

AASB Staff comments on IASB pre-ballot draft Exposure Draft

We understand that the IASB may be intending to issue this ED in response to particular concerns about how IAS 12 is interpreted in some countries (such as New Zealand and Hong Kong). If the IASB is to introduce an exception to the principle underlying IAS 12 in response to the concerns (and thereby compound the complexities for which IAS 12 is already criticised), we think it should be limited to those concerns. However, the proposals as drafted seem to go beyond those concerns, and indeed seem to go beyond the stated objective of the ED.

Furthermore, we are not convinced that it is necessary to introduce an exception to the principle – rather we think it would be preferable to clarify the principle in IAS 12.

Proposals go beyond addressing the concerns

The Introduction on page 3 of the pre-ballot draft states that ‘the proposed amendment is intended to provide a practical approach for measuring deferred tax liabilities when determination of the expected manner of recovery is difficult or subjective’. We are concerned that, as currently drafted (e.g. paragraph 51B), the ED would have a broad impact beyond the concerns it is intending to address, and inappropriately affect circumstances where determination of expected manner of recovery is neither difficult nor subjective.

We are particularly concerned with the treatment proposed when it is clear to an entity that it will only use an asset or only sell it. We think it is wrong to impose an arbitrary ‘lower of’ rule when management expectations of how they will recover the asset are clear and only relate to either use or sale. For an entity to base its deferred tax on recovery through use when it is clear that it will recover the asset through sale (and vice versa) inappropriately goes against the underlying principle of IAS 12. Furthermore, we note that determination of the expected manner of recovery of the carrying amount of an asset is not necessarily difficult or subjective, even if an entity expects recovery through both use and sale.

Proposals could clarify the principle rather than introduce an exception

The IASB could seek to clarify what is meant by IAS 12’s references to ‘recovery through use’. Without us passing judgment at this stage on possible ways in which the references could be clarified, we note the following two alternatives:

- (a) clarify that the remaining ‘depreciable amount’ of an IAS 16, 38 or 40 asset is the ‘expected to be recovered through use’ amount. Hence, assets that are not subject to depreciation, such as investment property carried at fair value, are assumed to be recovered through sale (and hence all revaluations on these assets). We note that this concept is already partially reflected in SIC 21, but could be expanded, and would warrant amendment to paragraph 4 of SIC 21; or
- (b) clarify that the nature of an underlying asset does not change just because an impairment-based model is seen as preferable to a depreciation-based model for indefinite (as distinct from infinite) life assets. Accordingly, the tax consequences of using such assets should be reflected in the deferred tax amounts to the extent the entity can reasonably determine the expected extent of use. In that regard, perhaps the IASB could give consideration to expressing a requirement along the following lines:
 - (i) if there is no intention to sell in the foreseeable future, deferred tax should be based on an assumption of recovery through use; and

- (ii) if there is an intention to sell in the foreseeable future, deferred tax should be based on an assumption of recovery through sale.

The IASB could also consider clarifying, in relation to IFRS 5, that it is not necessary for a non-current asset to be classified as held for sale before it can be regarded as being ‘expected to be recovered through sale’.

If the ED proceeds

If despite our comments above the ED proceeds along the lines of the pre-ballot draft, we have some drafting concerns as follows:

- Use of the words – ‘created by’ in paragraph 51B. This could be interpreted in several ways and could make the scope too narrow and thereby not address some practical concerns. For example, if there is a change in tax law and hence the tax base changes, effectively creating the temporary difference on the revalued asset, would this temporary difference be excluded?
- Paragraph 30(e) seems to suggest that, in assessing the recognition of a deferred tax asset, an entity can consider the deferred tax liability that would have arisen had the entity determined deferred tax in relation to an asset on the basis of using the asset rather than selling it. It is unclear why this paragraph is inserted in respect of the proposed exception. Other exceptions could also give rise to circumstances whereby the future tax consequences reflected in the accounts are not necessarily aligned with management intentions, but IAS 12 has not explicitly addressed those circumstances in relation to tax planning opportunities. Perhaps you could consider expressing the matter more generally, along the lines of paragraph BC14.