Multiple Tax Consequences of Recovering an Asset (IAS 12 *Income Taxes*)—April 2020

The Committee received a request about deferred tax when the recovery of the carrying amount of an asset gives rise to multiple tax consequences. In the fact pattern described in the request:

a. an entity acquires an intangible asset with a finite useful life (a licence) as part of a business combination. The carrying amount of the licence at initial recognition is CU100. The entity intends to recover the carrying amount of the licence through use, and the expected residual value of the licence at expiry is nil.
b. the applicable tax law prescribes two tax regimes: an income tax regime and a capital gains tax regime. Tax paid under both regimes meets the definition of income taxes in IAS 12. Recovering the licence's carrying amount has both of the following tax consequences:
    i. under the income tax regime—the entity pays income tax on the economic benefits it receives from recovering the licence's carrying amount through use, but receives no tax deductions in respect of amortisation of the licence (taxable economic benefits from use); and
    ii. under the capital gains tax regime—the entity receives a tax deduction of CU100 when the licence expires (capital gain deduction).
c. the applicable tax law prohibits the entity from using the capital gain deduction to offset the taxable economic benefits from use in determining taxable profit.

The request asked how the entity determines the tax base of the asset and, consequently, how it recognises and measures deferred tax.

The fundamental principle in IAS 12

The fundamental principle upon which IAS 12 is based (as stated in paragraph 10 of IAS 12) is that 'an entity shall, with certain limited exceptions, recognise a deferred tax liability (asset) whenever recovery or settlement of the carrying amount of an asset or liability would make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences'.

Applying the fundamental principle to the fact pattern

The recovery of the asset's carrying amount gives rise to two distinct tax consequences—it results in taxable economic benefits from use and a capital gain deduction that cannot be offset in determining taxable profit. Accordingly, applying the fundamental principle in IAS 12, an entity reflects separately these distinct tax consequences of recovering the asset's carrying amount.

An entity identifies temporary differences in a manner that reflects these distinct tax consequences by comparing:

a. the portion of the asset's carrying amount that will be recovered under one tax regime; to
b. the tax deductions the entity will receive under that same tax regime (which are reflected in the asset's tax base).

In the fact pattern described in the request, the Committee concluded that the entity identifies both:

a. a taxable temporary difference of CU100—the entity will recover the licence's carrying amount (CU100) under the income tax regime, but will receive no tax deductions under that regime (that is, none of the tax base relates to deductions under the income tax regime); and
b. a deductible temporary difference of CU100—the entity will not recover any part of the licence's carrying amount under the capital gains tax regime, but will receive a deduction of CU100 upon expiry of the licence (that is, all of the tax base relates to deductions under the capital gains tax regime).

The entity then applies the requirements in IAS 12 considering the applicable tax law in recognising and measuring deferred tax for the identified temporary differences.

The Committee concluded that the principles and requirements in IAS 12 provide an adequate basis for an entity to recognise and measure deferred tax in the fact pattern described in the request. Consequently, the Committee decided not to add the matter to its standard-setting agenda.