STAFF PAPER

March 2017

IFRS® Interpretations Committee Meeting

Project	IAS 12 *Income Taxes*		
Paper topic	Initial recognition exception and single-asset entities		
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Introduction

1. The IFRS Interpretations Committee (the Committee) received a submission questioning how, in its consolidated financial statements, an entity (Entity A) accounts for a transaction in which it acquires all of the shares of another entity (Entity B) that has an investment property as its only asset. In the fact pattern submitted, Entity B 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 Entity B is not a business. Entity A applies the fair value model in IAS 40 *Investment Property*. The submitter asked the Committee to consider whether the Board should amend the requirements in paragraph 15(b) of IAS 12 *Income Taxes* in this respect. Paragraph 15(b) of IAS 12 includes an exception from recognising a deferred tax liability on initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable profit (the initial recognition exception).

2. The Committee noted that:

   (a) because the transaction is not a business combination, Entity A applies paragraph 2(b) of IFRS 3 and allocates the purchase price to the individual identifiable assets acquired and liabilities assumed when it acquires Entity B; and

   (b) applying the initial recognition exception, Entity A does not recognise a deferred tax liability for the taxable temporary difference previously recognised by Entity B. This is because any deferred tax liability would arise from the initial recognition of an asset (ie the investment property) by Entity A in a transaction that is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

3. Accordingly, in the fact pattern submitted, Entity A allocates the entire purchase price to the investment property. This is consistent with the requirements of paragraph 20 of IAS 40, which requires an entity to measure its investment property at cost on initial recognition. The cost of the investment property is the purchase price of Entity B in this scenario.

4. Applying the fair value model in IAS 40, Entity A subsequently measures the property at its fair value. In the fact pattern submitted, the value of the investment property applying IAS 40 is higher than the purchase price of the shares of Entity B. As a consequence, Entity A recognises a gain on remeasuring the investment property at fair value after initial recognition. Applying IAS 12, Entity A also recognises any resulting deferred tax liability (asset).

5. The purpose of this paper is to:

   (a) analyse the comments received on the tentative agenda decision; and

   (b) ask the Committee whether it agrees with the staff recommendation to finalise the agenda decision.

Comment letter summary and staff analysis

6. We received eight comment letters, which are included in Appendix B to this paper. Three respondents (Ernst & Young Global Limited, Accounting Standards Board of Canada and Mazars) agree with the Committee's decision not to add this issue to its agenda for the reasons outlined in the tentative agenda decision. However, Mazars says that the requirements in IFRS Standards result in an accounting outcome that is far from satisfactory and regrets the absence of a project to revise the accounting for income taxes in the Board's work plan.

7. Three other respondents (Deloitte, the Accounting Standards Committee of Germany (ASCG) and the Israel Securities Authority (ISA)) also agree with the Committee's technical analysis and conclusions. However, these respondents raise concerns about particular aspects of the agenda decision.

8. Two respondents, Jacky Mandelkorn, CPA, and the Korean Institute of Certified Public Accountants (KICPA), do not agree with the Committee's technical analysis. Both respondents think that the initial recognition exception does not apply to the transaction.

9. Respondents' concerns, together with our analysis, are presented below.

Addressing subsequent recognition and measurement of deferred tax

Concern raised by respondent

10. The ASCG acknowledges that the wording of the tentative agenda decision refers to the question raised in the submission, ie whether Entity A recognises a deferred tax liability on initial recognition. However, the ASCG suggests expanding the tentative agenda decision to clarify how Entity A recognises and measures any deferred tax that arises when it subsequently remeasures the investment property at fair value applying IAS 40.

Staff analysis

11. The submission asked:

    (a) whether an entity recognises a deferred tax liability at initial recognition; and

    (b) if the initial recognition exception applies, to consider whether the Board should amend the requirements in IAS 12 to prevent an entity from recognising a gain subsequent to initial recognition.

12. The submission did not ask for clarity on the subsequent recognition and measurement of deferred tax in this situation.

13. If the Committee were to address subsequent recognition and measurement of deferred tax, then it would need to discuss the topic at a future meeting. This could result in an amended agenda decision, which we would re-issue for comment. We note, however, that the Board has previously discussed the initial and subsequent recognition of deferred tax in single-asset entities as part of the Agenda Consultation[1]—the Board's previous work on IAS 12 had identified questions in this respect. On the basis of feedback received, the Board concluded that a review of IAS 12 was not a higher priority than other projects, and decided to add neither a narrow-scope project nor a wider project on IAS 12 to its work plan. Consequently, we think that any discussion about the subsequent recognition of deferred tax would result in a similar conclusion to the discussion about possibly changing the initial recognition exception. We, therefore, recommend that the Committee does not address this issue.

Amending the description of the issue

Concern raised by respondent

14. The ISA says the wording included in the tentative agenda decision might misrepresent the essence of the submission, which was a request to find a solution to what the submitter viewed as the recognition of a gain on remeasurement that has no

[1] See example 5 in Agenda Paper 19A to the May 2016 Board meeting.

economic substance. The ISA suggests updating the wording of the tentative agenda decision to include details regarding the reason for the submission.

Staff analysis

15. We agree with the respondent's concerns and suggest amending the wording of the final agenda decision (see Appendix A for proposed changes to the wording of the tentative agenda decision).

Changing the Committee's agenda criteria

Concern raised by respondent

16. The ISA also says that in deciding whether to add an issue to its agenda, the Committee should consider whether the application of existing requirements in IFRS Standards results in the provision of useful financial information (such as information that is relevant and faithfully representative). The ISA says that, in its view, in the fact pattern submitted the acquirer's recognition of a gain on remeasurement at fair value does not result in the provision of useful financial information.

Staff analysis

17. Paragraph 5.16 of the *IFRS Foundation Due Process Handbook* describes the Committee's agenda criteria. Paragraph 5.16(b) of the *IFRS Foundation Due Process Handbook* requires the Committee to consider whether 'financial reporting would be improved through the elimination/reduction of diverse reporting methods'. We think this already requires the Committee to consider whether changing IFRS Standards would result in the provision of useful information. Accordingly, we think it is not necessary to amend the existing agenda criteria.

18. Further, at its September 2016 meeting the Committee discussed whether it should add a narrow scope project to address the question raised. The Committee agreed with the staff that any consideration of the initial recognition exception in the fact pattern submitted could not be undertaken effectively without also considering other IAS 12 issues identified regarding fair value measurement and single-asset entities (considered as part of the Agenda Consultation in Agenda Paper 19A to the May 2016 Board meeting). The Committee also noted that the Board had considered whether to

undertake a project on these issues as part of its Agenda Consultation, and had decided not to do so having considered the feedback on that consultation.

Wider issues with transactions involving single asset entities

Concern raised by respondent

19. Deloitte says that purchases and sales of single-asset entities give rise to a number of issues not only regarding deferred tax accounting, but also fair value measurement and the distinction between the accounting for asset purchases and business combinations. It suggests that the Board consider the wider accounting issues arising from such transactions as it develops its agenda for the next three years.

Staff analysis

20. We think it is not necessary for either the Board or the Committee to separately consider adding a project to address the wider accounting issues arising from transactions involving single-asset entities. Both of the other issues identified by Deloitte relate to topics that the Board is considering as part of other projects that are on its current work plan. The Board has commenced a Post Implementation Review of IFRS 13 *Fair Value Measurement*. In addition the Board published Exposure Draft *Definition of a Business and Accounting for Previously Held Interests* in June 2016, which aims to clarity the definition of a business. The Board discussed the summary of comment letters received in Agenda Paper 13 at its February 2017 meeting. The Board will redeliberate the proposed amendments regarding the definition of a business at a future meeting.

Application of the initial recognition exception

Concern raised by respondent

21. Two respondents do not agree with the Committee's technical analysis. Both respondents say that the initial recognition exception does not apply to the fact pattern submitted. Jacky Mandelkorn says that this is because the transaction results in the acquirer recognising a 'day one' profit on remeasurement of the investment property at fair value subsequent to initial recognition. Accordingly, in the respondent's view,

Entity A does not meet the criteria in paragraph 15(b)(ii) of IAS 12 because the transaction affects accounting profit at the time of the transaction. The respondent says it is inappropriate to characterise the gain as a 'day two' profit (as noted in Agenda Paper 6 to the September 2016 Committee meeting) because the acquirer recognises any gain immediately.

22. The KICPA thinks the initial recognition exception does not apply because the deferred tax liability does not arise from the acquisition transaction, but rather already exists in the acquired entity's financial statements before the transaction.

Staff analysis

23. Paragraph 15(b)(ii) of IAS 12 requires an entity not to recognise a deferred tax liability on the initial recognition of an asset if the transaction is not a business combination and affects neither accounting profit nor taxable profit at the time of the transaction. We continue to think that the initial recognition exception applies to the fact pattern submitted because the initial recognition of the investment property by the acquirer does not affect accounting profit. As outlined in Agenda Paper 6 of the Committee's September 2016 meeting, we think an entity considers the effect of a transaction on accounting or taxable profit only on initial recognition of the transaction.

24. In the fact pattern described in the submission, Entity A initially allocates the entire purchase price to the investment property and, thus, does not recognise any gain or loss when it initially recognises the transaction. After initial recognition, the application of the fair value measurement model in IAS 40 may result in Entity A recognising a gain when it measures the investment property at fair value. However, any gain or loss on remeasurement occurs *after* the initial recognition of the investment property, and not *on* initial recognition of that property. Accordingly, any gain or loss on remeasurement is not relevant when assessing whether the initial recognition exception is met. We think that characterising the gain as 'day one' or 'day two' does not affect the analysis.

25. We also think that the initial recognition exception applies despite the acquired entity having recognised a deferred tax liability in its financial statements. The Committee discussed this at its meeting in September 2016 (see paragraph 21 of Agenda Paper 6).

The Committee noted that the requirements in IAS 12—including the initial recognition exception—are applied from the perspective of the reporting entity, in this case Entity A. Entity A had not previously recognised the investment property in its consolidated financial statements and, thus, the initial recognition exception applies to this transaction.

Staff recommendation

26. On the basis of our analysis, we recommend confirming the tentative agenda decision as published in the IFRIC Update in September 2016. Appendix A to this paper sets out the draft wording for the final agenda decision.

Question for the Committee
Does the Committee agree with the staff recommendation to finalise the agenda decision outlined in Appendix A to this paper?

Appendix A—Proposed wording for final agenda decision

A1. We propose the following wording for the final agenda decision (new text is underlined and deleted text is struck through).

IAS 12 *Income Taxes*—Recognition of deferred taxes when acquiring a single-asset entity that is not a business

The <u>IFRS</u> Interpretations Committee <u>(the Committee)</u> received a submission questioning how, in its consolidated financial statements, an entity accounts for a transaction in which it acquires all of 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 ~~the Interpretations Committee~~ <u>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</u> to consider whether the requirements in paragraph 15(b) of IAS 12 should be amended <u>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</u> ~~in this respect~~.

The ~~Interpretations~~ 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 states that an entity does not recognise a deferred tax liability for taxable temporary differences that arise from the

> initial recognition of an asset or ~~a~~ 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 ~~Interpretations~~ Committee concluded that the requirements in IFRS Standards provide an adequate basis to enable an entity to determine how to account for the transaction. The ~~Interpretations~~ 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 ~~Interpretations~~ Committee decided not to add this issue to its agenda.
>
> The ~~Interpretations~~ 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 ~~Interpretations~~ Committee did not recommend that the Board consider adding a project to its agenda on this topic.

Appendix B—Copies of comment letters

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International Financial Reporting Standards
Interpretations Committee
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18 October 2016

Dear IFRS Interpretations Committee members,

Tentative Agenda Decision – IAS 12 *Income Taxes*—recognition of deferred taxes when acquiring a single-asset entity that is not a business

The global organisation of Ernst & Young is pleased to submit its comments on the above Tentative Agenda Decision, as published in the September 2016 *IFRIC Update*.

The IFRS Interpretations Committee (the Committee) received a submission "questioning how, in its consolidated financial statements, an entity accounts for a transaction in which it acquires all of the shares of another entity that has an investment property as its only asset." We agree with the Committee's tentative decision that, where it is determined that the transaction is not a business combination, no deferred tax is recognised and the requirements in IFRS standards provide an adequate basis to enable an entity to determine how to account for the transaction.

We also agree that any reconsideration of the initial recognition exception in paragraph 15(b) of IAS 12 would require a Board-level project and recognise the fact that the IASB has not added a project on IAS 12 to its agenda.

Accordingly, we support the Tentative Agenda Decision as worded in the September 2016 *IFRIC Update*.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully

Ernst & Young Global Limited

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Jerusalem, 8 November 2016

Director of Implementation Activities, IASB
30 Cannon Street London EC4M 6XH
United Kingdom

Subject: IFRS IC - Interpretations Committee's Tentative Agenda Decision

IAS 12 *Income Taxes*—Recognition of deferred taxes when acquiring a single-asset entity that is not a business (Agenda Paper 6)

Dear Madam or Sir,

Further to our submission regarding IAS 12 (Recognition of deferred taxes when acquiring a single-asset entity that is not a business), we read the IFRIC's decision from September 6th as was presented in the IFRIC UPDATE.

In its decision, the committee noted that "The Interpretations Committee concluded that the requirements in IFRS Standards provide an adequate basis to enable an entity to determine how to account for the transaction".

We agree with this conclusion, which is consistent with our preliminary view as was expressed in our submission. However, we are of the opinion that the wording included it the UPDATE might misrepresent the essence of our submission, which was a request to find a solution to such "day one profits" arising due to IAS 12 provisions even though such profits lack economic substance. In our submission, we tried to point out the problem of recognizing "day one profits" that have no economic substance when applying IAS 12 literally, and suggested an amendment or a clarification in order to avoid such profits.

We believe that such profits should be recognized in rare circumstances only, and therefore we believe that a transaction to acquire an entity that does not constitute a business, for the entity's fair value, should not result in recognition of profit. In particular, in light of the new suggested definition of a business, we are expected to see a greater amount of such arbitrary gains.

We are of the opinion that it is important to include in the UPDATE, details regarding the reason for the submission, which I hope has been clearly described in this letter, in order to better understand why the IFRIC was asked to discuss this issue.

Finally, we would like to express the importance we see in taking into account, among all criteria being considered when deciding whether to add a submission to the Committee's agenda, how an issue meets the fundamental characteristics of useful financial information (such as Relevance and Faithful Representation). We are of the opinion that in the case described in our submission these characteristics are not met, due to the recognition of a "day one profit" which lacks economic substance. As this issue is widespread, the outcome is that the usefulness of the financial statements is impaired.

Kind regards

Yehuda Algarisi
Chief accountant

From: Jacky Mendlekorn
Sent: 09 November 2016 13:07
To: Ifric
Subject: IAS 12 Income taxes- recognition of deferred taxes when acquiring a single-asset entity-agenda paper

IAS 12 Income taxes- recognition of deferred taxes when acquiring a single-asset entity which is not a business
-agenda paper 6
I (an Israeli accountant) reviewed this paper and wish to comment.
I believe that recording a gain on the case submitted to the IFRIC detailed in this paper is close to absurd and some preparers may implement this method according to the paper ,
because the standard is not clear and this method also usually results in recording a profit . The submitter wrote that this is a "day one profit"(see the end of the submission) and therefore the exemption in IAS 12 15b 2 is not met. I agree with this and this would solve the problem, but the preparers of the paper decided to call it a day two gain in the name of the submitter(see paragraph 8 in background information) but that's not what the submitter wrote. Immediately the profit has to be recorded and this is day one. Please review this again so the accounting in this matter will reflect the economics of the deal.
Yours truly
Jacky Mandelkorn,CPA

Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany
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IFRS Technical Committee
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Berlin, 14 November 2016

Dear Henry,

IFRS IC's tentative agenda decision in its September 2016 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the tentative agenda decision on IAS 12 taken by the IFRS Interpretations Committee (IFRS IC), as published in the September 2016 *IFRIC Update*. We agree with the IFRS IC's findings that

- the "initial recognition exemption" in IAS 12.15(b) applies to this transaction and, therefore,
- no deferred tax liability shall be recognised at initial recognition.

We acknowledge that the wording of the tentative agenda decision strictly refers to the question raised in the submission, i.e. whether a deferred tax liability shall or may be recognised at the date the asset is acquired. We believe that the agenda decision could be enhanced and be made even more decision-useful if the IFRS IC extended its answer to also cover subsequent recognition and measurement of the deferred tax liability.

If you would like to discuss our views further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow
President

Accounting Standards Board
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November 14, 2016

By e-mail to ifric@ifrs.

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs:

Re: Tentative agenda decision on IAS 12 *Income Taxes* – Recognition of deferred taxes when acquiring a single-asset entity that is not a business

This letter is the response of the staff of Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's tentative agenda decision on the recognition of deferred taxes when acquiring a single-asset entity that is not a business under IAS 12 *Income Taxes.* This tentative agenda decision was published in the September 2016 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the AcSB staff.

We agree with the Committee's decision not to add this item to its agenda because we think that IAS 12 is clear that an entity does not recognize deferred taxes for taxable temporary differences that arise from the initial recognition of an asset or 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).

Furthermore, we also agree with the Committee's conclusion that any reconsideration of the initial recognition exception in paragraph 15(b) of IAS 12 would require a Board-level project because the exception should not be amended for one type of transaction in isolation.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively, Andrew White, Principal, Accounting Standards (+1 416 204-3487 or email awhite@cpacanada.ca).

Yours truly,

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15 November 2016

Chair
IFRS Interpretations Committee
30 Cannon Street
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Dear Sir

Tentative agenda decision – IAS 12 *Income Taxes*: Recognition of deferred taxes when acquiring a single-asset entity that is not a business

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the September IFRIC Update of the tentative decision not to take onto the Committee's agenda the request for an amendment to IAS 12 in respect of the accounting in consolidated financial statements for the purchase of a single-asset entity that does not meet the definition of a business in IFRS 3 *Business Combinations*.

We agree with the analysis of the IAS 12's requirements included in the tentative agenda decision. However, we note that purchases and sales of 'single-asset' entities give rise to a number of issues around not only deferred tax accounting, but also fair value measurement and (as noted in the IASB's current project on the definition of a business) the distinction between asset purchase and business combination accounting.

As such, we recommend that the wider accounting issues arising from such transactions be considered by the Board as it develops its agenda for the next three years.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

MAZARS

IFRS Interpretations Committee
30 Cannon Street
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Paris, November 16, 2016

Tentative Agenda Decisions –IAS 12 *Income Taxes* – Recognition of deferred taxes when acquiring a single-asset entity that is not a business (Agenda Paper 6)

Dear Sir,

MAZARS is pleased to comment on the above IFRS Interpretations Committee tentative agenda decision published in the September IFRIC Update.

We agree with the IFRS Interpretations Committee's decision not to add this issue onto its agenda, and with the rationale expressed in the tentative agenda decision.

Solving this problem would indeed require a review of IAS 12 of a broader scope than that of a limited amendment or an interpretation, as there does not seem to be any easy way to remedy this problem within the framework of current standards (see illustration provided in Appendix to this letter).

That being said, we wish to point out that in the case submitted, the requirements of the current standards result in an accounting outcome ("day-one" profit in P&L due to the re-measurement at fair value of the investment property) that is far from satisfactory. We also note that in the past similar conclusions were reached regarding the application of IAS 12 to single-asset entities[1].

Therefore we regret the lack of any long-term project to revise the accounting of income tax in the Board's work plan.

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[1] Cf. IFRIC Update, July 2014, IAS 12 Income Taxes-recognition of deferred tax for a single asset in a corporate wrapper: the IFRS IC indicated that *"several concerns were raised with respect to the current requirements in IAS 12"* and that *"analysing and assessing these concerns would require a broader project than the Interpretations Committee could perform on behalf of the IASB. Consequently, the Interpretations Committee decided not to take the issue onto its agenda but instead to recommend to the IASB that it should analyse and assess these concerns in its research project on Income Taxes."*

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Should you have any questions regarding the above comments, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully

Michel Barbet-Massin **Edouard Fossat**

Financial Reporting Technical Support

Appendix

To illustrate the difficulty to remedy this problem, we propose to consider the following:

1. For illustration purposes, we will assume that the following assumptions (the figures below were not part of the submission, as reproduced in Agenda paper 6) apply to the acquisition by Entity A of a 100% stake in Entity B at the beginning of Year 6:

Discount rate (for fair value calculations at the end of Year 5):	5%	
Income tax rate applicable to Entity B's operations:	40%	
Acquisition cost by Entity B of the investment property at the beginning of Year 1 (tax basis):	CU100	
Amortisation period for tax purposes:	10	years
Tax basis of the investment property held by Entity B at the end of Year 5:	CU50	
Fair value of the investment property (*) at the end of Year 5:	CU150	
Fair value of Entity B's shares (*) at the end of Year 5: (price paid by Entity A for acquiring all the shares of Entity B at the end of Year 5)	CU121	

(*): See detailed calculations on the last page of this appendix.

2. In the case submitted, on acquisition of Entity B, Entity A recognises the following entries in its consolidated financial statements in application of the current standards (since Entity B was not a business):

	Dr	Cr
Investment property[2]	CU121	
Cash		CU121
Investment property	CU29	
FV remeasurement of Investment property (P&L)		CU29

[2] In this example, the price paid by Entity A for acquiring all the shares of Entity B at the end of Year 5 is based on their fair value (CU121), which differs from the net equity of Entity B (CU110 comprising: an investment property of CU150 and a differed tax liability of CU40).

3. This Day 1 profit arising from immediate remeasurement of the acquired investment property at fair value is the unexpected outcome the submitter points out.

4. Let's now assume that, instead of applying the Initial Recognition Exemption (IAS 12.15 & 24), Entity A should adjust the previous entries by a "gross-up" amount, calculated so that the cost of the Investment property less its corresponding DTL equals CU121 (purchase price of the shares).

   In the present case, this "gross-up" amount would be equal to CU47, leading to the following accounting entries:

	Dr	Cr
Investment property	CU168 (=CU121+CU47)	
Deferred tax liability		CU47
Cash		CU121
FV remeasurement of Investment property (P&L)	CU18	
Investment property		CU18
Deferred tax liability	CU7	
Income tax expense (P&L)		CU7

5. This method would not result in a satisfactory accounting outcome either, as there still would be a Day 1 impact on P&L (loss after tax of CU11) on subsequent fair value measurement of the investment property.

6. This is due to the fact that:

   - the "gross-up" amount by which the initial value of the investment property was increased (CU47) does not take into account the effect of time, since it represents an amount of deferred tax liability and is therefore recognised on an undiscounted basis (according to IAS 12.53);

   - whereas the fair value of the investment property at the end of Year 5 (CU121) includes the benefit of any future tax deductions for an amount that takes into account the effect of time[3] through the discounting of projected cash-flows.

[3] This amount is sometimes referred to as « Tax Amortisation Benefit » (or TAB).

Detailed calculations of the amounts measured at fair value at the end of Year 5:

	Year 6 (CU)	Year 7 (CU)	Year 8 (CU)	Year 9 (CU)	Year 10 (CU)	Year 11 (CU)	Year 12 (CU)	Year 13 (CU)	Year 14 (CU)	Year 15 (CU)	Terminal Value (CU)
FV of the investment property:											
Income before tax (=cash inflow)	15	15	15	15	15	15	15	15	15	15	97
Depreciation - tax deduction	*-15*	*-15*	*-15*	*-15*	*-15*	*-15*	*-15*	*-15*	*-15*	*-15*	*0*
Tax result	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*97*
Income tax (=cash outflow)	0	0	0	0	0	0	0	0	0	0	-39
Net cash flows	15	15	15	15	15	15	15	15	15	15	58
Net cash flows (discounted)	14	14	13	12	12	11	11	10	10	9	34
Net Present Value	150										
FV of Entity B's shares:											
Income before tax (=cash inflow)	15	15	15	15	15	15	15	15	15	15	97
Depreciation - tax deduction	*-10*	*-10*	*-10*	*-10*	*-10*	*0*	*0*	*0*	*0*	*0*	*0*
Tax result	*5*	*5*	*5*	*5*	*5*	*15*	*15*	*15*	*15*	*15*	*97*
Income tax (=cash outflow)	-2	-2	-2	-2	-2	-6	-6	-6	-6	-6	-39
Net cash flows	13	13	13	13	13	9	9	9	9	9	58
Net cash flows (discounted)	12	12	11	11	10	7	6	6	6	6	34
Net Present Value	121										

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December 29, 2016

To: Craig Smith

Cc: Henry Rees, Patrina Buchanan

IFRS Interpretation Committee

30 Cannon Street, London EC4M 6XH

United Kingdom

Re: KICPA's Comments on the IFRS IC's tentative agenda decision, IAS 12 *Income Taxes*-recognition of deferred taxes when acquiring a single-asset entity that is not a business

On behalf of the Korean Institute of Certified Public Accountants (KICPA), I send our response and comments regarding the IFRS IC's tentative agenda decision, IAS 12 *Income Taxes*-recognition of deferred taxes when acquiring a single-asset entity that is not a business.

I am aware of that the comment period for this agenda has already been completed, but it would be appreciated if you could consider these relevant examples and our suggestions.

Please do not hesitate to contact us if you have any questions regarding our comments. You may direct your inquiries either to me (ykahn@kicpa.or.kr) or to Ms. Seung-kyoung Yoo (skyoo@kicpa.or.kr), research fellow of KICPA.

Faithfully,

Yeong Kyun Ahn

The Vice President for Research and Education

KICPA's Comments on the IFRS IC's tentative agenda decision, IAS 12 *Income Taxes*-recognition of deferred taxes when acquiring a single-asset entity that is not a business

The IFRS IC meeting, held in September, 2016, came into conclusion that it would be reasonable not to recognize a deferred tax liability for taxable differences with the IAS 12 paragraph 15(b) applied, when an entity acquires all of the shares of another entity that has an investment property as its only asset and such transaction does not meet the definition of a business combination in IFRS 3, and then decided not to add this issue to the Committee's agenda.

As for the decision, we provide an example of deferred tax asset for deductible temporary differences and request the Committee give additional consideration to this issue.

Let's suppose that Company A would like to acquire all of the shares of Company B that has an investment property as its only asset. The recoverable amount of the investment property, the Company B holds, (i.e. the Company B's carrying amount of the asset) is 1 million dollars and the tax base of the same asset is 5 million dollars.

As the Company A files consolidated tax return, the main reason for the Company A to acquire the Company B is to reduce the corporate income taxes by utilizing the deductible temporary difference of 4 million dollars associated with the Company B's investment property. As such, in this case, the consideration given for the acquisition of Company B would be higher than the recoverable amount of the asset, 1 million dollars.

For example, if Company A acquires Company B for 1.3 million dollars per the negotiation with the stockholders of Company B (and this transaction does not meet the definition of a Business Combination applying IFRS 3), the company A would have to either recognize the investment property which has recoverable amount of 1 million dollars in the amount of 1.3 million dollars on initial recognition, or recognize the investment property in the amount of 1 million dollars with recognizing the impairment loss of 0.3 million dollars, since it is prohibited to recognize the deferred tax asset on initial recognition in accordance with IAS 12 paragraph 24 based on the current IFRIC's tentative decision.

However, we need to shed light on the core reasons for the Company A acquiring Company B. As it was mentioned earlier, one of the main reason for the Company A to acquire Company B is to reduce the Company A's income taxes by utilizing the 4 million dollars of deductible temporary difference that the Company B has, as Company A can benefit from this acquisition when they file the consolidated tax return. And it is also worth noting that the temporary difference has existed even before the acquisition point. In other words, this is Company A's purchase transaction acquiring the deferred tax asset that is worth maximum of 0.8 million dollars (4 million x 20%, when the corporate tax rate is 20%) from the Company B's pre-existing stockholders by paying additional 0.3 million dollars for consideration.

We need to be clear that the deferred tax liability or asset prohibited for recognition under IAS 12 paragraph 15 or 25 are **the ones arise from the initial recognition point of asset or liability**. However, the temporary difference explained in the previous example **did not arise from the point the Company A acquires Company B; rather the temporary difference had already existed within the Company B long before the Company A's acquiring transaction** and the Company A would have not paid more than the recoverable amount of the investment property if it had not been for the 80 million dollars of deferred tax assets of Company B. Thus, this is Company A's purchasing transaction of such temporary differences from the pre-existing stockholders of Company B.

Even in case of the issues received by IFRS IC, the **taxable temporary differences (and also deferred tax liability) did not arise from the acquiring transaction point**, rather **they had already existed in the Company B's financial statements before that transaction**. And Company A took over such separate deferred tax liability that has previously existed in the Company B's financial statements through purchase transaction.

IAS 12 paragraph 22(c) explains the reason for providing exemptions under paragraph 15 and 25 in the following paragraph.

> *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 paragraph 15 and 24, recognize 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.*

Based on IAS 12 paragraph 22(c) stated above, it is understood that the paragraph intends to prohibit the distortion of the asset's carrying amount resulting from a situation such that, new temporary difference arises from a purchasing transaction when an acquirer buys an asset in an amount of the fair value and in case of the acquirer recognize the deferred tax liability or deferred tax asset associated with that new temporary difference, the carrying amount of the acquired asset gets distorted as it is different than the fair value amount.

Even if we look at the issue in that aspect, this would rather result in the transparency issue of which the IASB is concerned as the carrying amount of the investment property would be distorted. This is because it cannot properly reflect the fair value of the asset if the acquiring entity cannot recognize the deferred tax liability as a separate item in their financial statement despite the fact that the entity paid the net fair value amount, which is the fair value of the asset after subtracting the deferred tax liability associated with it, for the purchase consideration to take over not only the investment property but also the separate deferred tax liability from the pre-existing stockholders.

Therefore, we believe that the discussed case is not considered as the exemption specified in IAS 12 paragraph 15.