STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	**Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12)**
Paper topic	Feedback Analysis—Other matters

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Introduction

1. As discussed in Agenda Paper 3 for this meeting, this paper includes our analysis of comments received on the Exposure Draft *Deferred Tax related to Assets and Liabilities arising from a Single Transaction* related to the scope of the proposed amendments, the proposed transition requirements and other matters raised by respondents. The paper also includes our preliminary recommendations for the International Accounting Standards Board (Board).

Structure of the paper

2. This paper includes:

   (a) scope of the proposed amendments (see paragraphs 4–17 of this paper);

   (b) transition requirements (see paragraphs 18–31 of this paper);

   (c) other matters (see paragraph 32 of this paper); and

   (d) summary of staff preliminary recommendations (see paragraph 33 of this paper).

3. There are three appendices to this paper:

   (a) Appendix A—Analysis of other matters;

   (b) Appendix B—Other transactions in the scope of the proposed amendments; and

   (c) Appendix C—Extracts from Appendix C to IFRS 16 *Leases*.

Scope of the proposed amendments

Board's proposals and rationale

4. The proposed amendments apply to any transaction—other than a business combination—that:

   (a) results in the recognition of an asset and liability and, at the time of the transaction, affects neither accounting profit nor taxable profit; and

   (b) gives rise to equal amounts of taxable and deductible temporary differences.

5. Paragraphs BC1–BC4 of the Exposure Draft explain the background to the proposed amendments. These paragraphs explain that the Board specifically considered leases and decommissioning obligations when developing the proposed amendments. However, the Board was aware that its conclusions would also apply to any transaction that meets the criteria in paragraph 4 above, which it viewed as appropriate. Accordingly, the Board did not limit the scope of the proposed amendments to only leases and decommissioning obligations.

Summary of respondents' concerns

6. Some respondents expressed concerns about the scope of the proposed amendments. These respondents said:

   (a) *the scope is too broad and thus might capture transactions not considered by the Board*—these respondents suggested limiting the scope of the amendments so that they would apply only to leases and decommissioning obligations. These respondents said the Board has not considered the effect of the proposed amendments on other transactions and there is a risk of unintended consequences. Some of these respondents provided examples of transactions that might be in the scope of the proposed amendments.[1] A few respondents suggested limiting the scope only to leases—they said this would avoid complexities associated with applying the amendments to decommissioning obligations.

(b) *the scope may not capture some transactions that it should*—these respondents said the proposed amendments would not capture transactions that give rise to an asset and liability but not to equal and offsetting temporary differences. Paragraph 11 discusses some such examples.

(c) *it is unclear whether some transactions are within the scope of the proposed amendments*: these respondents said it is unclear whether the proposed amendments would apply to (i) transactions that give rise to multiple assets and liabilities; and (ii) sale and leaseback transactions.

7. See paragraphs 37–38 of Agenda Paper 3C for more details.

Staff analysis

The scope is too broad

8. The objective of the proposed amendments was to narrow the scope of the recognition exemption so that it would not apply when it is not needed. Although the Board specifically considered leases and decommissioning obligations when developing the proposed amendments, the Board did not limit their application to only those transactions. This is because the principle underlying the proposed amendments—that the recognition exemption is unnecessary for transactions which give rise to equal and offsetting temporary differences—is applicable regardless of the nature of the transaction.

9. Some respondents provided examples of other transactions that might be within the scope of the proposed amendments, but did not explain why the proposals should not apply to such transactions. Appendix B includes our analysis of some of these

[1] See paragraph 38 of Agenda Paper 3C for examples provided by respondents.

transactions. Although we agree with respondents that the proposed amendments could apply to those transactions, we see no reason that they should not. Further, we think recognising deferred tax on such transactions would be less complex and costly than applying the recognition exemption. In our view the amendments should therefore apply to any transaction that, on initial recognition, gives rise to equal and offsetting temporary differences.

10. We also note that our preliminary recommendation to remove the capping proposal (see Agenda Paper 3A) would address respondents' concerns about the complexity of applying the proposed amendments, including in relation to decommissioning obligations.

The scope may not capture some transactions

11. Respondents provided examples of transactions that might result in the recognition of an asset and liability of equal amounts, but that would not be in the scope of the proposed amendments because they do not give rise to equal and offsetting temporary differences. These examples include:

    (a) leases for which payments are only partially deductible for tax purposes—for these leases, if tax deductions are attributable to the lease liability, the tax base of the lease asset would be zero but the tax base of the lease liability would not be zero; and

    (b) recognition of a deductible asset and a corresponding non-taxable deferred income as part of a government grant—the tax base of the asset would equal its carrying amount, but the tax base of the liability would be zero applying paragraph 8 of IAS 12.[2]

    In these examples, temporary differences related to the asset and liability would not be equal because the asset and liability have different tax bases even though they have equal carrying amounts on initial recognition.

12. In our view, the recognition exemption should continue to apply to transactions that do not give rise to equal and offsetting temporary differences. For such transactions,

[2] Paragraph 8 of IAS 12 states 'in the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in future periods.'

the principle underlying the proposed amendments (see paragraph 8 above) does not apply—these transactions are similar to other transactions to which the recognition exemption applies, for example the acquisition of a non-deductible asset.

13. We considered whether the amendments should apply *to the extent* equal temporary differences arise on initial recognition of a transaction—for example, temporary differences arising on partially-deductible leases (see paragraph 11(a) above) would be equal to some extent. However, this would require entities to partially apply the recognition exemption, thereby resulting in complexities similar to those arising from the capping proposal (see paragraph 15(a) of Agenda Paper 3A). We therefore continue to support the proposal that the amendments should apply only when equal and offsetting temporary differences arise on initial recognition.

Clarity regarding the scope

Transactions that give rise to multiple assets and liabilities

14. Paragraph 22A of the Exposure Draft specifies that the capping proposal applies to transactions that lead to the initial recognition of 'an asset and a liability'. We acknowledge that the wording of that paragraph might be read to imply that the amendments would apply only to transactions that result in the recognition of a single asset and liability.[3] However, if the Board agrees with our preliminary recommendation to remove the capping proposal, this paragraph would not be included in the final amendments.

15. Paragraphs 15 and 24 of IAS 12 (amended as proposed) would refer to transactions that 'give rise to equal amounts of taxable and deductible temporary differences'. In our view, this would capture transactions involving multiple assets and liabilities if those transactions give rise to equal and offsetting temporary differences on initial recognition.

[3] Paragraph 22A of the Exposure Draft states 'a transaction that is not a business combination may lead to the initial recognition of an asset and a liability and, at the time of the transaction, affect neither accounting profit nor taxable profit (tax loss). Equal amounts of taxable and deductible temporary differences may arise from the initial recognition of that asset and liability.'

Sale and leaseback transactions

16. In our view, the recognition exemption does not apply to sale and leaseback transactions. Sale and leaseback transactions generally result in the recognition of a gain or loss and, accordingly, affect accounting profit or taxable profit. We think further clarification is unnecessary.

Staff preliminary recommendation

17. Based on our analysis above in paragraphs 8–16, our preliminary recommendation is that the Board require entities to apply the amendments to transactions that, on initial recognition, gives rise to equal amounts of taxable and deductible temporary differences.

Transition requirements

Board's proposals and rationale

18. The Board proposed requiring entities to apply the proposed amendments retrospectively, but to provide relief in relation to the assessment of the recoverability of deferred tax assets. The transition relief would permit an entity to assess recoverability only at the beginning of the earliest comparative period presented. Paragraphs BC33–BC37 of the Exposure Draft explain the Board's rationale. In particular, the Board observed that requiring entities to assess whether the recoverability requirement would have been met at the date of initial recognition of each transaction within the scope of the proposed amendments could be impracticable or result in undue costs.

Summary of respondents' concerns

19. Many respondents did not comment on the proposed transition requirements. A few explicitly agreed with the proposed transition requirements, whilst a few expressed the following concerns:

    (a) *different outcomes of applying the transition relief:* a few respondents said the proposed transition requirements could lead to different accounting outcomes for economically similar situations. An entity would assess recoverability at different points in time depending on whether it applies the transition relief, and that could affect the extent to which it recognises deferred tax.

    (b) *interaction with the transition requirements in IFRS 16*: a few respondents said it is unclear how the proposed amendments would interact with some of the transition requirements in IFRS 16 (paragraph 22 below provides further information).

    (c) *alternative transition requirements:* one respondent suggested permitting entities to recognise and measure deferred tax based on the temporary differences determined at the beginning of the earliest comparative period presented.

    (d) *restatement of comparative information*: a few respondents said calculating deferred tax for the earliest comparative period presented could be challenging and result in undue costs. These respondents suggest requiring or permitting entities to apply the proposed amendments retrospectively with the cumulative effect recognised at the date of initial application of the proposed amendments (ie without restating comparative information).

20. See paragraphs 39–40 of Agenda Paper 3C for more details.

Staff analysis

Different outcomes of applying the transition relief

21. If the Board agree with our preliminary recommendation to remove the capping proposal, the transition relief would no longer be necessary—as explained in paragraph 26(a) of Agenda Paper 3A, entities would no longer be required to assess

recoverability on initial recognition of each transaction to determine the extent to which a deferred tax liability can be recognised. Accordingly, we plan to recommend that the Board no longer provide the transition relief.

Interaction with the transition requirements in IFRS 16

22. Paragraph C5 of IFRS 16 requires an entity to apply the Standard either:

    (a) retrospectively to each prior period presented applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (fully retrospective); or

    (b) retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application applying paragraphs C7–C13 of IFRS 16 and without restating comparative information (modified retrospective).[4]

23. The Board considered it unnecessary to provide specific requirements addressing the interaction between the proposed transition requirements and those of IFRS 16. Both the proposed amendments and IFRS 16 require retrospective application—retrospectively applying the proposed amendments and IFRS 16 would mean that the recognition exemption would not have applied to the equal and offsetting temporary differences that arose at the commencement date of the lease. Consequently, entities would generally recognise deferred tax for the temporary differences that exist at the date of initial application of the amendments.

24. Nonetheless, we acknowledge it may be unclear how an entity would apply the proposed amendments if it had applied the modified retrospective approach in IFRS 16. In that case, should an entity consider whether equal and offsetting temporary differences would have arisen:

    (a) at the commencement date of the lease, because the proposed amendments refer to equal amounts of taxable and deductible temporary differences 'at the time of the transaction'; or

    (b) when an entity recognises and measures the lease asset and lease liability at the date of initial application of IFRS 16, because the entity would recognise lease

[4] Appendix B to this paper reproduces paragraph C5 and paragraphs C7–C8 of IFRS 16 for ease of reference.

assets and liabilities for the first time at that date for leases that had been classified as operating leases?

25. Applying the modified retrospective approach could result in unequal temporary differences on the date of initial application of IFRS 16—this is because the carrying amounts of the lease asset and lease liability at that date could be different (see paragraph C8 of IFRS 16 in Appendix C to this paper). If an entity considers whether equal and offsetting temporary differences exist at the date of initial application of IFRS 16, it might conclude that the amendments would not apply. This would be inconsistent with what the Board intended. The following paragraphs consider whether alternative transition requirements could address this concern.

Alternative transition requirements

26. We considered respondents' suggestion that the Board could alternatively require entities to recognise and measure deferred tax based on temporary differences at the beginning of the earliest comparative period presented, with the cumulative effect recognised as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate).

27. We think requiring entities to apply this approach for leases would address concerns about the interaction with the transition requirements in IFRS 16 (see paragraphs 22–25 of this paper). Further, we think requiring this approach for both leases and decommissioning obligations would avoid the need to retrospectively assess whether those transactions gave rise to equal and offsetting temporary differences on initial recognition (which could be several years ago). In our view, such a transition approach would therefore make the amendments easier and less costly to apply, while still achieving their objective.

28. The transition requirements described above could result in an entity recognising deferred tax for some leases or decommissioning obligations that might otherwise be outside the scope of the proposed amendments (for example, a partially deductible lease). However, in our view the expected benefits of applying these transition requirements to all leases and decommissioning obligations would outweigh the cost of requiring entities to assess whether each individual lease and decommissioning obligation gave rise to equal and offsetting temporary differences on initial

recognition. We also note that, applying this approach, the cumulative effect of recognising deferred tax would be recognised in retained earnings. This would therefore avoid the outcome that the recognition exemption was designed to prevent.[5]

29. As discussed in paragraph 8–10 of this paper, the proposed amendments would also apply to transactions other than leases and decommissioning obligations. Identifying whether such transactions might be in the scope of the proposed amendments on a retrospective basis could also be costly and complex. In our view, the costs of requiring entities to apply the amendments retrospectively to other transactions might not outweigh the benefits of doing so. Therefore, we would propose that the Board allow an entity to apply the amendments prospectively to transactions other than leases and decommissioning obligations.

Restatement of comparative information

30. In our view, the expected benefits of restating comparative information would outweigh the costs of providing that information. Restating comparative information would provide useful information to users of financial statements, particularly for entities that currently do not recognise deferred tax for leases and decommissioning obligations. We note that our preliminary recommendation to remove the capping proposal and to simplify the transition requirements (see paragraph 27 above) would reduce the costs of applying the proposed amendments and restating comparative information.

Staff preliminary recommendation

31. Based on our analysis above in paragraphs 21–30, our preliminary recommendation is that the Board:

    (a) require entities to apply the amendments for the first time by recognising deferred tax for all temporary differences related to leases and decommissioning obligations at the beginning of the earliest comparative period presented, with the cumulative effect recognised as an adjustment to the

[5] See paragraph 15–16 of Agenda Paper 3.

opening balance of retained earnings (or other component of equity, as appropriate);

(b) allow entities to apply the amendments prospectively to transactions other than leases and decommissioning obligations; and

(c) not provide the transition relief proposed in the Exposure Draft.

Other matters

32. Appendix A to this paper sets out our analysis of other matters raised by respondents, for which we recommend no changes to the proposed amendments.

Summary of staff preliminary recommendations

33. Our preliminary recommendations are that the Board:

(a) require entities to apply the amendments to transactions that give rise to equal amounts of taxable and deductible temporary differences;

(b) require entities to apply the amendments for the first time by recognising deferred tax for all temporary differences related to leases and decommissioning obligations at the beginning of the earliest comparative period presented, with the cumulative effect recognised as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate);

(c) allow entities to apply the amendments prospectively to transactions other than leases and decommissioning obligations; and

(d) not provide the transition relief proposed in the Exposure Draft.

Question for the Committee
What are your views on the analysis and preliminary recommendations set out in this paper? Please explain why.

Appendix A—Analysis of other matters

A1. The following table summarises other matters raised by respondents along with our analysis and preliminary recommendation on those matters.

Matter	Staff analysis and recommendation
1. *Disclosure of unrecognised deferred tax liability* One respondent suggested requiring entities to disclose information to help users of financial statements understand the amount and nature of any unrecognised deferred tax liabilities that would result from the capping proposal.	*We recommend no change.* This suggestion would no longer be relevant if the Board agrees with our preliminary recommendation to remove the capping proposal.
2. *Practical expedient for portfolio of leases* One respondent suggested providing practical expedients, such as allowing an entity to apply the proposed amendments to a portfolio of leases rather than to each individual lease. In its view, this could help reduce the cost of applying the amendment.	*We recommend no change.* We understand this suggestion is intended to alleviate the costs of assessing whether the recoverability requirement is met by allowing such assessment to be made for a portfolio of leases. If the Board agrees with our preliminary recommendation to remove the capping proposal, providing such a practical expedient would be unnecessary. This is because entities would no longer be required to assess the recoverability requirement on initial recognition of a lease to determine the extent to which it can recognise a deferred tax liability (see paragraph 26(a) of Agenda Paper 3A).
3. *Wording of paragraphs in IAS 12* A few respondents said paragraphs 15, 22 and 24 of IAS 12 refer to initial recognition of an asset *or* a liability, rather than an asset *and* a liability. In their view, referring to an asset *and* a liability in paragraph 22A of the Exposure Draft would introduce inconsistencies within those paragraphs.	*We recommend no change.* We disagree that referring to an asset *and* a liability in the amendments would introduce inconsistencies in IAS 12. Nonetheless, if the Board agrees with our preliminary recommendation to remove the capping proposal, paragraph 22A of the Exposure Draft would no longer be included in the final amendments.
4. *Inconsistent treatment for assets acquired with financing* One respondent said the proposed amendments would not apply to the acquisition of an asset	*We recommend no change.* We understand that, in most situations in which an entity acquires an asset financed by a loan, tax deductions relate to the consumption of the asset

Matter	Staff analysis and recommendation
financed by a loan—this could result in inconsistent treatment of two economically-similar transactions.	and not to the repayment of the loan. Such situations would be economically similar to, and result in the same deferred tax accounting as, leases for which tax deductions are attributable to the lease asset. Such situations are not economically similar to leases for which tax deductions are attributable to the lease liability and, therefore, might appropriately result in different deferred tax accounting.
5. Expedite finalisation A few respondents suggested finalising the proposed amendments as quickly as possible to allow entities to apply the amendments as close to the adoption of IFRS 16 as practicable.	*We recommend no change.* The Board issued the Exposure Draft after the effective date of IFRS 16—it was therefore already aware that any amendments to IAS 12 could not be issued in time to apply them together with entities' first application of IFRS 16. Nonetheless, if the Board decides to finalise the amendments, it will aim to issue amendments as soon as practicable.
6. Drafting suggestions Some respondents suggested drafting improvements.	*We will consider during drafting* We will consider drafting suggestions when drafting any final amendments.

Appendix B—Other transactions in the scope of the proposed amendments

B1. This appendix analyses two transactions—other than leases and decommissioning obligations—that respondents said could be in the scope of the proposed amendments. We analysed only those transactions for which respondents provided enough information to determine whether temporary differences arise on initial recognition.

B2. We identified two such transactions:

(a) applying IFRS 2 *Share-based Payment*, an entity might recognise a cash-settled share-based payment liability and capitalise the cost of the services as part of the cost of a tangible or intangible asset. The entity receives tax deductions only when cash settlement occurs.

(b) applying IAS 23 *Borrowing Costs*, an entity might capitalise borrowing costs as part of the cost of a qualifying asset and recognise a liability to pay for those costs. The entity receives tax deductions only when payments are made.

B3. Assuming attribution of the tax deductions to the liability, these transactions would give rise to taxable and deductible temporary differences related to the asset and liability on initial recognition. As for leases and decommissioning obligations, these temporary differences would be equal and offsetting.[6] Accordingly, the proposed amendments would apply to these transactions and deferred tax would be recognised for the related temporary differences.

B4. We continue to see no reason why the entity should not recognise deferred tax for such transactions—similar to leases and decommissioning obligations, the recognition exemption is, in our view, unnecessary for such transactions. Further, recognising deferred tax for these temporary differences would be:

(a) consistent with the general principle in IAS 12 of recognising deferred tax for all temporary differences; and

(b) less complex and costly than applying the recognition exemption—ie it would avoid the need to separately track the related temporary differences.

[6] If an entity receives no tax deductions (or only partial deductions) for cash-settled share-based payments or borrowing costs payments, equal and offsetting temporary differences would not arise (for reasons similar to those explained in paragraph 11 of this paper).

Appendix C—Extracts from Appendix C to IFRS 16 *Leases*

C1. We reproduce below paragraphs C5 and C7–C8 of Appendix C to IFRS 16 for ease of reference:

> C5 A lessee shall apply this Standard to its leases either:
>
> (a) retrospectively to each prior reporting period presented applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; or
>
> (b) retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application in accordance with paragraphs C7–C13.
>
> …
>
> C7 If a lessee elects to apply this Standard in accordance with paragraph C5(b), the lessee shall not restate comparative information. Instead, the lessee shall recognise the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.
>
> **Leases previously classified as operating leases**
>
> C8 If a lessee elects to apply this Standard in accordance with paragraph C5(b), the lessee shall:
>
> (a) recognise a lease liability at the date of initial application for leases previously classified as an operating lease applying IAS 17. The lessee shall measure that lease liability at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate at the date of initial application.
>
> (b) recognise a right-of-use asset at the date of initial application for leases previously classified as an operating lease applying IAS 17. The lessee shall choose, on a lease-by-lease basis, to measure that right-of-use asset at either:

i. its carrying amount as if the Standard had been applied since the commencement date, but discounted using the lessee's incremental borrowing rate at the date of initial application; or

ii. an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.

(c) apply IAS 36 *Impairment of Assets* to right-of-use assets at the date of initial application, unless the lessee applies the practical expedient in paragraph C10(b).