

**IASB documents published to accompany**

**IAS 12**

# Income Taxes

The text of the unaccompanied standard, IAS 12, is contained in Part A of this edition. Its effective date when issued was 1 January 1998. The text of the Accompanying Guidance on IAS 12 is contained in Part B of this edition. This part presents the following document:

**BASIS FOR CONCLUSIONS**

## **Basis for Conclusions on IAS 12 *Income Taxes***

*This Basis for Conclusions accompanies, but is not part of, IAS 12.*

### **Introduction**

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- BC1 When IAS 12 *Income Taxes* was issued by the International Accounting Standards Committee in 1996 to replace the previous IAS 12 *Accounting for Taxes on Income* (issued in July 1979), the Standard was not accompanied by a Basis for Conclusions. This Basis for Conclusions is not comprehensive. It summarises only the considerations of the International Accounting Standards Board (Board) in developing amendments to IAS 12 since 2010. Individual Board members gave greater weight to some factors than to others.
- BC1A In August 2014 the Board published an Exposure Draft of proposed amendments to IAS 12 to clarify the requirements on recognition of deferred tax assets for unrealised losses on debt instruments measured at fair value. The Board subsequently modified and confirmed the proposals and in January 2016 issued *Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12)*. The Board's considerations and reasons for its conclusions are discussed in paragraphs BC37–BC62.
- BC2 The Board amended IAS 12 to address an issue that arises when entities apply the measurement principle in IAS 12 to temporary differences relating to investment properties that are measured using the fair value model in IAS 40 *Investment Property*.
- BC3 In March 2009 the Board published an exposure draft, *Income Tax* (the 2009 exposure draft), proposing a new IFRS to replace IAS 12. In the 2009 exposure draft, the Board addressed this issue as part of a broad proposal relating to the determination of tax basis. In October 2009 the Board decided not to proceed with the proposals in the 2009 exposure draft and announced that, together with the US Financial Accounting Standards Board, it aimed to conduct a fundamental review of the accounting for income tax in the future. In the meantime, the Board would address specific significant current practice issues.
- BC4 In September 2010 the Board published proposals for addressing one of those practice issues in an exposure draft *Deferred Tax: Recovery of Underlying Assets* with a 60-day comment period. Although that is shorter than the Board's normal 120-day comment period, the Board concluded that this was justified because the amendments were straightforward and the exposure draft was short. In addition, the amendments were addressing a problem that existed in practice and needed to be solved as soon as possible. The Board considered the comments it received on the exposure draft and in December 2010 issued the amendments to IAS 12. The Board intends to address other practice issues arising from IAS 12 in due course, when other priorities on its agenda permit this.

## Recovery of revalued non-depreciable assets

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- BC5 In December 2010, the Board incorporated in paragraph 51B of IAS 12 the consensus previously contained in SIC Interpretation 21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets*. However, because paragraph 51C addresses investment property carried at fair value, the Board excluded such assets from the scope of paragraph 51B. Paragraphs BC6 and BC7 set out the basis that the Standing Interpretations Committee (SIC) gave for the conclusions it reached in developing the consensus expressed in SIC-21.
- BC6 The SIC noted that the *Framework for the Preparation and Presentation of Financial Statements*<sup>1</sup> stated that an entity recognises an asset if it is probable that the future economic benefits associated with the asset will flow to the entity. Generally, those future economic benefits will be derived (and therefore the carrying amount of an asset will be recovered) through sale, through use, or through use and subsequent sale. 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. Consistently with this, the carrying amount of a non-depreciable asset, such as land having an unlimited life, will be recovered only through sale. In other words, because the asset is not depreciated, no part of its carrying amount is expected to be recovered (ie consumed) through use. Deferred taxes associated with the non-depreciable asset reflect the tax consequences of selling the asset.
- BC7 The SIC noted that the expected manner of recovery is not predicated on the basis of measuring the carrying amount of the asset. For example, if the carrying amount of a non-depreciable asset is measured at its value in use, the basis of measurement does not imply that the carrying amount of the asset is expected to be recovered through use, but through its residual value upon ultimate disposal.

## Recovery of investment properties

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### Reason for the exception

- BC8 IAS 12 applies the principle that the measurement of deferred tax liabilities and deferred tax assets should reflect the tax consequences that would follow from the manner in which the entity expects to recover or settle the carrying amount of its assets and liabilities. In many cases, however, an entity expects to rent out investment property to earn rental income and then sell it to gain from capital appreciation at some point in the future. Without specific plans for disposal of the investment property, it is difficult and subjective to estimate how much of the carrying amount of the investment property will be recovered through cash flows from rental income and how much of it will be recovered through cash flows from selling the asset.

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<sup>1</sup> The reference is to the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the Board in 2001 and in effect when the SIC discussed this matter.

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- BC9 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.
- BC10 To address this issue, the Board introduced an exception to the principle in IAS 12 that applies when an entity adopts an accounting policy of remeasuring investment property at fair value. 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.
- BC11 Many respondents to the exposure draft of September 2010 commented that the Board should develop application guidance rather than creating an exception. The Board could have achieved a similar result in some cases by providing application guidance on how to apply the underlying principle to investment property. However, the Board chose an exception because it is simple, straightforward and can avoid unintended consequences by a strict definition of its scope. In fact, this exception is very similar to application guidance. However, it is technically an exception because, in some cases, the asset's carrying amount is assumed to be recovered entirely through sale even though an entity expects it to be recovered partly through sale and partly through use.
- BC12 The Board also noted that application guidance would not resolve a practice issue that arises when the future income generated from an asset is expected to exceed the carrying amount of that asset and that future income will be subject to two or more different tax regimes. In those situations, IAS 12 provides no basis for determining which tax rate and tax base apply to the recovery of the carrying amount. The Board concluded that the practical way to resolve this issue was to create an exception that determines the manner of recovery of an asset within the scope of that exception.

### **Scope of the exception**

- BC13 The Board understands that the concerns raised in practice relate primarily to investment property measured using the fair value model in IAS 40. The Board proposed in the exposure draft that the exception should also apply to property, plant and equipment or intangible assets measured using the revaluation model in IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*. That was because in assessing the difficulty and subjectivity involved in determining the expected manner of recovering the carrying amount of the underlying asset, there is no underlying difference between regularly fair valuing assets through a revaluation accounting policy and applying a fair value measurement model.

- BC14 Many respondents disagreed with the proposal to include property, plant and equipment or intangible assets measured using the revaluation model in IAS 16 or IAS 38 in the scope of the exception. They stated that many items of property, plant and equipment are recovered through use rather than through sale, and that this is consistent with the definition of property, plant and equipment in IAS 16. In addition, many respondents disagreed with the presumption of recovery through sale when the underlying assets are intangible assets for similar reasons. They also warned of unintended consequences that could arise because of the varying nature of intangible assets. Many respondents suggested limiting the scope of the exception to investment properties measured using the fair value model in IAS 40. Having considered those comments, the Board adopted that suggestion.
- BC15 Some respondents supported inclusion of property, plant and equipment in the scope of the exception, including property, plant and equipment measured on a cost basis, because of their concerns about the lack of discounting deferred tax assets and deferred tax liabilities and about a possible double-counting of tax effects (see paragraph BC19). However, the Board concluded that considering concerns about the lack of discounting and about the possible double-counting was outside the limited scope of the amendments.
- BC16 The Board made it clear that the exception also applies on initial measurement of investment property acquired in a business combination if the investment property will subsequently be measured using the fair value model in IAS 40. If the exception did not apply in these circumstances, deferred taxes might reflect the tax consequences of use at the acquisition date, but at a later date reflect the tax consequences of sale. The Board believes that measurement of deferred taxes at the acquisition date should be consistent with the subsequent measurement of the same deferred taxes. For the same reason, the Board concluded that the exception should not apply to investment property initially measured at fair value in a business combination if the entity subsequently uses the cost model.
- BC17 Having considered the responses to the exposure draft, the Board decided not to extend the exception to other underlying assets and liabilities that are measured at fair value, including financial instruments or biological assets. This is because the Board understands that the most significant current practice issues relate to investment property. In addition, the Board wished to avoid unintended consequences of expanding the scope to other assets and liabilities that are measured on a fair value basis.
- BC18 The Board concluded that the amendments should apply to all temporary differences that arise relating to underlying assets within the scope of the exception, not just those separate temporary differences created by the remeasurement of the underlying asset. This is because the unit of account applied in determining the manner of recovery in the Standard is the underlying asset as a whole, not the individual temporary differences.

### **Measurement basis**

- BC19 The Board decided that when the exception applies, there should be a presumption that deferred taxes should be measured to reflect the tax consequences of recovering the carrying amount of the investment property entirely through sale. In making that decision, the Board considered various views expressed by interested parties, which included, but were not limited to the following:
- (a) the tax effect would be double-counted in some situations if deferred taxes are measured on the basis of the tax consequences of use, because the investment property is measured at fair value, which reflects some of these tax consequences; and
  - (b) presuming sale is consistent with a fair value measurement basis that reflects the price that would be received if the investment property is sold.
- BC20 Many respondents to the exposure draft said that choosing a measurement basis of fair value is an accounting policy choice that does not imply or predict recovery of the investment property through sale. Many also said that the proposed exception would solve the double-counting problem partially but not completely. The Board noted that the aim of the exception was neither to link the accounting policy with measurement of deferred taxes (see paragraph BC7), nor to remove completely the double-counting of tax effects (see paragraph BC15). The aim of this exception is to provide a practical approach when determination of the expected manner of recovery is difficult and subjective.
- BC21 In many cases when an entity chooses the fair value model for investment property, investment properties are recovered through sale. Even if an investment property earns income through rental use in a given period, the value of the future earnings capacity of the investment property will often not decrease and that value will ultimately be realised through sale. Therefore, the Board retained its proposal to introduce a presumption of recovery through sale.
- BC22 The Board made that presumption rebuttable because the Board believes that it is not always appropriate to assume the recovery of investment property through sale. The Board initially proposed in the exposure draft that the presumption of recovery through sale is not appropriate when the entity has clear evidence that it will consume the asset's economic benefits throughout its economic life. The Board set a criterion that refers to consumption of the asset's economic benefits, rather than to the recovery of the carrying amount, because the Board understands that there is diverse practice regarding the meaning of the recovery of the carrying amount through use or through sale.
- BC23 After considering the responses to the exposure draft, the Board reworded the rebuttable presumption so that clear evidence would not be required to rebut it. Instead, the presumption is rebutted if an asset is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale.

Many respondents were concerned that, because clear evidence is an ambiguous term, the requirement to gather clear evidence would have been onerous for entities that have no problem applying the existing principle in IAS 12, and could have led to abuse by entities that choose whether to gather clear evidence to achieve a favourable result. The Board chose to use the term 'business model' because it is already used in IFRS 9 *Financial Instruments* and would not depend on management's intentions for an individual asset. Many respondents were concerned that the presumption would lead to inappropriate results in some cases because it would not be rebutted if a minor scrap value would be recovered through sale. The Board also reworded the rebuttable presumption in order to respond to those concerns. The Board also made it clear that the presumption of recovery through sale cannot be rebutted if the asset is non-depreciable because that fact implies that no part of the carrying amount of the asset would be consumed through use (see paragraph BC6).

- BC24 The Board also considered other approaches to the measurement of deferred tax liabilities and deferred tax assets when the exception applies, specifically whether deferred taxes should be measured on the basis of the lower of the tax consequences of recovery through use and through sale. However, the Board rejected such an approach, noting that it would have created:
- (a) conceptual and practical concerns about whether deferred tax assets should be measured to reflect the lower of, or higher of, the tax consequences of use and of sale;
  - (b) a measurement basis that some believe would be arbitrary; and
  - (c) concerns that entities might be required to measure deferred taxes on a basis that is inconsistent with their expectations of recovery of the carrying amount of the underlying asset.
- BC25 Some respondents to the exposure draft drew the mistaken conclusion that the exposure draft required presumption of *immediate* sale at the end of the reporting period when assessing the presumption of recovery through sale. The Board observed that paragraph 47 of IAS 12 requires deferred tax assets and liabilities to be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled on the basis of tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. This requirement applies even when the presumption of recovery through sale is used. For clarification, the Board adjusted the illustrative example following paragraph 51C to reflect the requirement in paragraph 47.
- BC26 In the exposure draft, the Board proposed to withdraw SIC-21. However, many respondents commented that SIC-21 should be retained in order to avoid unintended consequences. Having considered the responses to the exposure draft, the Board decided to incorporate SIC-21 into IAS 12 in its entirety after excluding from the scope of SIC-21 the investment property subject to the requirement in paragraph 51C.

### **Assessment of deferred tax assets**

- BC27 The Board inserted paragraph 51E to confirm that the requirements in paragraphs 24–33 (deductible temporary differences) and paragraphs 34–36 (unused tax losses and unused tax credits) relating to assessment of deferred tax assets continue to apply even when the presumption of recovery through sale arises. The Board did not think that additional guidance would be necessary.

### **Disclosure requirement**

- BC28 The Board proposed in the exposure draft disclosure of the fact of, and reasons for, the rebuttal of the presumption of recovery through sale if the entity has rebutted the presumption. However, many respondents said that this disclosure would add little or no value to the financial statements. IAS 1 *Presentation of Financial Statements* already requires disclosures regarding material judgements. Thus, there is no need to disclose a particular judgement on specific types of assets. The Board was convinced by those arguments and did not proceed with the proposed disclosure requirement.

### **The costs and benefits of the amendments to IAS 12**

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- BC29 Computation of the tax consequences of selling assets is complex in some tax jurisdictions and there are concerns that the amendments to IAS 12 will increase the administrative burden for some entities in those tax jurisdictions.
- BC30 However, the Board believes that the benefit of providing the exception outweighs this potential increase in administrative burden for some entities. This is because the purpose of the exception is to enable preparers to measure deferred taxes in these circumstances in the least subjective manner and in so doing enhance the comparability of financial information about deferred taxes for the benefit of users of financial statements. It is also expected to result in an overall reduction of the administrative burden for entities that have previously had to consider the tax consequence of both use and sale of an investment property when measuring deferred taxes.
- BC31 Many respondents to the exposure draft said that entities would not benefit from the amendments in jurisdictions in which this practice issue did not exist but would suffer from an increased administrative burden as a result of the amendments. Their criticism mainly focused on the rebuttable presumption, as discussed in paragraphs BC22 and BC23. They also said that the disclosure requirement proposed in the exposure draft would be onerous.
- BC32 After considering the responses to the exposure draft, the Board narrowed the scope of the exception to apply only to investment property carried at fair value. It reworded the rebuttable presumption so that clear evidence would no longer be required to rebut the presumption. The Board also did not pursue the proposed disclosure requirement regarding the fact of, and reason for, the rebuttal. After those changes, the Board believes that the amendments will not be onerous for entities that have previously been able to establish without difficulty how they expect to recover investment property carried at fair value.



## Transition and effective date

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- BC33 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to apply retrospectively a change in accounting policy resulting from the initial application of an IFRS that does not have a transition provision. The Board did not include any transition provision in the amendments because, in the Board's view, it would not be unduly burdensome for entities to apply the changes to IAS 12 retrospectively.
- BC34 The Board acknowledges that the amendments may add some administrative burden if they apply to investment property acquired in a business combination that occurred in a previous reporting period. For example, it could be difficult to restate goodwill and recalculate previous impairment reassessments if some information is not available and an entity is unable to separate the effects of hindsight. However, the Board reasoned that the amendments apply only to specific circumstances. Moreover, IAS 8 provides sufficient guidance to deal with cases when it might be impracticable to reassess impairment of goodwill or recoverability of deferred tax assets.
- BC35 Consequently, the Board concluded that the cost of requiring retrospective application is outweighed by the benefit of consistent application of the amendments by entities to all periods presented in the financial statements. Accordingly, the Board decided that entities should apply the amendments to IAS 12 retrospectively in accordance with IAS 8.

## First-time adoption of IFRSs

- BC36 The Board identified no reason to adjust the exception for application by a first-time adopter at its date of transition to IFRSs.

## ***Recognition of Deferred Tax Assets for Unrealised Losses (2016 amendments)***

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- BC37 The IFRS Interpretations Committee (the 'Interpretations Committee') was asked to provide guidance on how an entity determines, in accordance with IAS 12, whether to recognise a deferred tax asset when:
- (a) the entity has a debt instrument that is classified as an available-for-sale financial asset in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.<sup>2</sup> Changes in the market interest rate result in a decrease in the fair value of the debt instrument to below its cost (ie it has an 'unrealised loss');
  - (b) it is probable that the issuer of the debt instrument will make all the contractual payments;
  - (c) the tax base of the debt instrument is cost;

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<sup>2</sup> IFRS 9 *Financial Instruments* replaced IAS 39. IFRS 9 applies to all items that were previously within the scope of IAS 39. Under IFRS 9, the same question arises for debt instruments measured at fair value.

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- (d) tax law does not allow a loss to be deducted on a debt instrument until the loss is realised for tax purposes;
- (e) the entity has the ability and intention to hold the debt instrument until the unrealised loss reverses (which may be at its maturity);
- (f) tax law distinguishes between capital gains and losses and ordinary income and losses. While capital losses can only be offset against capital gains, ordinary losses can be offset against both capital gains and ordinary income; and
- (g) the entity has insufficient taxable temporary differences and no other probable taxable profits against which the entity can utilise deductible temporary differences.

BC38 The Interpretations Committee reported to the Board that practice differed because of divergent views on the following questions:

- (a) Do decreases in the carrying amount of a fixed-rate debt instrument for which the principal is paid on maturity always give rise to a deductible temporary difference if this debt instrument is measured at fair value and if its tax base remains at cost? In particular, do they give rise to a deductible temporary difference if the debt instrument's holder expects to recover the carrying amount of the asset by use, ie continuing to hold it, and if it is probable that the issuer will pay all the contractual cash flows? (see paragraphs BC39–BC45)
- (b) Does an entity assume that it will recover an asset for more than its carrying amount when estimating probable future taxable profit against which deductible temporary differences are assessed for utilisation if such recovery is probable? This question is relevant when taxable profit from other sources is insufficient for the utilisation of the deductible temporary differences related to debt instruments measured at fair value. In this case, an entity may only be able to recognise deferred tax assets for its deductible temporary differences if it is probable that it will collect the entire cash flows from the debt instrument and therefore recover it for more than its carrying amount. (see paragraphs BC46–BC54)
- (c) When an entity assesses whether it can utilise deductible temporary differences against probable future taxable profit, does that probable future taxable profit include the effects of reversing deductible temporary differences? (see paragraphs BC55–BC56)
- (d) Does an entity assess whether a deferred tax asset is recognised for each deductible temporary difference separately or in combination with other deductible temporary differences? This question is relevant, for example, when tax law distinguishes capital gains and losses from other taxable gains and losses and capital losses can only be offset against capital gains. (see paragraphs BC57–BC59)

**Existence of a deductible temporary difference**

- BC39 In the case of many debt instruments, the collection of the principal on maturity does not increase or decrease taxable profit that is reported for tax purposes. This is the case in the example illustrating paragraph 26(d) of IAS 12. Interest is paid at the contractual rate each year, and on maturity of the debt instrument the issuer pays the principal of CU1,000. In this example, if the investor continues to hold the debt instrument, the investor only pays taxes on the interest income. The collection of the principal does not trigger any tax payments.
- BC40 Because the collection of the principal does not increase or decrease the taxable profit that is reported for tax purposes, some thought that the collection of the principal is a non-taxable event. Sometimes, tax law does not explicitly address whether the collection of the principal has tax consequences. Consequently, proponents of this view thought that a difference between the carrying amount of the debt instrument in the statement of financial position and its higher tax base does not give rise to a deductible temporary difference, if this difference results from a loss that they expect will not be realised for tax purposes.
- BC41 Those who held this view thought that the loss would not be realised for tax purposes if the entity has the ability and intention to hold the debt instrument over the period until the loss reverses, which might be until maturity, and it is probable that the entity will receive all the contractual cash flows. In this case, differences between the carrying amount of the debt instrument in the statement of financial position and its tax base reverse over the period to maturity, as a result of continuing to hold the debt instrument.
- BC42 The Board considered the guidance in IAS 12 on the identification of temporary differences and rejected the reasoning presented in paragraphs BC40 and BC41. Paragraphs 20 and 26(d) of IAS 12 specify that a difference between the carrying amount of an asset measured at fair value and its higher tax base gives rise to a deductible temporary difference. This is because the calculation of a temporary difference in IAS 12 is based on the premise that the entity will recover the carrying amount of an asset, and hence economic benefits will flow to the entity in future periods to the extent of the asset's carrying amount at the end of the reporting period. In contrast, the view presented in paragraphs BC40 and BC41 is based on the assessment of the economic benefits that are expected at maturity. The Board noted that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount.
- BC43 Consequently, the Board concluded that decreases below cost in the carrying amount of a fixed-rate debt instrument measured at fair value for which the tax base remains at cost give rise to a deductible temporary difference. This applies irrespective of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use, ie continuing to hold it, or whether it is probable that the issuer will pay all the contractual cash flows. Normally, the collection of the entire principal

does not increase or decrease taxable profit that is reported for tax purposes, because the tax base equals the inflow of taxable economic benefits when the principal is paid. Typically, the tax base of the debt instrument is deducted either on sale or on maturity.

BC44 The economic benefit embodied in the related deferred tax asset arises from the ability of the holder of the debt instrument to achieve future taxable gains in the amount of the deductible temporary difference without paying taxes on those gains. In contrast, an entity that acquires the debt instrument described in the example illustrating paragraph 26(d) of IAS 12 for its fair value at the end of Year 2 (in the example, CU918) and continues to hold it, has to pay taxes on a gain of CU82, whereas the entity in that example will not pay any taxes on the collection of the CU1,000 of principal. The Board concluded that it was appropriate for the different tax consequences for these two holders of the same instrument to be reflected in the deferred tax accounting for the debt instrument.

BC45 The Board has added an example after paragraph 26 of IAS 12 to illustrate the identification of a deductible temporary difference in the case of a fixed-rate debt instrument measured at fair value for which the principal is paid on maturity.

### **Recovering an asset for more than its carrying amount**

BC46 The Board noted that paragraph 29 of IAS 12 identifies taxable profit in future periods as one source of taxable profits against which an entity can utilise deductible temporary differences. Future taxable profit has to be probable to justify the recognition of deferred tax assets.

BC47 The guidance in paragraph 29 of IAS 12 does not refer to the carrying amount of assets within the context of estimating probable future taxable profit. Some thought, however, that the carrying amount of an asset to which a temporary difference is related limits the estimate of future taxable profit. They argued that accounting for deferred taxes should be based on consistent assumptions, which implies that an entity cannot assume that, for one and the same asset, the entity will recover it:

- (a) for its carrying amount when determining deductible temporary differences and taxable temporary differences; as well as
- (b) for more than its carrying amount when estimating probable future taxable profit against which deductible temporary differences are assessed for utilisation.

BC48 Consequently, proponents of this view thought that an entity cannot assume that it will collect the entire principal of CU1,000 in the example illustrating paragraph 26(d) of IAS 12 when determining probable future taxable profit. Instead, they thought that an entity must assume that it will collect only the carrying amount of the asset.

- BC49 The Board noted however that determining temporary differences and estimating probable future taxable profit against which deductible temporary differences are assessed for utilisation are two separate steps and the carrying amount of an asset is relevant only to determining temporary differences. The carrying amount of an asset does not limit the estimation of probable future taxable profit. In its estimate of probable future taxable profit, an entity includes the probable inflow of taxable economic benefits that results from recovering an asset. This probable inflow of taxable economic benefits may exceed the carrying amount of the asset.
- BC50 Moreover, a limitation on the estimate of probable future taxable profit by the carrying amount of assets can lead to inappropriate results in other scenarios. For example, a significant part of the assets of a profitable manufacturing entity is property, plant and equipment and inventories. Property, plant and equipment may be measured using the cost model (paragraph 30 of IAS 16 *Property, Plant and Equipment*) and inventories are measured at the lower of cost and net realisable value (paragraph 9 of IAS 2 *Inventories*). If such an entity expects to generate future taxable profit, it may be inconsistent to assume that it will only recover these assets for their carrying amount. This is because a significant part of the manufacturing entity's probable future taxable profit results from using those assets to generate taxable profit in excess of their carrying amount.
- BC51 If a limitation such as the one described in paragraph BC50 was made, then, for the purpose of consistency, the entity would need to assume that it will not recover any of its assets for more than their carrying amount. The Board decided that it would not be appropriate to limit the estimate of probable future taxable profit to the carrying amount of related assets only for assets to which temporary differences are related, because there is no basis for a different assessment that would depend on whether a deductible temporary difference is related to an asset or not.
- BC52 Some respondents to the Exposure Draft expressed concern that the guidance might be applied more broadly, and in their view, inappropriately, to other assets, and not merely to debt instruments measured at fair value. Some other respondents were concerned that any guidance would give the false impression that future taxable profit should be estimated on an individual asset basis. The Board noted that the principle that the estimate of probable future taxable profit includes an expected recovery of assets for more than their carrying amounts is not limited to any specific type or class of assets.
- BC53 However, the Board also noted that there are cases in which it may not be probable that an asset will be recovered for more than its carrying amount. An entity should not inappropriately assume that an asset will be recovered for more than its carrying amount. The Board thought that this is particularly important when the asset is measured at fair value. In response to that concern, the Board noted that entities will need to have sufficient evidence on which to base their estimate of probable future taxable profit, including when that estimate involves the recovery of an asset for more than its carrying amount. For example, in the case of a fixed-rate debt instrument measured at fair value, the entity may judge that the contractual nature of future cash

flows, as well as the assessment of the likelihood that those contractual cash flows will be received, adequately supports the conclusion that it is probable that it will recover the fixed-rate debt instrument for more than its carrying amount, if the expected cash flows exceed the debt instrument's carrying amount. The Board thought that such an example could enhance understanding and reduce the risk of arbitrary estimates of future taxable profit.

- BC54 The Board has added paragraph 29A to IAS 12 to clarify to what extent an entity's estimate of future taxable profit (paragraph 29) includes amounts from recovering assets for more than their carrying amounts.

### **Probable future taxable profit against which deductible temporary differences are assessed for utilisation**

- BC55 The Interpretations Committee observed that there is uncertainty about how to determine probable future taxable profit against which deductible temporary differences are assessed for utilisation when this profit is being assessed to determine the recognition of all deferred tax assets. The uncertainty relates to whether the probable future taxable profit should include or exclude deductions that will arise when those deductible temporary differences reverse.

- BC56 The Board noted that deductible temporary differences are utilised by deduction against taxable profit, excluding deductions arising from reversal of those deductible temporary differences. Consequently, taxable profit used for assessing the utilisation of deductible temporary differences is different from taxable profit on which income taxes are payable, as defined in paragraph 5 of IAS 12. If those deductions were not excluded, then they would be counted twice. The Board has amended paragraph 29(a) to clarify this.

### **Combined versus separate assessment**

- BC57 The Board considered the guidance in IAS 12 on the recognition of deferred tax assets. Paragraph 24 of IAS 12 requires deferred tax assets to be recognised only to the extent of probable future taxable profit against which the deductible temporary differences can be utilised. Paragraph 27 explains that:

- (a) the deductible temporary differences are utilised when their reversal results in deductions that are offset against taxable profits of future periods; and
- (b) economic benefits in the form of reductions in tax payments will flow to the entity only if it earns sufficient taxable profits against which the deductions can be offset.

- BC58 The Board noted that:
- (a) tax law determines which deductions are offset against taxable income in determining taxable profits. The Board also noted that paragraph 5 of IAS 12 defines taxable profit as the profit of a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable.

- (b) no deferred tax asset is recognised if the reversal of the deductible temporary difference will not lead to tax deductions.

BC59 Consequently, if tax law offsets a deduction against taxable income on an entity basis, without segregating deductions from different sources, an entity carries out a combined assessment of all its deductible temporary differences relating to the same taxation authority and the same taxable entity. However, if tax law offsets specific types of losses only against a particular type, or types, of income (for example, if tax law limits the offset of capital losses to capital gains), an entity assesses a deductible temporary difference in combination with other deductible temporary differences of that type(s), but separately from other deductible temporary differences. Segregating deductible temporary differences in accordance with tax law and assessing them on such a basis is necessary to determine whether taxable profits are sufficient to utilise deductible temporary differences. The Board has added paragraph 27A to IAS 12 to clarify this.

### Transition

BC60 The Board decided to require the adjustment of comparative information for any earlier periods presented. However, this amendment allows the change in opening equity of the earliest comparative period presented that arises upon the first application of the amendment to be recognised in opening retained earnings (or in another component of equity, as appropriate), without the need to allocate the change between opening retained earnings and other components of equity. This is to avoid undue cost and effort.

BC61 The Board noted that, with the exception of the amounts that would have to be adjusted within equity, the accounting required by these amendments is based on amounts and estimates at the end of the reporting periods. The changes to the accounting are mechanical in nature and so the Board expects that the cost of adjusting comparatives should not exceed the benefits of greater comparability.

BC62 The Board has not added additional transition relief for first-time adopters. This is consistent with the fact that IFRS 1 *First-time Adoption of International Financial Reporting Standards* does not include an exception to, or exemption from, the retrospective application of the requirements in IAS 12.

### Income tax consequences of payments on financial instruments classified as equity (amendments issued in December 2017)

BC63 The Board was asked about the income tax consequences of payments on financial instruments classified as equity; should an entity recognise them in profit or loss, or in equity? In particular, the Board was asked whether the requirements in paragraph 57A (paragraph 52B before the amendments were made) apply only in the circumstances described in paragraph 52A (for example, when there are different tax rates for distributed and undistributed profits), or whether those requirements apply as long as payments on financial instruments classified as equity are distributions of profit.

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- BC64 The Board observed that:
- (a) paragraph 57A describes how an entity accounts for income tax consequences of dividends paid. Dividends are defined in IFRS 9 as ‘distributions of profits to holders of equity instruments in proportion to their holdings of a particular class of capital’.
  - (b) paragraph 57A first requires an entity to link the income tax consequences of dividends to past transactions or events that generated distributable profits. An entity then applies the requirements in paragraph 58 to determine where to recognise those income tax consequences. Applying paragraph 57A, the entity recognises the income tax consequences of dividends according to where it has recognised the past transactions or events that generated distributable profits.
  - (c) the reason for the income tax consequences of dividends should not affect where those income tax consequences are recognised. It does not matter whether such consequences arise, for example, because of different tax rates for distributed and undistributed profits or because of the deductibility of dividends for tax purposes. This is because, in both cases, the income tax consequences arise from the distribution of profits.
  - (d) linking the recognition of the income tax consequences of dividends to how the tax consequences arise (for example, because of different tax rates, rather than because of different tax-deductibility rules) would lead to arbitrary results and a lack of comparability across entities in different tax jurisdictions. Tax jurisdictions choose different methods of imposing tax or providing tax relief. What matters is the resulting tax effect, not the mechanism.
- BC65 Accordingly, the Board concluded that an entity should recognise all income tax consequences of dividends applying the requirements in paragraph 57A. However, the Board also observed that, before those requirements were amended, the requirements in paragraph 57A could be misread to imply that paragraph 57A applied only in the circumstances described in paragraph 52A.
- BC66 Consequently, the Board clarified that the requirements in paragraph 57A apply to all income tax consequences of dividends.
- BC67 The Board noted that the amendments do not suggest that an entity applies paragraph 57A to the income tax consequences of all payments on financial instruments classified as equity. Rather, paragraph 57A applies only when an entity determines payments on such instruments are distributions of profits (ie dividends). An entity may need to apply judgement in making this determination.
- BC68 The Board considered whether to include requirements on how to determine if payments on financial instruments classified as equity are distributions of profits. It decided not to do so for the following reasons:



- (a) including indicators or requirements that distinguish distributions of profits from other distributions goes beyond the scope of the amendments to IAS 12. Any attempt by the Board to define or describe distributions of profits could affect other IFRS Standards and IFRIC Interpretations, and risks unintended consequences.
- (b) the amendments do not change what is and is not a distribution of profits. They simply clarify that the requirements in paragraph 57A apply to all income tax consequences of dividends.

BC69 The Board concluded that finalising the amendments without adding the possible requirements mentioned in paragraph BC68 would nonetheless be beneficial to preparers and users of financial statements. In particular, the amendments would eliminate the potential for inconsistent accounting that resulted from the ambiguity of the scope of the requirements in paragraph 57A that existed before those requirements were amended.

### Transition

BC70 The Board decided that an entity applies the amendments to income tax consequences of dividends recognised on or after the beginning of the earliest comparative period when it first applies the amendments. This is because application of the amendments before that date could affect only components of equity as at the beginning of the earliest comparative period. The Board concluded that entities would have sufficient information to apply the amendments to the income tax consequences of dividends that occur in comparative reporting periods and that applying the amendments in this way will enhance comparability of reporting periods.

### Deferred Tax related to Assets and Liabilities arising from a Single Transaction (2021 amendments)

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- BC71 In May 2021 the Board issued *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*. The amendments narrowed the scope of the recognition exemption in paragraphs 15 and 24 of IAS 12 (recognition exemption) so that it no longer applies to transactions that, on initial recognition, give rise to equal taxable and deductible temporary differences.
- BC72 The amendments were issued in response to a recommendation from the Interpretations Committee. Research conducted by the Interpretations Committee indicated that views differed on whether the recognition exemption applied to transactions, such as leases, that lead to the recognition of an asset and liability. These differing views resulted in entities accounting for deferred tax on such transactions in different ways, reducing comparability between their financial statements.
- BC73 For simplicity, paragraphs BC74–BC91 explain the basis for the amendments using leases as an example. The explanation applies equally to other transactions affected by the amendments, such as decommissioning, restoration and similar liabilities (decommissioning obligations) and the corresponding amounts recognised as part of the cost of the related asset.

## Background

### Temporary differences and the application of the recognition exemption

- BC74 Applying IFRS 16 *Leases*, an entity recognises a right-of-use asset (lease asset) and a lease liability at the commencement date of a lease. On initial recognition of the lease asset and lease liability, an entity assesses whether temporary differences arise in determining whether to recognise deferred tax. In making this assessment, an entity determines the tax bases of the lease asset and lease liability by identifying the amounts attributable to them for tax purposes. In some jurisdictions, an entity may receive tax deductions for lease payments when it makes such payments. In such situations, 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.
- BC75 An entity applies judgement in determining whether tax deductions are attributable to the lease asset or lease liability, having considered the applicable tax law.
- BC76 Applying IAS 12, temporary differences arise on initial recognition only when the entity determines that tax deductions are attributable to the lease liability because:
- (a) when tax deductions are attributable 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 and will 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 does not recognise deferred tax on initial recognition but does so if and when temporary differences arise after initial recognition.
  - (b) when tax deductions are attributable to the lease liability, the tax bases of the lease asset and lease liability are nil, reflecting that the entity will receive tax deductions in respect of the lease liability equal to its carrying amount and will receive no tax deductions on recovering the carrying amount of the lease asset. Consequently, temporary differences associated with the lease asset and lease liability arise on initial recognition of the lease.
- BC77 Before the amendments were issued, views differed on whether the recognition exemption applied to temporary differences that arise in the situation described in paragraph BC76(b). If an entity concluded that the recognition exemption applied, it recognised no deferred tax in respect of the lease (either on initial recognition or subsequently throughout the lease term).

### **Purpose of the recognition exemption**

- BC78 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 the resulting deferred tax liability or asset and adjust the carrying amount of the asset or liability by the same amount. Such adjustments would make the financial statements less transparent and IAS 12, therefore, prohibits the recognition of deferred tax in these circumstances.
- BC79 The Board observed that, when temporary differences arise on initial recognition of a lease asset and lease liability, these temporary differences are often equal and offsetting (that is, the taxable and deductible temporary differences are of the same amount). If the recognition exemption were not applied, an entity would generally recognise a deferred tax asset and liability of the same amount for these temporary differences. The recognition of a deferred tax asset and liability of the same amount would not require an 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 would not occur in such situations. The Board, therefore, concluded that the recognition exemption is not generally needed if on initial recognition a transaction gives rise to equal taxable and deductible temporary differences.

### **Narrowing the scope of the recognition exemption**

- BC80 In the light of the observations summarised in paragraph BC79, the Board decided to narrow the scope of the recognition exemption so that it does not apply to transactions that, on initial recognition, give rise to equal taxable and deductible temporary differences.
- BC81 The Board considered how this narrower scope of the recognition exemption would apply when an entity does not recognise a deferred tax asset and liability of the same amount for equal taxable and deductible temporary differences. Specifically, an entity could recognise a deferred tax asset and liability of different amounts if it is unable to recognise the deferred tax asset in full (see paragraphs BC82–BC87), or if different tax rates apply to the measurement of each temporary difference (see paragraph BC88).

### **Inability to recognise deferred tax assets**

- BC82 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' (the recoverability requirement). Because of the recoverability requirement, sometimes equal taxable and deductible temporary differences might result in an entity recognising unequal amounts of deferred tax assets and liabilities.

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- BC83 To address this situation, when it exposed draft amendments for comment, the Board proposed that the recognition exemption continue to apply to the extent that an entity would otherwise recognise unequal amounts of deferred tax assets and liabilities (the capping proposal). Applying the capping proposal, an entity would recognise deferred tax assets and liabilities of the same amount and only to the extent that, applying the recoverability requirement, the entity would recognise a deferred tax asset.
- BC84 Feedback on the draft amendments indicated that the capping proposal would be:
- (a) inconsistent with the principles in IAS 12 because the Standard generally requires an entity to recognise a deferred tax liability for all taxable temporary differences; and
  - (b) complex and burdensome to apply.
- BC85 In response to this feedback, the Board removed the capping proposal. The Board concluded that:
- (a) applying the recognition exemption to a deferred tax liability only because an entity is unable to recognise a corresponding deferred tax asset applying the recoverability requirement would be inconsistent with how the recognition exemption is applied in other situations.
  - (b) removing the capping proposal would significantly reduce the complexity of applying the amendments while still achieving their objective (see BC92(a)). In particular, by removing the capping proposal, the Board would:
    - (i) not require an entity to assess the recoverability requirement on initial recognition of each applicable transaction to determine the extent to which a deferred tax liability can be recognised.
    - (ii) simplify the accounting when, on initial recognition, deferred tax assets are not recognised in full. In such cases, had the capping proposal been retained in the amendments, entities would have been required to track separately the portions of temporary differences to which the recognition exemption was applied.
- BC86 Removing the capping proposal might result in an entity recognising unequal amounts of deferred tax assets and liabilities on initial recognition of a transaction. In such cases, an entity would recognise any difference in profit or loss (see paragraph 22(b) of IAS 12). For example, an entity would recognise an income tax loss if, on initial recognition, it recognises a deferred tax liability but is unable to recognise an equal and offsetting deferred tax asset. The Board concluded that this accounting appropriately reflects the entity's expectation that it will be unable to benefit fully from the tax deductions available when it settles the liability, but that it is nonetheless required to make future tax payments as it recovers the asset. As explained in paragraph BC85(a), applying the recognition exemption to the deferred tax liability only

because an entity is unable to recognise a corresponding deferred tax asset would be inconsistent with how the recognition exemption is applied in other situations.

- BC87 Further, the Board expects that unequal amounts of deferred tax assets and liabilities would arise on initial recognition only infrequently, because an entity might often meet the recoverability requirement through the future reversal of taxable temporary differences arising from the same transaction.

#### **Different tax rates apply**

- BC88 An entity might recognise a deferred tax asset and liability of different amounts for equal taxable and deductible temporary differences if different tax rates apply to the measurement of the deferred tax asset and liability. As noted in paragraph BC86, an entity would recognise any difference in profit or loss. The Board concluded that the expected benefits of applying the recognition exemption in these situations would not outweigh the costs because:

- (a) applying the recognition exemption in these situations would be complex because the recognition exemption would apply to only a small portion of the resulting deferred tax; and
- (b) these situations are expected to arise only in a limited number of jurisdictions and the net effect of applying different tax rates will often be immaterial.

### **Other considerations**

#### **Attribution of tax deductions to the lease asset or lease liability**

- BC89 Some respondents to the draft amendments suggested that the Board provide application guidance to help entities assess whether tax deductions are attributable to the lease asset or lease liability (see paragraph BC74). The Board decided not to provide such application guidance because the expected benefits of doing so would not outweigh the costs. The Board concluded that providing such guidance:

- (a) was unnecessary to achieve the objective of the amendments—the amendments will result in entities recognising deferred tax for temporary differences that arise on leases (either on initial recognition or subsequently) regardless of whether tax deductions are attributable to the lease asset or lease liability; and
- (b) could cause unintended consequences—any such guidance could affect how entities, in other situations, consider the applicable tax laws in determining the tax base of assets and liabilities.

#### **Advance lease payments and initial direct costs**

- BC90 Applying IFRS 16, an entity initially measures a lease liability at the present value of the lease payments not paid at the commencement date. An entity's initial measurement of a lease asset includes the initial measurement of the lease liability as well as advance lease payments and initial direct costs.

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BC91 The recognition of the lease liability and the related component of the lease asset's cost may give rise to equal taxable and deductible temporary differences as explained in paragraph BC79. The amendments apply to any such equal taxable and deductible temporary differences that arise. In addition, making advance lease payments or paying initial direct costs could result in additional taxable temporary differences associated with the lease asset, to which an entity would apply the applicable requirements in IAS 12. In response to requests to do so, the Board included an example illustrating the accounting for deferred tax on advance lease payments and initial direct costs.

### Effect analysis

BC92 The Board concluded that the expected benefits of the amendments outweigh the costs because:

- (a) the amendments will reduce diversity in the reporting of transactions such as leases and decommissioning obligations and align the accounting for deferred tax on such transactions with the general principle in IAS 12 of recognising deferred tax for temporary differences; and
- (b) concerns about the costs of applying the draft amendments related mainly to the application of the capping proposal (see paragraph BC84(b)). The Board's decision to remove the capping proposal addressed most of those concerns.

### Transition

BC93 The Board decided not to require retrospective application of the amendments in accordance with IAS 8. Instead, it decided to 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. It concluded that these requirements appropriately balance expected benefits and costs. Retrospective application would require entities to retrospectively assess whether each lease and decommissioning obligation gave rise to equal taxable and deductible temporary differences on initial recognition, which could have occurred a long time ago. The Board concluded that its transition approach would, therefore, make the amendments easier and less costly to apply than a full retrospective approach, while still achieving their objective. Such an approach also prevents any uncertainty about how the amendments interact with the transition requirements in IFRS 16.

BC94 The Board also required entities to apply the amendments prospectively to transactions other than leases and decommissioning obligations (that is, to such transactions that occur on or after the beginning of the earliest comparative period presented). Were the amendments to be applied retrospectively, determining whether such transactions are in the scope of the amendments and then reconsidering the accounting for those transactions could be costly and complex. The Board concluded that the costs of requiring

entities to apply the amendments retrospectively for those other transactions would outweigh the benefits of doing so.

BC95 For reasons similar to those explained in paragraph BC93, the Board required first-time adopters to recognise deferred tax for all temporary differences associated with leases and decommissioning obligations existing at the date of transition to IFRSs.

