IFRS™

STAFF PAPER

April 2020

IASB Meeting

Project	**Deferred Tax Related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12)**
Paper topic	Feedback summary—Background and overview

CONTACT(S)	Siobhan Hammond	shammond@ifrs.org	+44 (0) 20 7246 6937
	Gustavo Olinda	golinda@ifrs.org	+44 (0) 20 7246 6481
	Jawaid Dossani	jdossani@ifrs.org	+44 (0) 20 7332 2742

Introduction and purpose

1. In July 2019 the International Accounting Standards Board (Board) published Exposure Draft *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*, which proposed a narrow-scope amendment to IAS 12 *Income Taxes*. The proposed amendment would narrow the scope of the recognition exemption in paragraphs 15 and 24 of IAS 12 so that the exemption would not apply to the extent that, on initial recognition of a transaction, an entity would recognise equal amounts of deferred tax assets and liabilities.

2. The purpose of Agenda Papers 12G–12I is to provide the Board with a summary of feedback on the Exposure Draft. We are not asking the Board to make any decisions at this meeting. However, to help us develop our papers for future Board meetings, we will ask the Board for its initial thoughts on the feedback.

Structure of the papers

3. This paper includes:

   (a) background (paragraphs 7–15);

   (b) feedback overview (paragraphs 16–17);

   (c) next step (paragraph 18); and

   (d) question for the Board.

4. There is one appendix to this paper: Appendix A—Demographic information.

5. Agenda Papers 12H–12I for this meeting provide more information on the feedback:

   (a) Agenda Paper 12H summarises the main matters identified by respondents; and

   (b) Agenda Paper 12I discusses (i) alternative approaches suggested, (ii) feedback on the proposed transition requirements; and (iii) requests for application guidance and examples, and other comments.

6. Agenda Papers 12G–12I use the following terms to describe the extent to which particular feedback was provided by respondents:

Term	*Extent of response among respondents*
Almost all	all except a very small minority
Most	a large majority, with more than a few exceptions
Many	a small majority or large minority
Some	a small minority, but more than a few
A few	a very small minority

Background

7. As a general principle, IAS 12 requires an entity to recognise deferred tax for all temporary differences. However, the Standard prohibits entities from recognising deferred tax assets or liabilities—both on initial recognition and subsequently—for

deductible or taxable temporary differences arising from the 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 (recognition exemption).

8. Applying IFRS 16 *Leases*, an entity recognises an asset and liability at the commencement date of a lease. Similarly, applying IAS 16 *Property, Plant and Equipment* (or IFRS 16) and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, an entity recognises an asset and liability when it initially recognises a decommissioning obligation. In some cases, such transactions may give rise to temporary differences.

9. On initial recognition of a lease, an entity assesses whether temporary differences arise in determining whether to recognise deferred tax applying IAS 12.[1] In making this assessment, an entity determines the tax base of the right-of-use asset (lease asset) and the tax base of the lease liability by identifying the amounts attributable to them for tax purposes. When an entity receives tax deductions on making lease payments, the entity determines whether those tax deductions are attributable to:

   (a) the lease asset (and interest expense)—because the deductions relate to the expenses arising from the lease (that is, depreciation and interest expense); or

   (b) the lease liability (and interest expense)—because the deductions relate to the repayment of the lease liability and interest expense.

10. An entity applies judgement in determining whether tax deductions relate to the lease asset or lease liability, having considered the applicable tax law.

11. Applying IAS 12, temporary differences arise only when the entity determines that tax deductions relate to the lease liability. This is because:

   (a) when tax deductions relate to the lease asset, the tax bases of the lease asset and lease liability equal their carrying amounts, reflecting that the entity will receive tax deductions equal to the carrying amount of the lease asset

[1] For simplicity, paragraphs 9–15 explain the basis for the proposed amendments using leases as an example, but the explanation applies equally to other transactions such as decommissioning obligations.

and receive no tax deductions in respect of the lease liability. Consequently, no temporary differences arise on initial recognition of the lease and the recognition exemption does not apply. Accordingly, the entity recognises no deferred tax on initial recognition, but does so if and when temporary differences arise after initial recognition.

(b) when tax deductions relate to the lease liability, the tax bases of the lease asset and lease liability are zero, reflecting that the entity will receive tax deductions in respect of the lease liability equal to its carrying amount and receive no tax deductions on recovering the carrying amount of the lease asset. Consequently, temporary differences arise on initial recognition of the lease and the recognition exemption applies. Accordingly, the entity recognises no deferred tax in respect of the lease (either on initial recognition or subsequently throughout the lease term).

12. Paragraph 22(c) of IAS 12 explains the purpose of the recognition exemption. If temporary differences arise on initial recognition of an asset or liability in a transaction that is not a business combination and affects neither accounting profit nor taxable profit, an entity would—in the absence of the exemption—recognise deferred tax and adjust the carrying amount of the asset or liability by the same amount. Such adjustments would make the financial statements less transparent and, for this reason, IAS 12 prohibits the recognition of deferred tax in these circumstances.

13. On initial recognition of a lease asset and lease liability, temporary differences would either:

(a) not arise—because the tax deductions relate to the lease asset (see paragraph 11(a)); or

(b) be equal and offsetting (that is, the resulting taxable and deductible temporary differences would be of the same amount)—because the tax deductions relate to the lease liability (see paragraph 11(b)).

14. Accordingly, when temporary differences arise, they are equal and offsetting. If the recognition exemption were not applied, an entity would generally recognise a deferred tax asset and liability of the same amount. The recognition of a deferred tax asset and liability of the same amount would not require any adjustment to the

carrying amount of the related lease asset or lease liability, nor would it have any effect on profit or loss. Thus, the outcome the recognition exemption was designed to prevent (see paragraph 12) does not apply to a lease and the exemption is not needed on initial recognition of a lease when an entity would otherwise recognise a deferred tax asset and liability of the same amount.

15. The Board decided to propose a narrow-scope amendment to IAS 12 that would narrow the scope of the recognition exemption so that it would not apply to a transaction that gives rise to both an asset and a liability on initial recognition. This approach would result in entities recognising deferred tax assets and liabilities for temporary differences arising from the initial recognition of a lease. This in turn would result in an entity recognising the tax effects of a lease as it recovers the lease asset and settles the lease liability, thereby aligning the accounting for deferred tax related to leases with the general principle in IAS 12 (see paragraph 7). Regardless of whether tax deductions are attributable to the lease asset or lease liability, the narrow-scope amendment would result in entities recognising deferred tax assets and liabilities for temporary differences that arise (on initial recognition and subsequently). An entity would typically offset these deferred tax assets and liabilities in the statement of financial position (applying paragraphs 74–75 of IAS 12).

Feedback overview

16. The Board received 68 comment letters. Appendix A to this paper provides a summary by type of respondent and geographical region. Matters raised by respondents were generally consistent across types of respondents and geographical regions, however we have highlighted trends to the extent any have been identified and are considered relevant.

17. Almost all respondents agree with the Board's decision to address the accounting for deferred tax related to leases and decommissioning obligations. Of these respondents:

    (a) many support the proposed amendments. Many of these respondents say the amendments would provide clarity and promote consistent application of IAS 12. A few of these respondents also say the amendments would:

        (i) result in more useful information for users of financial statements; and

        (ii) better reflect the economics of transactions such as leases and decommissioning obligations for which the asset and liability are integrally linked.

    (b) many agree with the direction of the proposed amendments, however they disagree with, or express concerns about, particular aspects of the proposals and request clarification. The main concerns identified relate to:

        (i) the proposal to limit the recognition of deferred tax liabilities to the amount of the related deferred tax asset recognised;

        (ii) the interaction of the proposed amendments with the requirement to reassess unrecognised deferred tax assets;

        (iii) the proposed amendments' scope;

        (iv) the attribution of tax deductions; and

        (v) the requirements for advance lease payments and initial direct costs.

        Agenda Paper 12H discusses these concerns further, together with background information.

    (c) many disagree with the proposed amendments and say the costs of finalising the amendments would outweigh the expected benefits of doing so. Many of these respondents express concerns similar to those discussed in paragraph 17(b) above and suggest alternative approaches the Board could consider. Paragraphs 2–11 of Agenda Paper 12I discuss these alternatives.

Next step

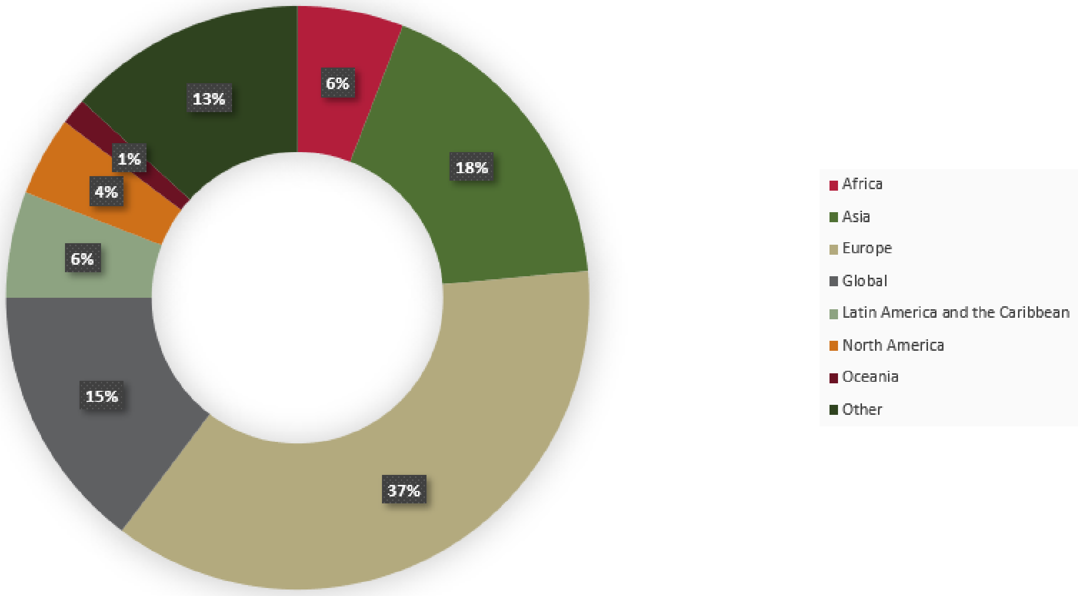
18. We plan to bring a paper to a future Board meeting analysing the feedback and providing recommendations for the Board on the project direction.

Question for the Board

Question
To help us develop our papers for future Board meetings, what are the Board's thoughts on the feedback as summarised in Agenda Papers 12G–12I?

Appendix A—Demographic information

A1. This pie chart illustrates the breakdown of comment letters by geographical region:



A2. This pie chart illustrates the breakdown of comment letters by respondent type: