAS 12 is that one amount of deferred tax is calculated that combines the carrying amount of the asset inside in the consolidated financial statements of the parent with the tax base of the shares. In such cases, the amount that will be deductible on the sale of the shares for tax purposes replaces the amount that will be deductible on the recovery of the carrying amount of the asset inside for tax purposes as the tax base of the asset inside. The rate at which the sale of the shares is taxed is the applicable tax rate.

- (b) When the parent expects to recover the carrying amount of the asset inside by selling the shares in the single-asset entity, only the deferred tax related to the shares is recognised. No deferred tax related to the asset inside is recognised.

Current IAS 12

- 15. Paragraphs 51 and 51A of current IAS 12 require an entity in measuring deferred tax to take into consideration the expected manner of recovery in determining the applicable tax rate, or the tax base, if tax law makes reference to the manner of recovery.
- 16. Paragraphs 51 and 51A of current IAS 12 do not, however, over-ride:
 - (a) the general distinction between inside temporary differences and outside temporary differences, if tax law makes this distinction (see paragraphs 11 and 38 of IAS 12); or
 - (b) the inherent assumption in accounting for deferred tax that is the carrying amount of all assets is recovered (see *Objective* of IAS 12 and paragraph 16 of IAS 12).
- 17. In other words, an entity measures deferred tax based on the assumption that it recovers the carrying amount of both the asset inside and the shares. If, in this situation, tax law refers to the manner of recovery, the entity measures deferred tax using the tax rate and the tax base that result from the entity's expectation of the manner of recovery. An entity cannot, however:

- (a) omit the recognition of deferred tax based on the expectation that it will not recover the carrying amount of the asset; or
- (b) merge the inside temporary difference and the outside temporary difference, in a manner contrary to tax law.

Faithful representation

Divergent reading of IAS 12 observed in practice

18. Some think that IAS 12 does not require to recognise a deferred tax liability related to the asset inside, if the parent or the subsidiary will definitely never take any action that will require it to pay the tax for which the deferred tax liability would be recognised. Otherwise, the accounting would not faithfully represent the underlying commercial reality.

Current IAS 12

19. Current IAS 12 requires an entity to account for deferred tax based on the inherent assumption that is the carrying amount of all assets is recovered (see the *Objective* of IAS 12 and paragraph 16 of IAS 12). Consequently, the expectation of whether the carrying amount of an asset will be recovered or not does not affect the recognition of deferred tax.

Proposed amendment

Conclusions from analysis of divergent readings of IAS 12 observed in practice

20. Analysing the divergent readings of IAS 12 that we observed in practice and why they come to a different conclusion, we think that the relevant guidance in IAS 12 is clear with one exception:
21. Paragraphs 51 and 51A are not crystal clear on the facts that:
- (a) the expected manner of recovery of the carrying amount of an asset (or the expected manner of settlement of the carrying amount of a liability) affects either or both the applicable tax rate or the tax base of the asset

(or liability) only if tax law specifies different tax rates or tax bases depending on the manner of recovery (or settlement); and

- (b) paragraphs 51 and 51A do not over-ride:
 - (i) the general distinction between inside temporary differences and outside temporary differences, if tax law distinguishes between the asset inside and the shares in the subsidiary (see paragraphs 11 and 38 of IAS 12); and
 - (ii) the inherent assumption in accounting for deferred tax that is the carrying amount of all assets is recovered (see the *Objective* of IAS 12 and paragraph 16 of IAS 12).

- 22. Accordingly, we propose to amend paragraph 51 A of IAS 12 to provide clarification.
- 23. With this amendment, we think the principles are clearly expressed in IAS 12. However, we think that part of the reason why there is significant diversity in practice is due to the fact that the relevant guidance is spread all over IAS 12.
- 24. Consequently, we propose to illustrate the application of these principles by using an example of a subsidiary that has only one single asset in it. Given that the issue is most prevalent in the investment property sector, we recommend an example of an entity that has one investment property in it.
- 25. Considering the significance of the diversity in practice, we understand that this guidance should be mandatory in nature, ie application guidance rather than implementation guidance.
- 26. We recommend that this application guidance should follow paragraph 38 of IAS 12, because:
 - (a) application guidance is, in the case of IAS 12, included in the main body of the standard; and
 - (b) paragraph 38 of IAS 12 explains the inside/outside perspective for investments in subsidiaries.

Transition

27. We do not think that any transition relief is necessary, because we do not foresee any difficulty in applying the amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Consequential amendments

28. We reviewed other IFRSs for possible consequences of the proposed amendment. We have not identified any consequential amendments that would be triggered by the amendment proposed in this paper.
29. Specifically, we think that no consequential amendment is needed to IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

Update on comment letter analysis

30. After the discussion of the issue in the November 2011 Committee meeting, we received another comment letter on the issue.
31. The commentator¹ highlights that in many parts of the world, it is not uncommon for entities to hold investment properties through corporate wrappers to achieve tax efficiency on the eventual disposal of the investment properties. The application of the tentative decision would therefore result in the recognition of deferred tax liabilities that the commentator states will never materialise.
32. The commentator believes that such accounting may fail to reflect the underlying commercial reality of these transactions and result in financial information that is not useful for making economic decisions. The commentator therefore thinks that the determination should reflect the expected manner of recovery of the carrying amount of an asset. The commentator bases that view on paragraphs 47 and 51 of IAS 12.
33. We understand that the commentator supports the views presented in paragraphs 13, 14 and 18 above.

¹ CapitaLand

34. Consequently, we think that the commentator’s concerns were already included in the Committee’s previous discussions.

Annual improvements criteria assessment

35. We assessed the potential amendment to IAS 12, whose aim is to clarify the accounting for deferred tax related to a subsidiary with only one asset in it, against the annual improvement criteria. The assessment is reproduced in full in Appendix B to this paper.
36. On the basis of the assessment, we recommend to the Committee that the proposed amendment should be made through Annual Improvements.

Staff recommendation

37. Considering the results from the Committee’s discussions at its September 2011 and November 2011 meetings, and our analysis of the divergent technical views observed in practice, we think that the Committee should recommend to the Board that the amendment proposed in Appendix A of this paper should be included in the 2011-2013 Annual improvements cycle.

Questions to the IFRS Interpretations Committee

Questions—proposed amendment to IAS 12

1. Does the Committee agree to recommend to the Board that it should amend IAS 12 to clarify the determination of deferred tax assets and deferred tax liabilities in consolidated financial statements?
2. Does the Committee agree to recommend to the Board that no transition relief and consequential amendments to other IFRSs are needed?
3. Does the Committee agree to recommend to the Board that it should adopt the text of the proposed amendment as shown in Appendix A? If not, what changes should be made?

Appendix A—Proposed wording for Annual Improvements

The proposed amendment to IAS 12 is presented below.

Amendment to IAS 12 *Income Taxes*

Paragraph 51A is amended (new text is underlined and deleted text is struck through).
 Paragraph 38A and the example following paragraph 38A and paragraph 98C are added.
 Paragraphs 38 and 51 have been included for ease of reference but are not proposed for amendment.

Investments in subsidiaries, branches and associates and interests in joint arrangements

38 Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint arrangements (namely the parent or investor's share of the net assets of the subsidiary, branch, associate or investee, including the carrying amount of goodwill) becomes different from the base (which is often cost) of the investment or interest. Such differences may arise in a number of different circumstances, for example:

- (a) the existence of undistributed profits of subsidiaries, branches, associates and joint arrangements;
- (b) changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and
- (c) a reduction in the carrying amount of an investment in an associate to its recoverable amount.

In consolidated financial statements, the temporary difference may be different from the temporary difference associated with that investment in the parent's separate financial statements if the parent carries the investment in its separate financial statements at cost or revalued amount.

38A These temporary differences associated with the carrying amount of investments in subsidiaries, branches and associates or interests in joint arrangements are in addition to the temporary differences related to the assets and liabilities held by those subsidiaries, branches and associates or joint arrangements, if tax law distinguishes both sets of assets and liabilities. This standard requires an entity to recognise deferred tax assets and deferred tax liabilities on both sets of temporary differences, unless a specific exception applies.

Example

Parent A holds all the shares in Subsidiary B, whose sole asset is an investment property. Subsidiary B does not constitute a business and has no other assets or liabilities. Parent A uses the fair value model in IAS 40 *Investment Property* to measure the investment property in its consolidated financial statements. The carrying amount of the investment property in the consolidated financial statements of Parent A is CU300¹. The share of Parent A in the net assets of Subsidiary B is CU300 as well.

Parent A and Subsidiary B file separate tax returns. When the carrying amount of the investment property is recovered, an amount of CU200 will be deductible in the tax return of Subsidiary B. When Parent A recovers the carrying amount of its investment in Subsidiary B, an amount of CU100 will be deductible in the tax return of Parent A.

The tax rate that applies to the taxable income of Subsidiary B is 30 per cent, whereas a tax rate of 10 per cent applies to capital gains of Parent A. Parent A expects to sell the shares in Subsidiary B in the foreseeable future.

The tax base of the investment property is CU200 because Subsidiary B will deduct that amount in its separate tax filing if it recovers the carrying amount of the investment property. The taxable temporary difference relating to the investment property is CU100 (CU300-CU 200). The resulting deferred tax liability is measured applying the tax rate of 30 per cent applicable to the taxable income of Subsidiary B.

The tax base of Parent A's investment in Subsidiary B is CU100 because parent A will deduct that amount in its separate tax filing if it recovers the carrying amount of the investment by selling the investment (see paragraph 11). The taxable temporary difference relating to the investment in Subsidiary B is CU 200 (CU300-CU100). The deferred tax liability relating to the investment in Subsidiary B is measured at the tax rate applicable to capital gains of Parent A, which is 10 per cent.

The tax base of the investment property in the consolidated financial statements is CU200 and the tax rate applicable for measuring the deferred tax liability relating to the investment property is 30 per cent, even if it is common in the jurisdiction where the investment property is located to buy or sell investment property by buying or selling the shares in the entity that holds the investment property and even if Parent A expects to recover the carrying amount of the investment property by selling its shares in Subsidiary B.

Thus, Parent A recognises in its consolidated financial statements a deferred tax liability of CU30 relating to the investment property held by Subsidiary B and a deferred tax liability of CU20 relating to the investment in Subsidiary B.

Parent A recognises the deferred tax liability relating to the investment property, regardless of whether it expects to recover the carrying amount of the investment property in the foreseeable future. It is inherent in the recognition of an asset that its carrying amount will be recovered in the form of economic benefits that flow to the entity in future periods (see paragraph 16).

Parent A recognises the deferred tax liability relating to its investment in Subsidiary B, because it is probable that the temporary difference relating to the investment in Subsidiary B will reverse in the foreseeable future (see paragraph 39).

¹ In this example, monetary amounts are denominated in “currency units (CU)”.

[...]

Measurement

[...]

51 The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of the assets and liabilities.

51A In some jurisdictions, the manner in which an entity recovers (settles) the carrying amount of an asset (liability) may affect either or both of:

- (a) the tax rate applicable when the entity recovers (settles) the carrying amount of the asset (liability); and
- (b) the tax base of the asset (liability).

If applicable tax law determines the tax rate applicable or the tax base by reference to the manner of recovery (settlement) of the carrying amount of an asset (a liability) in such cases, an entity measures deferred tax liabilities and deferred tax assets using the tax rate applicable and the tax base consistent with the expected manner of recovery or settlement. The expected manner of recovery (settlement) of the carrying amount of an asset (a liability) does not over-ride:

- (a) the distinction between:
 - (i) temporary differences associated with the carrying amount of investments in subsidiaries, branches and associates or interests in joint arrangements, and
 - (ii) temporary differences associated with assets and liabilities held by those subsidiaries, branches, associates or joint arrangements (see paragraph 38A); nor
- (b) the inherent assumption of IAS 12 that an entity will recover the carrying amount of its assets and settle the carrying amount of its liabilities.

[...]

Effective date

[...]

98C *Improvements to IFRSs* issued in [date] amended paragraph 51A and added paragraph 38A and the example following paragraph 38A. An entity shall apply those amendments for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact.

Basis for Conclusions on proposed amendment to IAS 12 Income Taxes

This Basis for Conclusions accompanies, but is not part of, the proposed amendment

Recognition of deferred tax for a single asset in a corporate entity

- BC1 The IFRS Interpretations Committee (the Committee) reported to the Board that there was diversity in practice in determining deferred tax in circumstances in which:
- (a) an entity holds a subsidiary that has a single asset within it;
 - (b) the parent and the subsidiary file separate tax returns; and
 - (c) the parent expects to recover the carrying amount of the asset within the subsidiary by selling the shares in the subsidiary.
- BC2 When presenting consolidated financial statements, some follow the approach taken by the tax law and recognise deferred tax related to both the single asset within the subsidiary and the shares in the subsidiary. Others recognise only the deferred tax related to the shares in the subsidiary.
- BC3 A third group determines deferred tax by comparing the carrying amount (in the consolidated financial statements) of the asset within the subsidiary with the tax base of shares and using the tax rate that applies if the parent recovers the carrying amount of the shares.
- BC4 The Board considered the guidance in IAS 12 on the determination of deferred tax assets and deferred tax liabilities in consolidated financial statements. The Board noted that paragraphs 11 and 38 require the recognition of deferred tax related to both the shares in the subsidiary and the assets and liabilities held by the subsidiary, if tax law distinguishes between both sets of assets and liabilities. The fact that the subsidiary has only one asset within it does not change that conclusion. The Board proposes to add paragraph 38A and the example following paragraph 38A to clarify this.
- BC5 The Board also noted that paragraphs 51 and 51A do not over-ride:
- (a) the general distinction between deferred tax related to the shares in the subsidiary and deferred tax related to the assets and liabilities held by the subsidiary, if tax law distinguishes between the shares in the subsidiary and the assets and liabilities held by the subsidiary; and
 - (b) the inherent assumption in accounting for deferred tax assets and deferred tax liabilities that is the carrying amount of an asset is recovered (see the *Objective* of IAS 12 and paragraph 16).
- BC6 Consequently, if tax law distinguishes between the shares in the subsidiary and the assets and liabilities held by the subsidiary then management's expectation of the manner of recovery does not affect the distinction between deferred tax related to both sets of assets and liabilities. The Board proposes to amend paragraph 51A to clarify this.
- BC6 As a result, if a subsidiary has a single asset within it, the parent must in its consolidated financial statements recognise deferred tax assets and deferred tax liabilities arising from any temporary differences associated with the single asset held within the subsidiary and deferred tax assets and deferred tax liabilities arising from temporary differences associated with the parent's shares in the subsidiary. The only exception is when tax law does not distinguish between the investment in the subsidiary and the assets and liabilities held by the subsidiary, eg if the parent files consolidated tax returns.

Appendix B—Annual Improvements assessment criteria

B1. In planning whether an issue should be addressed by amending IFRSs within the annual improvements project, the IASB assesses the issue against certain criteria. All the criteria (a)-(d) must be met to qualify for inclusion in annual improvements. We have assessed the proposed amendment against the enhanced annual improvements criteria, which are reproduced in full below:

Annual improvements criteria	Staff assessment of the proposed amendment
<p>(a) The proposed amendment has one or both of the following characteristics:</p> <p>(i) clarifying—the proposed amendment would improve IFRSs by:</p> <ul style="list-style-type: none"> • clarifying unclear wording in existing IFRSs, or • providing guidance where an absence of guidance is causing concern. <p>A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle.</p> <p>(ii) correcting—the proposed amendment would improve IFRSs by:</p> <ul style="list-style-type: none"> • resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirements should be applied, or • addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs. <p>A correcting amendment does not propose a new principle or a change to an existing principle, but may create an exception from an existing principle.</p>	<p>(a) Yes. The proposed amendment clarifies the determination of deferred tax in consolidated financial statements in the case of ‘single-asset’ entities. The clarifying amendment maintains consistency with the existing principles in IAS 12 in accounting for deferred tax assets and deferred tax liabilities in consolidated financial statements.</p>

Annual improvements criteria	Staff assessment of the proposed amendment
(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.	(b) Yes. We believe that the proposed amendment is well defined and is sufficiently narrow in scope such that the consequences of the proposed change have been considered—it contributes to consistent accounting for deferred taxes in consolidated financial statements, in particular in the investment property sector.
(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.	(c) Yes. We think that the IASB will reach a conclusion on this issue on a timely basis, because it aligns with the existing principles in IAS 12 for the accounting for deferred tax assets and deferred liabilities in consolidated financial statements.
(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.	(d) Yes. There is no current or planned IASB project on income taxes. Income taxes is only a possible project for the Board’s future agenda.

Appendix C—relevant IFRS literature

Extracts from IAS 12 *Income Taxes*

Objective

- 5 The objective of this Standard is to prescribe the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of:
- (a) the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's statement of financial position; and
 - (b) transactions and other events of the current period that are recognised in an entity's financial statements.

It is inherent in the recognition of an asset or liability that the reporting entity expects to recover or settle the carrying amount of that asset or liability. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, this Standard requires an entity to recognise a deferred tax liability (deferred tax asset), with certain limited exceptions. ...

Definitions

[...]

Tax base

[...]

- 11 In consolidated financial statements, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. The tax base is determined by reference to a consolidated tax return in those jurisdictions in which such a return is filed. In other jurisdictions, the tax base is determined by reference to the tax returns of each entity in the group.

Recognition of deferred tax liabilities and deferred tax assets

Taxable temporary differences

[...]

- 16 It is inherent in the recognition of an asset that its carrying amount will be recovered in the form of economic benefits that flow to the entity in future periods. When the carrying amount of the asset exceeds its tax base, the amount of taxable economic benefits will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability. As the entity recovers the carrying amount of the asset, the taxable temporary difference will reverse and the entity will have taxable profit. This makes it probable that economic benefits will flow from the entity in the form of tax payments. Therefore, this Standard requires the recognition of all deferred tax liabilities, except in certain circumstances described in paragraphs 15 and 39.

Investments in subsidiaries, branches and associates and interests in joint arrangements

- 38 Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint arrangements (namely the parent or investor's share of the net assets of the subsidiary, branch, associate or investee, including the carrying amount of goodwill) becomes different from the tax base (which is often cost) of the investment or interest. Such differences may arise in a number of different circumstances, for example:
- (a) the existence of undistributed profits of subsidiaries, branches, associates and joint arrangements;
 - (b) changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and
 - (c) a reduction in the carrying amount of an investment in an associate to its recoverable amount.
- In consolidated financial statements, the temporary difference may be different from the temporary difference associated with that investment in the parent's separate financial statements if the parent carries the investment in its separate financial statements at cost or revalued amount.
- 39 **An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, except to the extent that both of the following conditions are satisfied:**
- (a) **the parent, investor, joint venturer or joint operator is able to control the timing of the reversal of the temporary difference; and**
 - (b) **it is probable that the temporary difference will not reverse in the foreseeable future.**
- [...]
- 44 **An entity shall recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint arrangements, to the extent that, and only to the extent that, it is probable that:**
- (a) **the temporary difference will reverse in the foreseeable future; and**
 - (b) **taxable profit will be available against which the temporary difference can be utilised.**

Measurement

- [...]
- 47 **Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.**
- [...]
- 51 **The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.**
- 51A In some jurisdictions, the manner in which an entity recovers (settles) the carrying amount of an asset (liability) may affect either or both of:
- (a) the tax rate applicable when the entity recovers (settles) the carrying amount of the asset (liability); and
 - (b) the tax base of the asset (liability).
- In such cases, an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.
- [...]

Mr Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
London
EC4M 6XH

Dear Mr Upton

Tentative agenda decision: IAS 12 *Income Tax* – Corporate wrapper

We are writing to you to express our concern over the tentative decision and the current development on the above Tentative Agenda Decision published by the IFRS Interpretations Committee in the September 2011 *IFRIC Update*.

The staff of the IFRS Interpretations Committee has acknowledged in its November 2011 staff paper 4B Appendix A that the effect of its tentative decision could result in the recognition of deferred tax for temporary differences that are not probable to reverse in the foreseeable future and could be challenged as not being a faithful representation of transactions.

In many parts of the world, it is not uncommon for entities to hold investment properties through corporate wrappers to achieve tax efficiency on the eventual disposal of the investment properties. The application of the tentative decision would result in a provision of deferred tax liabilities that will never materialise.

We believe that such accounting standard may fail to reflect the underlying commercial reality of these transactions and results in financial information that is not useful for making economic decisions. The determination of tax base should also reflect the management intent, which will act in the most economically advantageous way under normal circumstances, to arrive at the most optimal way to hold their investments through corporate wrappers.

Furthermore, we believe that IAS 12 focuses on management's intent and the applicable tax legislation relevant to that intent. IAS 12.47 states that "*deferred taxes shall be measured at the tax rates that are expected to apply to the period when the asset is realised ...*" and IAS 12.51 states that "*the measurement of deferred tax liabilities ... shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities*". **[emphasis added]**

We therefore disagree with the IFRS Interpretations Committee's tentative decision that IAS 12 is clear in requiring that entities "recognise deferred tax for temporary differences relating to underlying assets even if the entity does not expect to dispose of the asset separately from the entity which holds it." It is not clear to us that the relevant IAS 12 paragraphs (as stated in the tentative decision) should always override the principles in paragraphs 47 and 51. We believe that the principles in paragraphs 47 and 51 should take precedence and therefore, the rate applicable on disposal of the corporate structure should be applied to measure the deferred taxes if a sale of the investment properties would occur in this manner.

Financial statements are read, in the main, for the purpose of making economic decisions. The financial statements should therefore (i) provide information that has either predictive or confirmatory value or both and (ii) should faithfully represent the economics and commercial reality of the transactions.

The application of the principles stated in paragraphs 47 and 51 would result in a deferred tax amount that adequately reflects the expected tax consequences upon realisation of the value of the asset.

We agree that the IFRS Interpretations Committee should not take this issue onto its agenda. However, given that the IFRS Interpretations Committee is not taking this issue onto the agenda, we believe that the IFRS Interpretations Committee should not, at the same time, influence current accounting by providing a view for their agenda decision.

We therefore respectfully suggest that the IFRS Interpretations Committee reconsider this aspect of the tentative agenda decision and refrain from publishing a view on the accounting to be applied in practice.

Finally, we agree with the IFRS Interpretations Committee's view that *there are other broader concerns relating to this issue* and believe that the Board should take this issue onto its active agenda. Until then, we urge the Committee to consider redrafting the second paragraph of the tentative agenda decision or issuing a clarification, taking into consideration the observations listed above.

We appreciate your kind consideration.

Yours faithfully

Arthur Lang
Group Chief Financial Officer
CapitaLand Limited