STAFF PAPER

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Project	**Multiple tax consequences of recovering an asset (IAS 12)**		
Paper topic	Initial consideration		
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about IAS 12 *Income Taxes*. The submission asks how an entity accounts for deferred taxes when the recovery of the carrying amount of an asset gives rise to multiple tax consequences.

2. The objective of this paper is to:

   (a) provide the Committee with a summary of the matter;

   (b) present our research and analysis; and

   (c) ask the Committee whether it agrees with our recommendation not to add this matter to its standard-setting agenda.

Structure of the paper

3. This paper includes:

   (a) background information;

(b) summary of outreach;

(c) staff analysis; and

(d) staff recommendation.

4. There are three appendices to the paper:

   (a) Appendix A—proposed wording of the tentative agenda decision;

   (b) Appendix B—submission; and

   (c) Appendix C—Example B after paragraph 51A of IAS 12.

Background information

5. In some tax jurisdictions, the manner in which an entity recovers the carrying amount of an asset—for example, whether it recovers the asset through use or through sale—determines the tax consequences that follow from such recovery. For example, the manner of recovery of an asset may affect the applicable tax rates and the tax base attributed to that asset. The tax law may also prohibit entities from offsetting taxable profit or loss arising from one manner of recovery (eg through use) from taxable profit or loss arising from another manner of recovery (eg through sale).

6. Paragraph 51 of IAS 12 requires an entity to measure deferred tax assets and liabilities reflecting 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. For example, if an entity expects to recover the carrying amount of an asset through sale, the entity determines the tax base of that asset, and the tax rate it applies in measuring deferred tax, in accordance with the tax consequences applicable to a recovery through sale.

7. The Committee received a submission describing a situation in which the expected manner of recovery of an asset's carrying amount gives rise to two distinct tax consequences. These tax consequences arise under two different tax regimes even though there is only one expected manner of recovery (through use). The submitter asks how an

entity determines the tax base of the asset and, consequently, how it accounts for deferred tax in this situation.

8. The submitter provides the following example:

   (a) Entity A acquires an intangible asset with a finite useful life (a licence) as part of a business combination.[1] The fair value of the licence is CU100 at the acquisition date—accordingly, the carrying amount of the licence at initial recognition is also CU100. The entity expects to recover the carrying amount of the licence only through use, and the expected residual value of the licence at expiry is nil.

   (b) the applicable tax law prescribes two different tax regimes: income tax regime (income regime) and capital gain tax regime (capital regime).[2] The recovery of the carrying amount of the licence through use has tax consequences under both regimes, as follows:

      i. *under the income regime*: Entity A pays income tax on the economic benefits it receives from recovering the carrying amount of the licence through use, but receives no tax deductions in respect of amortisation of the licence (taxable economic benefits from use).

      ii. *under the capital regime*: Entity A receives a tax deduction when the licence expires—this deduction is equal to the fair value of the licence of CU100 at initial recognition (capital gain deduction).[3]

   (c) the tax law prohibits Entity A from using the capital gain deduction to offset the taxable economic benefits from use in determining taxable profit. The tax rate applied to taxable economic benefits from use could also be different from the tax rate applied to the capital gain deduction.

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[1] The exemption from recognising deferred taxes on initial recognition of an asset or liability in paragraphs 15 and 24 of IAS 12 does not apply to business combinations.

[2] Tax paid under both the income regime and the capital regime meets the definition of income taxes and, accordingly, is within the scope of IAS 12.

[3] The tax law also allows a tax deduction under the capital regime on sale or relinquishment of the licence.

9. The submission identifies two ways of accounting for deferred tax arising on initial recognition of the asset in these circumstances:

(a) View 1: an entity identifies a single tax base.[4] The total amount of tax deductions the entity will receive from recovering the asset's carrying amount is CU100. Accordingly, the tax base of the asset is CU100. The asset's carrying amount at initial recognition is also CU100. Therefore, because the tax base of the asset equals its carrying amount, no temporary difference arises on initial recognition and the entity would not recognise deferred tax at that date.

(b) View 2: an entity accounts for the tax consequences under each regime separately. The entity would compare the tax deductions available under one regime to the portion of the asset's carrying amount that it expects to recover under that regime in identifying any temporary difference. Applying this view, the entity would consider the different tax consequences, as follows:

i. *tax consequences under the income regime*—the entity will not receive any tax deduction from recovering the asset under the income regime. Therefore, it would identify a tax base of nil. However, the entity recovers the full carrying amount of the asset (CU 100) under this regime. Therefore, there is a taxable temporary difference between the tax base (nil) and the carrying amount expected to be recovered under this regime (CU100). The entity would recognise a deferred tax liability applying the tax rate applicable under the income regime.

ii. *tax consequences under the capital regime*—the entity will receive a tax deduction of CU100 under the capital regime. Therefore, it would identify a tax base of CU100. However, the entity does not recover any part of the asset's carrying amount under this regime. Therefore, there is a deductible temporary difference between the tax base (CU100) and the carrying amount expected to be recovered under this regime (nil).

[4] Paragraph 7 of IAS 12 defines the tax base of an asset—paragraph 22 of this paper reproduces that paragraph.

The entity would recognise a deferred tax asset applying the tax rate applicable under the capital regime. However, the entity would recognise a deferred tax asset only to the extent it is probable that taxable profit under the capital regime will be available against which the entity can utilise this deductible temporary difference.[5]

10. The submission provides further details about each of these views, including a numeric example illustrating the outcomes. Appendix B to this paper reproduces the submission.

Summary of outreach

11. We sent information requests to members of the International Forum of Accounting Standard-Setters, securities regulators, and large accounting firms. The submission was also made available on our website.

12. The request asked those participating to provide information about whether, based on their experience:

    (a) the fact pattern described in the submission is common—if the fact pattern is common, we asked in which jurisdictions and for what types of assets it is common, which tax regimes it affects, and the predominant accounting observed; and

    (b) they are aware of other situations in which:

        i. the expected manner of recovery of an asset (be it only through use, only through sale, or through a combination of both) gives rise to taxable economic benefits under one tax regime, but corresponding deductible amounts under another regime; and

        ii. the entity cannot offset taxable profits assessed under one regime with deductions received under the other.

[5] Paragraph 29(a) of this paper expands on the requirements related to the recognition of deferred tax assets.

13. We received 12 responses—seven from national standard-setters and five from large accounting firms. The views received represent informal opinions and do not reflect the official views of those respondents or their organisations.

Findings from outreach

Is the fact pattern common?

14. Some respondents say the fact pattern described in the submission is common in Australia and the UK. Other respondents do not say the fact pattern is common, but say the same or similar fact patterns exist in these and other jurisdictions. Some respondents say the fact pattern is not common in their jurisdictions.

15. Some respondents say fact patterns observed involve assets such as brands, mining rights and some items of property, plant and equipment. One respondent says the fact pattern is common in the mining industry in the UK and Australia.

16. Some respondents say tax consequences usually arise under income and capital regimes, as in the fact pattern described in the submission. However, one respondent identified similar situations involving other tax regimes.

What is the predominant accounting?

17. Some respondents say they have observed diversity in reporting, with some entities applying view 1 and others view 2 (see paragraph 9 of this paper).

Staff Analysis

The fundamental principle in IAS 12

18. The objective section of IAS 12 states:

> 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 … future tax consequences

> of … the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's statement of financial position…

19. Paragraph 10 of IAS 12 describes, as 'the fundamental principle' upon which IAS 12 is based:

> …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...

20. Consistent with this principle, paragraphs 15 and 24 of IAS 12 require an entity to recognise deferred tax for all temporary differences (with limited exceptions). The existence of a temporary difference means that the recovery or settlement of the carrying amount of an asset or liability will have future tax consequences. This is because a temporary difference represents the difference between the amount attributed to the asset (liability) for accounting purposes (carrying amounts) and the amount attributed to that asset (liability) for tax purposes (tax bases).

Application of the fundamental principle to the fact pattern

21. As explained in paragraph 8 of this paper, in the fact pattern described in the submission, the recovery of the carrying amount of the asset through use gives rise to two distinct tax consequences—it results in taxable economic benefits from use (under the income regime) and a capital gain deduction (under the capital regime) that cannot be offset in determining taxable profit.

22. Paragraph 7 of IAS 12 states:

> The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those

economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

23. Paragraph 10 of IAS 12 states:

> Where the tax base of an asset or liability is not immediately apparent, *it is helpful to consider the fundamental principle upon which this Standard is based …* [emphasis added]

Is the tax base of the asset immediately apparent?

24. Our outreach identified that entities have differing views as to how to determine the tax base of the asset in the fact pattern described in the submission (see paragraph 17 of this paper):

    (a) proponents of view 1 (see paragraph 9(a) of this paper) say the tax base is CU100 because this is the amount that will be deductible for tax purposes against any economic benefits that will flow to the entity when it recovers the asset's carrying amount—in their view, the fact that the capital gain deduction cannot be used to offset the taxable economic benefits from use is irrelevant in assessing the tax base. They say the definitions of 'tax base' and 'temporary differences' in paragraph 5 of IAS 12 imply that an asset or liability can have only one tax base and only one temporary difference.

    (b) proponents of view 2 (see paragraph 9(b) of this paper) say it is necessary to separately consider the tax base of the asset under the income regime (which results in the taxable economic benefits from use) from the tax base under the capital regime (which results in the capital gain deduction).

25. It could also be said that, applying paragraph 7 of IAS 12 (see paragraph 22), no amount will be deductible for tax purposes against the taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset. This is because the economic benefits received when the entity recovers the asset are taxable under the income regime, and the capital gain deduction is not deductible against these economic benefits. Accordingly, the tax base of the asset could be viewed as nil.

26. In our view, the differing views in paragraphs 24–25 indicate that the tax base of the asset is not immediately apparent in this situation, and that an entity would then consider the fundamental principle in IAS 12 in determining the accounting for deferred tax.

Would the accounting resulting from View 1 reflect the fundamental principle?

27. View 1 described in the submission would result in the entity offsetting tax consequences that cannot be offset in accordance with the tax law (see paragraph 8(c) of this paper). This would not, in our view, faithfully reflect the tax consequences that arise from recovering the carrying amount of the asset. Accordingly, applying this view would be inconsistent with the fundamental principle in IAS 12.

28. For example, if the entity were to compare the tax base of the asset (based on the capital gain deduction available under the capital regime) with its carrying amount (the recovery of which will result in taxable economic benefits from use under the income regime) and conclude there is no temporary difference, the entity would not recognise deferred tax (see paragraph 9(a) of this paper). This conclusion would be inconsistent with the fact that recovering the asset's carrying amount will have the following tax consequences:

    (a) the entity will pay tax under the income regime as it recovers the asset. This is because the tax law prohibits the entity from offsetting the capital gain deduction against the taxable economic benefits it will receive from recovering the asset's carrying amount.

    (b) the entity will receive the capital gain deduction under the capital regime, even though it will not earn any taxable economic benefits against which it can utilise this deduction.

29. The accounting described in paragraph 28 would also not reflect the fact that:

    (a) the entity might be unable to recognise a deferred tax asset in relation to the capital gain deduction applying the requirements in paragraphs 24 and 27A of

IAS 12—this is because the entity might have limited sources of taxable profit under the capital regime against which it can utilise that deduction.[6]

(b) different tax rates may apply to the capital gain deduction and the taxable economic benefits from use—applying this view would not reflect these different tax rates.

Applying the fundamental principle to the fact pattern

30. Applying the fundamental principle in IAS 12, in our view, an entity reflects separately the tax consequences of recovering the asset under the income regime (which results in taxable economic benefits from use) and the tax consequences under the capital tax regime (which results in the capital gain deduction).

31. In order to separately reflect those tax consequences, the entity would identify (a) the portion of the carrying amount of the asset that will be recovered under one tax regime, and (b) the tax deductions that will be received under that same tax regime (which are reflected in the asset's tax base). The entity would then compare these two amounts in identifying temporary differences associated with the asset. Disaggregating temporary differences to reflect tax consequences is similar to the approach illustrated in some examples included in IAS 12, such as Example B after paragraph 51A of IAS 12 (reproduced in Appendix C).

32. In the fact pattern described in the submission, the entity would identify both:

(a) a taxable temporary difference of CU100—the entity will recover the asset's carrying amount (CU100) under the income regime, but will receive no tax deductions under that regime (ie none of the tax base relates to deductions under that regime); and

[6] Paragraph 24 of IAS 12 requires an entity to recognise a deferred tax asset only to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. Paragraph 27A states that 'if tax law restricts the utilisation of losses to deduction against income of a specific type, a deductible temporary difference is assessed in combination only with other deductible temporary differences of the appropriate type'.

(b) a deductible temporary difference of CU100— the entity will not recover any part of the asset's carrying amount under the capital regime, but will receive a deduction of CU100 upon expiry of the asset (ie all of its tax base relates to deductions under that regime).

33. The entity would then apply the requirements in IAS 12 considering the applicable tax law in recognising and measuring deferred tax for the identified temporary differences. For example, the entity would (a) apply the tax rate applicable under each regime to the respective temporary differences to calculate the deferred tax liability and deferred tax asset, and (b) assess whether to recognise a deferred tax asset for the deductible temporary difference by reference to the probability of future taxable profits assessed under the capital regime only.

34. This accounting results in an outcome that is similar to that described in View 2 of the submission (see paragraph 9(b) of this paper). We think this accounting also aligns with the Board's rationale in developing an amendment to IAS 12 in 2010.

Paragraph BC9 of the Basis for Conclusion on IAS 12

35. In December 2010, the Board issued amendments to IAS 12. The 2010 amendments addressed the accounting for deferred tax relating to investment properties measured using the fair value model in IAS 40 *Investment Property*. In particular, the amendments addressed how an entity applies the requirements in paragraph 51 of IAS 12 (see paragraph 6 of this paper) when it expects to recover the carrying amount of such items through both use and sale. The 2010 amendments introduced paragraph 51C of IAS 12, which states that there is a rebuttable presumption that the carrying amount of investment property measured using the fair value model will be recovered entirely through sale.

36. Paragraph BC9 of IAS 12 states:

> It is particularly difficult and subjective to determine the entity's expected manner of recovery for investment property that is measured using the fair value model in IAS 40. In contrast, for investment property that is measured using the cost model in IAS 40, the Board believes that the estimates required for

> depreciation establish the expected manner of recovery because there is a general presumption that an asset's *carrying amount is recovered* through use *to the extent* of the amount subject to depreciation and through sale *to the extent* of the residual value. [emphasis added]

37. The difference between the situation discussed in paragraph BC9 and the fact pattern described in the submission is that, in the former, the entity recovers the carrying amount of the asset from both using it and then selling it (ie there are two manners of recovery). However, we think these fact patterns are similar in that, in both cases, the expected manner of recovery of the carrying amount of the asset (be it only through use, only through disposal, or through a combination of both) gives rise to two distinct tax consequences. Therefore, we think the explanation in paragraph BC9 of IAS 12 is also relevant to the fact pattern described in the submission.

38. In our view, the accounting described in paragraphs 30–34 of this paper is consistent with the explanation in paragraph BC9 for investment property measured using the cost model in IAS 40. Paragraph BC9 indicates that IAS 12 requires an entity to split the carrying amount of the asset to reflect the tax consequences arising from different manners of recovery of the asset (ie through use and through sale).

39. The rebuttable presumption that the carrying amount of investment property measured using the fair value model will be recovered only through sale (which assumes that tax consequences arise only through sale) is described as an 'exception to the principle in IAS 12' in paragraph BC10 of IAS 12. That paragraph states that 'the purpose of *the exception* is to reflect the entity's expectation of recovery of the investment property in a practical manner that involves little subjectivity' [emphasis added].

40. These paragraphs explain that, applying IAS 12 to a fact pattern that involves two distinct tax consequences, an entity disaggregates the carrying amount (and consequently the tax base) to reflect the applicable tax consequences of recovering the carrying amount of the asset or liability in accordance with the fundamental principle in IAS 12.

Is there a dual manner of recovery in the fact pattern?

41. In the fact pattern described in the submission, the tax law prescribes a similar tax treatment for the sale, relinquishment, or expiry of the licence. Accordingly, some might say that, for tax purposes, expiry is similar to a disposal event and therefore there is a dual manner of recovery. However, as noted in paragraph 37, there would be no difference in the accounting that would follow from such a view.

Conclusion

42. Based on our analysis in paragraphs 18–41 of this paper, we conclude that, in the fact pattern described in the submission, IAS 12 requires an entity to reflect separately the distinct tax consequences of recovering the carrying amount of the asset when measuring deferred tax associated with the asset (ie the entity applies the accounting described in paragraph 31 of this paper).

Question 1 for the Committee
1. Does the Committee agree with our analysis of the requirements in IAS 12, outlined in paragraphs 18–41 of this paper?

Should the Committee add this matter to its standard setting agenda?

Is it necessary to add to or change IFRS Standards to improve financial reporting?[7]

43. Based on our analysis in paragraphs 18–41 of this paper, we conclude that IAS 12 provides an adequate basis for an entity to account for deferred tax in the fact pattern described in the submission.

[7] Paragraph 5.16(b) of the *Due Process Handbook*.

Staff recommendation

44. Based on our assessment of the Committee's agenda criteria in paragraphs 5.16-5.17 of the Due Process Handbook (discussed in paragraph 43 above), we recommend that the Committee does not add this matter to its standard-setting agenda. Instead, we recommend publishing a tentative agenda decision that outlines how the applicable requirements in IAS 12 apply to the fact pattern described in the submission.

45. Appendix A to this paper outlines the proposed wording of the tentative agenda decision.

Questions 2 and 3 for the Committee
2. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda? 3. Does the Committee have any comments on the proposed wording of the tentative agenda decision outlined in Appendix A to this paper?

Appendix A—proposed wording of the tentative agenda decision

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

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 only 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. The recovery of the licence's carrying amount through use has 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).

   ii. under the capital gains tax regime: the entity receives a tax deduction of CU100 when the licence expires (capital gain deduction).

c. the 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 accounts for deferred tax.

The fundamental principal in IAS 12

Paragraph 10 of IAS 12 states that 'where the tax base of an asset or liability is not immediately apparent, it is helpful to consider the fundamental principle upon which this

Standard is based'. The same paragraph describes, as that fundamental principle, '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 Committee observed that, in the fact pattern described in the request, the tax base of the asset is not immediately apparent. The Committee also observed that 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 the distinct tax consequences of recovering the asset's carrying amount.

An entity identifies temporary differences in a manner that reflects these distinct tax consequences—the entity would do so by comparing (a) the portion of the asset's carrying amount that will be recovered under one tax regime, with (b) the tax deductions that will be received 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 (ie none of the tax base relates to deductions under that 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 (ie all of the tax base relates to deductions under that 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 account for deferred tax in the fact pattern described in the request. Consequently, the Committee [decided] not to add the matter to its standard-setting agenda.

Appendix B—submission

B1. We have reproduced the submission below, and in doing so deleted details that would identify the submitters of the request. We have only reproduced information relevant to the matter discussed in this paper.

Deferred tax accounting where the expected manner of recovery of an asset through use only gives rise to tax consequences under multiple regimes

Background information

Tax legislation in certain jurisdictions results in income and profits being assessable under multiple tax regimes depending on the nature of the transaction, with no ability to settle the multiple tax obligations by offsetting one against the other. The multiple tax regimes may exist within a single jurisdiction, an example being a jurisdiction with separate income tax and capital gains tax (CGT) mechanisms. Multiple tax regimes may also apply to the same income and profits across multiple jurisdictions, an example being where operations in an offshore location are taxed in both the local and parent entity jurisdictions.

In certain circumstances, a single expected manner of recovery of an asset may give rise to tax consequences under multiple regimes.

Example:

- An entity acquires a license as part of a business combination - measured and recognised at fair value.
- The entity intends to hold the license until expiry at which point it will have a residual value of zero. The entity will fully depreciate the carrying amount of the license for accounting purposes over its period of use, during which it will generate both accounting and taxable income.
- Under tax legislation in the relevant jurisdiction, the license has no deductible/depreciable amount for income tax purposes. However, the entity is entitled to a deduction on sale, relinquishment or expiry for CGT purposes. The CGT deductible amount can only be used to calculate net capital gains or losses (i.e. the deduction is not available to reduce assessable income for income tax purposes).
- As the license has been acquired as part of a business combination, the initial recognition exception within IAS 12 *Income Taxes* paragraphs 15 and 24 does not apply (i.e. any deferred tax must be recognised as part of the business combination accounting).

Issue

An entity expects to recover the entire carrying amount of an asset through use only (i.e. no further recovery on disposal) and this gives rise to tax consequences under multiple tax regimes – i.e. income tax during period of use and CGT at end of use. What is the tax base when the asset has a depreciable amount for CGT purposes but not for income tax?

Views

There is diversity amongst the major accounting firms on this particular issue. We are aware of three views in practice:

- View 1: single tax base
- View 2: multiple tax bases
- View 3: accounting policy choice

Each of these views is considered in turn below.

View 1: single tax base

Under this view, it is assumed that it is only necessary to identify a single tax base where there is a single expected manner of recovery of the accounting carrying amount. In the example under consideration, the asset is considered to have a tax base that is available to the Entity as a result of the recovery of the asset through use, being the CGT tax base.

Paragraph 5 of IAS 12 defines the tax base of an asset or liability as the amount attributed to that asset or liability for tax purposes and defines a temporary difference as the difference between the carrying amount of an asset or liability in the statement of financial position and its tax base. As such, deferred tax should be recognised based on the difference between the asset's carrying amount and its tax base. Assuming the CGT tax base and carrying amount are consistent at the date of the business combination, there is no temporary difference and therefore no deferred tax to recognise as part of the business combination accounting.

A deductible temporary difference, potentially giving rise to a deferred tax asset (DTA), arises over time as the asset is depreciated for accounting purposes with no equivalent change in the CGT tax base. The potential DTA represents the tax effect of the temporary difference between the carrying amount of the asset and the future CGT tax deduction. The potential DTA would be assessed for recoverability, which determines whether it can be recognised.

This view considers that:

- The expected manner of recovery of the asset is through use. At the end of the useful life of the license (expiry), the entity is entitled to a deductible amount for CGT purposes. This represents the tax base.
- For the purpose of measuring deferred tax, it is not relevant that the Entity is not entitled to a tax deduction *during* the period of use under the income tax regime as an available (CGT) tax base for the asset has been identified.
- It is also not relevant that the CGT deductible amount can only be used to calculate net capital gains, as this impacts only the recognition of any DTA that arises in relation to the CGT deductible amount (i.e. whether there are probable capital gains to utilise the CGT deductible amount now or in the future).

- The CGT tax base is the appropriate single tax base because it is available to the Entity regardless of the manner of, or intention relating to, recovery (i.e. through use only; through use and subsequent sale; and through sale only).
- Refer to Appendix 1 for an illustrative example of View 1.

View 2: multiple tax bases

Under this view, the Entity expects to recover the entire carrying amount through the period of use, with no further recovery on disposal. Deferred taxes are recognised having regard separately to the future tax consequences arising from recovery through use, for which there is no income tax deduction, and the future tax consequences that arise at the end of use/expiry, for which there is a CGT tax base.

At the date of the business combination, the Entity recognises a deferred tax liability (DTL) for the future income tax consequences associated with the expected recovery through use. The DTL is based on the taxable temporary difference between the asset's carrying amount (i.e. acquisition date fair value) and the tax base (i.e. an income tax base of nil).

The Entity will also consider the recognition of a DTA for the future CGT tax consequences associated with the expiry of the license. The DTA is based on the deductible temporary difference between the asset's residual value of nil (being the expected value at the end of use) and the tax base (i.e. the CGT tax base). The recognition of this DTA depends on an assessment of its recoverability.

This view considers that:

- The overall objective of IAS 12 is to account for the current and future tax consequences which reflect the expected recovery of the carrying amount of the asset.
- The objective paragraph of IAS 12 goes on to state "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."
- The expected manner of recovery of the asset is through use. This gives rise to two tax consequences:
  - Income tax – assessable income arising from realisation of the carrying amount with nil tax depreciation/deduction during the period of use
  - CGT - deductible amount is available at relinquishment/expiry with nil taxable proceeds
- Income tax: As the Entity recovers the carrying amount of the license through use, it will pay higher income tax due to there being no tax depreciation/deduction (i.e. compared to a situation where there were no tax consequences, such as the income generated from the license being exempt from tax). Recognition of an income tax DTL is consistent with the objective paragraph in IAS 12.
- CGT: At the end of the asset's useful life (license expiry), the Entity will be entitled to a CGT deductible amount that can be applied against future capital gains. While the CGT deductible amount will reduce

future capital gains, making tax on future capital gains smaller, it does not impact the payment of future income tax.

- The two tax consequences are separate/distinct. That is, the CGT outcome does not impact the income tax outcome. Therefore, recognition of a DTL for income tax purposes and separate consideration of a DTA for CGT purposes, is appropriate. Accounting for both future tax consequences is consistent with the overall objective of IAS 12.
- To measure the deferred tax associated with the separate income tax and CGT tax consequences, it is appropriate to allocate the carrying amount of the asset based on the expected manner of recovery.
    - The income tax DTL is measured having regard to that portion of the asset's carrying amount that is expected to be recovered during the period of use, i.e. the depreciable amount of the asset. Therefore, the DTL is based on the taxable temporary difference between the asset's depreciable amount (given nil residual value this will be the asset's carrying amount) and the nil income tax base.
    - The CGT-related DTA is measured having regard to that portion of the carrying amount expected to be recovered through sale or at expiry, being the asset's residual value (which in the case of expiry is nil). Therefore, the DTA is based on the deductible temporary difference between the asset's nil residual value and the CGT tax base which is equal to the acquisition date fair value.

  Allocating the carrying amount across the tax regimes in this manner is consistent with paragraph BC6 of the Basis for Conclusions to IAS 12, which notes that 'recognition of depreciation implies that the carrying amount of a depreciable asset is expected to be recovered through use to the extent of its depreciable amount, and through sale at its residual value'.
- Refer to Appendix 1 for an illustrative example of View 2.

View 3: determination of tax base is an accounting policy choice

This view acknowledges that IAS 12 is unclear on how to determine an asset's tax base when the expected manner of recovery through use only gives rise to tax consequences under multiple tax regimes. Accordingly, an Entity is able to make an accounting policy choice between Views 1 and 2 above. The accounting policy must be developed in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and be consistently applied to all similar transactions.

Appendix 1: Illustrative example

- Fact pattern:
  - Business combination purchase consideration: $100
  - Fair value of license: $100 with an estimated life of 3 years
  - Other assets and liabilities of the business were included in the business combination but have been ignored for simplicity
  - Income tax depreciable amount: Nil
  - CGT deductible amount (upon sale or expiry): $100
  - Corporate income tax rate (income tax and CGT): 30%
  - No forecast capital gains to support the recognition of a DTA relating to the future CGT deductible amount

View 1: single tax base

Business combination accounting:

Purchase consideration (PC)	100
Identifiable net assets (INA)	
License	100
Deferred tax (1)	-
Total	100
Goodwill (PC – INA)	-

(1) Temporary Difference = Nil (license carrying amount (CA) of 100 less tax base of 100). Therefore no deferred tax to recognise as part of the business combination.

Subsequent Accounting

	Y0	Y1	Y2	Y3	**Total**
Accounting income		50	60	70	**180**
License depreciation		(30)	(35)	(35)	**(100)**
PBT		20	25	35	**80**
ITE (see calc below)		(15)	(18)	(21)	**(54)**
NPAT		5	7	14	**26**
Effective tax rate (ETR)		***75%***	***72%***	***60%***	**67%**
Income tax expense					
Current tax					
Assessable income		50	60	70	

Deductions		-	-	-	
Taxable income		50	60	70	
Current ITP @ 30% (**A**)		(15)	(18)	(21)	
Deferred tax					
Carrying amount	100	70	35	0	
Tax base	100	100	100	100	
Temporary difference	-	30	65	100	
Potential DTA @ 30%	-	9	19.5	30	
DTAs not recognised	-	(9)	(19.5)	(30)	
Net DTA		-	-	-	
Change in deferred tax (**B**)		-	-	-	
ITE (**A + B**)		(15)	(18)	(21)	

The ETR does not equal to the corporate income tax rate throughout the period of use (assuming that the CGT DTA is not recognised). Refer to Appendix 2 for the impact on the ETR when the Entity is able to recognise the DTA relating to the future CGT deductible amount.

View 2: multiple tax bases

- Fact pattern:
  - All facts are identical to those assumed in View 1
  - Any potential impairment of goodwill is ignored for simplicity

Business combination accounting:

Purchase consideration (PC)	100
Identifiable net assets (INA)	
License	100
Deferred tax (1)	(30)
Total	70
Goodwill (PC – INA)	30

(1) Taxable Temporary Difference (income tax) = 100 (license CA of 100 less tax base of 0). Gives rise to an income tax DTL of 30 (i.e. 100 @ 30%). Deductible Temporary Difference (CGT) = 100 (nil residual value less tax base of 100). Gives rise to a CGT DTA of 30 (i.e. 100 @ 30%). However, DTA is not recognised because future recovery is not considered probable.

Subsequent Accounting:

	Y0	Y1	Y2	Y3	**Total**
Accounting income		50	60	70	**180**
License depreciation		(30)	(35)	(35)	**(100)**
PBT		20	25	35	**80**
ITE (see calc below)		(6)	(7.5)	(10.5)	**(24)**
NPAT		14	17.5	24.5	**56**
Effective tax rate (ETR)		***30%***	***30%***	***30%***	**30%**
Income tax expense					
Current tax					
Assessable income		50	60	70	
Deductions		-	-	-	
Taxable income		50	60	70	
Current ITP @ 30% (**A**)		(15)	(18)	(21)	
Deferred tax					
1. Income tax					

Carrying amount	100	70	35	0	
Tax base	0	0	0	0	
Temporary difference	(100)	(70)	(35)	0	
Deferred tax liability @ 30%	(30)	(21)	(10.5)	0	
Change in deferred tax (**B**)		9	10.5	10.5	
2. CGT					
Carrying amount	-	-	-	-	
Tax base	100	100	100	100	
Temporary difference	100	100	100	100	
Potential DTA @ 30%	30	30	30	30	
DTAs not recognised	(30)	(30)	(30)	(30)	
Net DTA	-	-	-	-	
Change in deferred tax (**C**)		-	-	-	
ITE (**A + B + C**)		(6)	(7.5)	(10.5)	

The ETR is equal to the corporate income tax rate throughout the period of use while the CGT DTA is not recognised. Initial recognition of the CGT DTA and any subsequent remeasurement will impact the ETR. To the extent the CGT DTA was recognised as part of the business combination, this would impact the amount of goodwill recognised. In that scenario, the ETR would continue to equal to the corporate income tax rate except when the CGT DTA is remeasured.

Appendix 2: Probable future capital gains

Same fact pattern as per Appendix 1 above except the Entity forecasts capital gains to recognise the DTA relating to the CGT deductible amount (i.e. the probable recognition threshold is met).

View 1: single tax base

Business combination accounting:

Purchase consideration (PC)	100
Identifiable net assets (INA)	
License	100
Deferred tax (1)	-
Total	100
Goodwill (PC – INA)	-

(1) Temporary Difference = Nil (license CA of 100 less tax base of 100). Therefore no deferred tax balance to recognise as part of the business combination.

Subsequent Accounting

	Y0	Y1	Y2	Y3	**Total**
Accounting income		50	60	70	**180**
License depreciation		(30)	(35)	(35)	**(100)**
PBT		20	25	35	**80**
ITE (see calc below)		(6)	(7.5)	(10.5)	**(24)**
NPAT		14	17.5	24.5	**56**
Effective tax rate (ETR)		***30%***	***30%***	***30%***	**30%**
Income tax expense					
Current tax					
Assessable income		50	60	70	
Deductions		-	-	-	
Taxable income		50	60	70	
Current ITP @ 30% (**A**)		(15)	(18)	(21)	
Deferred tax					
Carrying amount	100	70	35	0	

Tax base	100	100	100	100	
Temporary difference	-	30	65	100	
Potential deferred tax asset @ 30%	-	9	19.5	30	
DTAs not recognised					
Change in deferred tax (**B**)		9	10.5	10.5	
ITE (**A + B**)		(6)	(7.5)	(10.5)	

Recognition of the emerging DTA relating to the CGT deductible amount results in an ETR that equals the corporate income tax rate throughout the period of use.

Appendix C—Example B after paragraph 51A of IAS 12

C1. We have reproduced below Example B after paragraph 51A of IAS 12.

Example B

An item or property, plant and equipment with a cost of 100 and a carrying amount of 80 is revalued to 150. No equivalent adjustment is made for tax purposes. Cumulative depreciation for tax purposes is 30 and the tax rate is 30%. If the item is sold for more than cost, the cumulative tax depreciation of 30 will be included in taxable income but sale proceeds in excess of cost will not be taxable.

The tax base of the item is 70 and there is a taxable temporary difference of 80. If the entity expects to recover the carrying amount by using the item, it must generate taxable income of 150, but will only be able to deduct depreciation of 70. On this basis, there is a deferred tax liability of 24 (80 at 30%). If the entity expects to recover the carrying amount by selling the item immediately for proceeds of 150, the deferred tax liability is computed as follows:

	Taxable Temporary Difference	*Tax Rate*	*Deferred Tax Liability*
Cumulative tax depreciation	*30*	*30%*	*9*
Proceeds in excess of cost	*50*	*nil*	*–*
Total	*80*		*9*

(note: in accordance with paragraph 61A, the additional deferred tax that arises on the revaluation is recognised in other comprehensive income)