STAFF PAPER

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IASB Meeting

Project	**Deferred Tax Related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12)**		
Paper topic	Feedback Summary—Main matters		
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Introduction

1. As discussed in Agenda Paper 12G for this meeting, this paper summarises the main matters identified by respondents on the proposed amendments to IAS 12 *Income Taxes*, included in Exposure Draft *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*. In particular, this paper summarises respondents' comments on:

    (a) the proposal to limit the recognition of deferred tax liabilities to the amount of the related deferred tax asset recognised (Topic I—paragraphs 2–14);

    (b) the interaction of the proposed amendments with the requirement to reassess unrecognised deferred tax assets (Topic II—paragraphs 15–22);

    (c) the proposed amendments' scope (Topic III—paragraphs 23–24);

    (d) the attribution of tax deductions (Topic IV—paragraphs 25–29); and

    (e) the requirements for advance lease payments and initial direct costs (Topic V—paragraphs 30–33).

Summary of main matters

Topic I—Limiting the recognition of deferred tax liabilities

Background

2. As explained in paragraphs 7–15 of Agenda Paper 12G, when temporary differences arise on initial recognition of a lease or decommissioning obligation, they are equal and offsetting. Accordingly, an entity would generally recognise a deferred tax asset and liability of the same amount. However, paragraph 24 of IAS 12 requires an entity to recognise deferred tax assets only 'to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised' (recoverability requirement). Because of the recoverability requirement, in some situations equal taxable and deductible temporary differences might result in an entity recognising unequal amounts of deferred tax assets and liabilities. The Board therefore addressed this in the Exposure Draft.[1]

3. The Board decided to propose that an entity would recognise deferred tax assets and liabilities of the same amount, but only to the extent that the entity would recognise a deferred tax asset applying the recoverability requirement.[2] The recognition exemption would therefore continue to apply to any portion of the deferred tax liability for which an entity recognises no corresponding deferred tax asset. If an entity were to recognise any such excess deferred tax liability, the entity would then need to adjust the carrying amount of the related asset as the other side of the entry. Recognising this portion of the deferred tax liability would result in the outcome the recognition exemption was designed to prevent (see paragraph 12 of Agenda Paper 12G).

Respondents' comments

4. Many respondents express concerns about the capping proposal, saying it would:
   (a) be complex and burdensome to apply (paragraphs 5–11);

[1] Paragraphs BC21–BC22 of the Exposure Draft provide further explanation of when and why this might occur.

[2] For ease of reading, we refer to this as the 'capping proposal' throughout the rest of this paper and Agenda Paper 12I.

(b) be inconsistent with IAS 12 (paragraph 12); and

(c) not capture all situations that might result in unequal amounts of deferred tax assets and liabilities (paragraphs 13–14).

Complex and burdensome to apply

5. Many respondents say the capping proposal would be complex and burdensome to apply—in particular, because it would require ongoing monitoring of deferred tax assets and liabilities at the individual asset and liability level.

6. Some say the capping proposal would increase the frequency and complexity of assessing IAS 12's recoverability requirement because entities typically assess the recoverability of deferred tax assets only at the end of a reporting period. For example, BDO says:

> Currently, most entities apply [the recoverability requirement] by computing deferred tax and then preparing an overall assessment of future taxable profit and the reversal of taxable temporary differences in order to determine the extent to which they should recognise deferred tax assets. This is typically done as at a financial reporting period end (e.g. 31 December for a calendar year end entity).

7. However, applying the capping proposal, an entity would be required to perform the recoverability assessment on initial recognition of each individual transaction within the scope of the amendments. Some say this might not always be possible and could raise new questions. For example, EY says:

> Paragraph 27A of IAS 12 specifically states that '[i]f tax law imposes no such restrictions, an entity assesses a deductible temporary difference in combination with all of its other deductible temporary differences.' Hence, the assessment required by paragraph 22A(a) of the [Exposure Draft] will not just need to look at the transaction itself. Instead, it would involve a much broader assessment of an entity's tax position and it may not always be possible to specifically attribute the deferred tax asset recognised to a specific underlying transaction or balance sheet item…these requirements raise

> questions about the attribution of expected future taxable profits to new transactions that are recognised. In particular, it raises the question whether 'probable future taxable profits' that supported the recognition of deferred tax assets for past tax losses should be 're-attributed' (in whole or in part) to the deductible temporary differences described in paragraph 22A(a) of the [Exposure Draft].

8. BDO illustrates questions that might arise when an entity already has unrecognised deferred tax assets:

> However, when…an entity has deferred tax assets that are already unrecognised due to [the recoverability requirement], the way in which the proposed amendments would be applied becomes unclear. For example, assume an entity had CU 1,500 of deferred tax assets related to unutilised tax losses carried forward that were unrecognised since they did not satisfy [the recoverability requirement]. The entity then enters into a new lease agreement that would give rise to equal and off-setting deferred tax assets and liabilities of CU 200. The entity would be required to apply [proposed paragraph 22A(a) of IAS 12] to determine whether the deferred tax asset relating to the deductible temporary difference should be recognised, and then [proposed paragraph 22A(b) of IAS 12] to determine if the corresponding deferred tax liability should be recognised as well. We believe it is unclear how [proposed paragraph 22A(a) of IAS 12] should be applied in this instance; should the deductible temporary difference arising from the lease be linked to the corresponding lease liability for the purposes of recoverability, or should it not?
> This is because the existing 'notional' (i.e. unrecognised) deferred tax asset of CU 1,500 relating to tax losses would also be available to off-set the unwinding of a deferred tax liability relating to the newly recognised lease, so we believe it is unclear how the deferred tax asset arising from the application of [proposed paragraph 22A(a) of IAS 12] should be determined. Would the amended standard require the recoverability of the

> deferred asset that is 'linked' to the deferred tax liability to be assessed first before considering how other unrecognised deferred tax assets might justify the valuation of the deferred tax asset? We believe the Board should clarify the ordering of these requirements.

9. A few respondents describe situations in which the proposed amendments might be particularly complex to apply. For example, an entity might recognise only 25% of a deferred tax asset and liability relating to a decommissioning obligation because only 25% of that deferred tax asset is recoverable. The recognition exemption would therefore apply to 75% of the deferred tax liability. These respondents say the proposed amendments would require an entity to track separately the portion of the decommissioning costs that relates to the deferred tax liability recognised; this would not only be costly but could raise new questions. For example, it is unclear how and to what extent an entity would allocate the reversal of the taxable temporary difference between the recognised and unrecognised portions of the deferred tax liability. EY says it is unclear whether the application of the capping proposal reduces the taxable temporary difference, the effective tax rate used in determining the deferred tax liability or both.

10. A few respondents suggest deleting the capping proposal to address these application challenges. For example, PwC says:

> We suggest that these challenges are addressed by requiring that the deferred tax liability is recognised in these circumstances and that the resulting tax consequences are presented in the income statement.

11. However, EY says ‘the recognition of Day 1 gains and losses could run counter to the objective of the [recognition exemption] and would not be appropriate, in our view.’ Instead, it suggests requiring that an entity continues to apply the recognition exemption to lease transactions in which it is readily determinable that the deferred tax asset is not fully recoverable. While this would reduce the scope of the amendments, it would, in EY’s view, offer a reasonable cost-benefit trade-off.

Inconsistent with IAS 12

12. The capping proposal would limit the recognition of deferred tax liabilities; however, IAS 12 requires the recognition of deferred tax liabilities for all taxable temporary differences unless the recognition exemption applies. Some respondents therefore say the capping proposal would contradict IAS 12's general recognition principle, and create circularity within its recognition requirements. For example, EY says:

> Under the current IAS 12 model, the amount recognised for deferred tax assets is restricted by reference to the existence of deferred tax liabilities (and suitable future taxable profits), whereas this amendment proposes that the reverse is applied.

Other situations that might result in unequal amounts of deferred tax

13. Some respondents say the capping proposal addresses only one situation in which equal amounts of taxable and deductible temporary differences may result in unequal amounts of deferred tax assets and liabilities—however, there could also be other situations. For example, taxable and deductible temporary differences may reverse in different future periods and, if tax rates in those future periods vary, the resulting amounts of the deferred tax asset and liability would be unequal. Deloitte says this situation is likely to arise when an entity is subject to graduated rates of income tax or if different substantially enacted income tax rates apply in different periods.

14. These respondents suggest either:

    (a) developing a principle for the treatment of deferred tax in these situations. This would clarify how an entity applies the recognition exemption to any portion of the deferred tax liability that exceeds the deferred tax asset and vice versa, regardless of the reason; or

    (b) similar to the suggestion in paragraph 10, requiring recognition of all deferred tax assets and liabilities with any resulting differences being recognised in profit or loss.

Topic II—Reassessment of unrecognised deferred tax assets

Background

15. Paragraphs BC25–BC28 of the Exposure Draft state:

> BC25 The proposed amendments do not address the reassessment of unrecognised deferred tax assets because paragraph 37 of IAS 12 already does so.
>
> BC26 Applying IAS 12, an entity might not recognise a deferred tax asset in some situations not only because of the recoverability requirement, but also because the recognition exemption would apply. If an entity considers that it did not recognise deferred tax assets because of the recognition exemption, then paragraph 22(c) would preclude their subsequent recognition. In such a case, the entity would not reassess unrecognised deferred tax assets. However, if an entity considers that it did not recognise deferred tax assets because of the recoverability requirement, it would apply paragraph 37 and subsequently reassess unrecognised deferred tax assets.
>
> BC27 The Board is aware that entities might reach different conclusions about whether to reassess unrecognised deferred tax assets related to leases or decommissioning obligations in such situations. Therefore, the Board considered whether to address reassessment as part of the proposed amendments.
>
> BC28 The Board decided against doing so because:
>
> (a) it would be difficult to address the matter narrowly as part of the proposed amendments. Attempting to do so would be likely to raise questions for transactions beyond those covered by the proposed amendments—for example, whether entities could or should apply any proposed requirement in this respect to transactions not considered by the proposed amendments.
>
> (b) addressing this matter would add significant complexity to the proposed amendments without evidence that this matter is prevalent. In particular, taxable temporary differences arising

> from the same transaction make it likely that the recoverability requirement will be met for many of the transactions within the scope of the proposed amendments (see paragraphs BC20–BC22).

Respondents' comments

16. Some respondents commented on:

    (a) the Board's decision not to address the reassessment of unrecognised deferred tax assets (paragraphs 17–19); and

    (b) whether unrecognised deferred tax liabilities are subsequently recognised (paragraphs 20–22).

Reassessment of unrecognised deferred tax assets

17. Some respondents disagree with the Board's decision not to address the reassessment of unrecognised deferred tax assets—they say it would result in differences in reporting that would, in turn, reduce the usefulness of information that results from applying the amendments.

18. A few respondents say it is possible to address this matter narrowly without raising questions for other transactions. For example, the Accounting Standards Council Singapore says:

> The proposed amendments prohibit the recognition exemption from being applied to temporary differences arising from transactions within the scope of the [Exposure Draft]. It follows that any unrecognised deferred tax asset for those deductible temporary differences cannot be due to the recognition exemption. This differs from the other transactions, in which an entity might not recognise a deferred tax asset not only because of the recoverability requirement, but also because the recognition exemption would apply.

19. The Korea Accounting Standards Board says the matter is prevalent—it says 'there are numerous cases in practice where the entity initially [does not recognise] a deferred tax asset but subsequently meets the recoverability requirement, especially in decommissioning obligations'.

Subsequent recognition of unrecognised deferred tax liabilities

20. Some respondents suggest the Board address the subsequent accounting for unrecognised deferred tax liabilities to the extent the related unrecognised deferred tax asset is subsequently recognised. For example, the Accounting Standards Committee of Germany says:

> …we fail to see how an entity would have to account for the portion of the deferred tax liability that it did not recognise applying the proposed requirement in para. 22A(b), if it subsequently reassessed the unrecognised deferred tax asset from the same transaction in accordance with para. 37 of IAS 12.

21. Grant Thornton says:

> Until now, there was no need for guidance on the reassessment of unrecognised deferred tax liabilities because all taxable temporary differences were recognised without limits. Given that the amendments introduce an initial cap to the deferred tax liability, we believe the amendments should include guidance on reassessments of the deferred tax liability.

22. However, some respondents observe that paragraph BC24 of the Exposure Draft explains that the recognition exemption continues to apply to any unrecognised portion of the deferred tax liability—accordingly, an entity would not subsequently reassess unrecognised deferred tax liabilities. Some respondents suggest including the explanation in BC24 within IAS 12. Some also suggest reconsidering the subsequent accounting for unrecognised deferred tax liabilities. For example, Mazars says:

> When the reassessment of unrecognised deferred tax assets leads to recognising an increased amount of deferred tax assets, our understanding of paragraph BC24 of the proposed amendments is that the additional amount of deferred tax asset would necessarily be recognised as income in the profit and loss statement (since the [recognition exemption] would continue to apply to the unrecognised portion of the deferred tax liability). We find it very counter-intuitive not to increase the carrying amount of the deferred tax liability, using the portion of the

taxable difference that has not been recognised because of the 'cap' applied on the initial recognition of the deferred tax liability.

Topic III—Scope of the proposed amendments

Background

23. The proposed amendments apply to any transaction 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.

Respondents' comments

24. Some respondents express concern about the scope of transactions that could be affected by the proposals. Of these respondents:

    (a) a few suggest limiting the scope of the amendments to leases and decommissioning obligations. They say 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 provide examples of other transactions which might be within the scope of the proposed amendments, such as transactions in which an entity:

        (i) recognises assets contributed by customers and a related contract liability;

        (ii) recognises a non-monetary government grant at fair value with a corresponding liability;

        (iii) enters into a cash-settled share-based payment arrangement and capitalises the related cost; and

        (iv) capitalises borrowing costs and recognises a liability to pay those borrowing costs.

    (b) a few suggest limiting the scope of the amendments only to leases—they say the application of the proposed amendments to decommissioning obligations raises a number of complexities (such as those discussed in topics I and II above, which they say arise more frequently in relation to decommissioning obligations than leases).

(c) a few say the proposed amendments may not capture all leases. In some situations, the initial recognition of a lease might give rise to unequal amounts of taxable and deductible differences. This might happen if, for example, (i) deductions for lease payments are attributable to the lease liability; and (ii) the applicable tax law restricts the deductibility of those lease payments to only a proportion of those payments[3].

(d) the FRC (UK) says the proposed amendments would not apply to the acquisition of an asset financed by a loan—this could result in inconsistent treatment of two economically-similar transactions.

(e) Syngenta International AG says it is unclear whether the proposed amendments apply to sale and leaseback transactions:

> To be comprehensive, the Final Amendments should also clarify that a sale and leaseback transaction should be treated as a single transaction for IAS 12 purposes. The sale would almost always have immediate effect on accounting and/or taxable profit, so that the initial recognition exemption would not apply to the temporary differences arising. However, if the sale and the leaseback were treated as separate transactions when applying IAS 12, it would be possible to conclude that the leaseback affected neither accounting nor taxable profit at the time and because the temporary differences are unequal [4], the proposed amendment is not applicable to them, with the result that the initial recognition exemption would still apply.

(f) BP says it is unclear whether the proposed amendments would apply if an entity recognises multiple assets or liabilities as a result of a single transaction. In some situations, an entity might recognise more than one

[3] In this situation, the tax base of the lease asset will continue to be zero (as explained in paragraph 11(b) of Agenda Paper 12G for this meeting). However, the tax base of the liability will not be zero because only a portion of the lease payments are deductible for tax purposes.

[4] This is because, applying IFRS 16, an entity measures the lease asset at a proportion of the previous carrying amount of the underlying asset sold.

asset as a result of a single transaction which, combined, would give rise to deferred tax liabilities equal to the deferred tax asset arising from a single liability.

Topic IV—Attribution of tax deductions to the deferred tax asset or liability

Background

25. As explained in paragraphs 9–10 of Agenda Paper 12G, on initial recognition of a lease, IAS 12 requires an entity to determine the tax base of the lease asset and lease liability. In doing so, the entity determines whether tax deductions received on making lease payments are attributable to the lease asset or lease liability. An entity applies judgement in determining whether tax deductions relate to the lease asset or lease liability, having considered the applicable tax law.

Respondents' comments

26. Some respondents suggest providing application guidance and illustrative examples to help entities assess whether tax deductions are attributable to the lease asset or lease liability—these respondents say not doing so could result in continued differences in reporting. For example ACTEO-AFEP-MEDEF (a group of preparer representative bodies) says that while the amendments would improve consistency in amounts recognised in profit or loss, differences in the recognition of deferred tax would continue depending on whether an entity attributes tax deductions to the lease asset or lease liability—ie an entity would recognise a deferred tax asset and liability on initial recognition of a lease if tax deductions were attributed to the liability whereas it would not if those deductions were attributed to the asset. Syngenta agrees that an entity would typically offset the deferred tax asset and liability that would result when tax deductions are attributed to the liability—however, it says the amounts disclosed would be significantly different depending on whether tax deductions are attributed to the asset or liability.

Suggested solutions

27. The Malaysian Accounting Standards Board suggests clarifying that entities in the same tax jurisdiction are expected to reach the same conclusions for similar transactions.

28. The FRC (UK) says it is unnecessary to seek consistency across jurisdictions for which deductions are attributable to the asset and those for which deductions are attributable to the liability—this is because the two situations are not economically similar. However, if consistency is an objective, it says:

> A simpler, more pragmatic and more cost-effective way of achieving consistency between those situations where tax deductions relate to lease assets and with those where they relate to the lease liability would be to require entities to assume they relate to the lease asset. In other words, if a transaction (that is not a business combination) leads to the initial recognition of a lease asset and a lease liability and, at the time of the transaction, affects neither accounting profit nor taxable profit then, for the purpose of calculating temporary differences, it should be assumed that tax deductions relate to the asset. This approach would remove many of the complexities inherent in the proposed solution and achieve a more consistent effective tax rate as changes in the tax difference will coincide with the recognition of expenses in profit or loss.

29. Syngenta suggests requiring an entity to attribute tax deductions to the deferred tax liability unless applicable tax legislation contains specific provisions to make an alternative determination.

Topic V—Advance lease payments and initial direct costs

Background

30. Paragraphs BC16–BC18 explain the Board's considerations on advance lease payments and initial direct costs:

> BC16 Applying IFRS 16, an entity initially measures a lease asset and a lease liability at the present value of the lease payments that are not paid at the commencement date of the lease. An entity also recognises advance lease payments and initial direct costs incurred as part of the cost of a lease asset.
>
> BC17 The recognition of the lease liability and the related component of the lease asset may give rise to equal and offsetting temporary differences as explained in paragraph BC10(b). In addition, making advance lease payments or paying initial direct costs could result in additional taxable temporary differences associated with the lease asset. Accordingly, the Board considered whether advance lease payments and initial direct costs would affect the proposed amendments, and concluded that they would not.
>
> BC18 Making advance lease payments or paying initial direct costs do not give rise to equal and offsetting temporary differences. Therefore, an entity would apply the existing requirements in IAS 12 to any taxable temporary difference arising from such payments. The proposed amendments would still apply to equal and offsetting temporary differences arising from the recognition of the lease liability and the related component of the lease asset.

Respondents' comments

31. A few respondents say an entity would be required to track separately the advance lease payment and initial direct cost components of a lease asset, which would be complex and inconsistent with IFRS 16 (which considers the lease asset as one unit of account).

32. Some respondents suggest providing examples or explaining further how an entity accounts for deferred tax relating to advance lease payments and initial direct costs. Some say the explanation in paragraphs BC16–BC18 is in the form of application guidance and should, therefore, be included in IAS 12.

33. Deloitte suggests clarifying whether advance lease payments and initial direct costs are considered to represent separate transactions or whether the proposed amendments apply only to the portion of the deductible and taxable temporary differences that are equal. Notwithstanding the explanation in paragraphs BC16–BC18, it says some could view leases (with advance payments or initial direct costs) as transactions in which the deductible and taxable temporary differences are unequal.