AASB Exposure Draft

ED 178
April 2009

Income Tax

Comments to AASB by 19 June 2009

Australian Government

Australian Accounting Standards Board

Commenting on this AASB Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 19 June 2009. Comments should be addressed to:

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Respondents to the IASB are asked to send their comments electronically through the 'Open to Comment' page on the IASB website (www.iasb.org)

All non-confidential submissions to the AASB will be made available to the public on the AASB website: www.aasb.gov.au.

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This AASB Exposure Draft is available on the AASB website: www.aasb.gov.au. Alternatively, printed copies of this AASB Exposure Draft are available by contacting:

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AASB REQUEST FOR COMMENTS

In light of the Australian Accounting Standards Board's (AASB's) policy of incorporating International Financial Reporting Standards (IFRSs) into Australian Accounting Standards, the AASB is inviting comments on:

(a) any of the proposals in the attached International Accounting Standards Board (IASB) Exposure Draft, including the specific questions on the proposals as listed in the Invitation to Comment section of the attached IASB Exposure Draft; and

(b) the 'AASB Specific Matters for Comment' listed below.

The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Due Date for Comments to the AASB

Comments should be submitted to the AASB by 19 June 2009. This will enable the AASB to consider those comments in the process of formulating its own comments to the IASB. Constituents are also strongly encouraged to send their response to the IASB.

AASB Specific Matters for Comment

If approved, the proposals in this Exposure Draft will replace AASB 112 *Income Taxes*. It is expected that the proposals would have significant implications for the accounting for income taxes in Australia, including the proposed changes to the methodology for recognising and measuring deferred taxes and the treatment of uncertain tax positions.

As such, the AASB would particularly value comments on:

1. any issues that could arise from applying the proposals in this Exposure Draft to the specific features of Australian income tax laws. Please include in your consideration whether the proposals would resolve existing practice issues and the extent to which the proposals could create new practice issues;

2. the implications that the proposals could have on Australian Interpretations that currently address Australian-specific income tax accounting issues, including Interpretation 1039 *Substantive Enactment of Major Tax Bills in Australia* and Interpretation 1052 *Tax Consolidation Accounting*, and your views on how those implications should be dealt with;

3. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

   (a) not-for-profit entities; and

   (b) public sector entities.

   For example, whether there are any issues associated with applying the proposals to account for the obligations of public sector entities to pay 'income tax equivalents', noting that paragraph Aus2.1 of AASB 112 currently includes income tax equivalents within its scope;

4. whether, overall, the proposals would result in financial statements that would be useful to users; and

5. whether the proposals are in the best interests of the Australian economy.

March 2009

Exposure Draft ED/2009/2

Income Tax

Comments to be received by 31 July 2009

International
Accounting Standards
Board®

Exposure Draft

INCOME TAX

Comments to be received by 31 July 2009

ED/2009/2

This exposure draft *Income Tax* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued as an International Financial Reporting Standard (IFRS). Comments on the draft IFRS and its accompanying documents (see separate booklet) should be submitted in writing so as to be received by **31 July 2009.** Respondents are asked to send their comments electronically to the IASB website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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APPENDIX B
Application guidance

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Introduction

IN1 This exposure draft contains proposals by the International Accounting Standards Board for an International Financial Reporting Standard (IFRS) on income tax to replace IAS 12 *Income Taxes*. The draft IFRS includes proposals on the treatment of uncertain tax amounts.

IN2 The Board undertook this project for two reasons. First, it has received many requests to clarify various aspects of IAS 12. Second, the Board and the US Financial Accounting Standards Board (FASB) agreed to consider the accounting for income tax as part of their work to reduce differences between IFRSs and US generally accepted accounting principles (GAAP).

IN3 IAS 12 and SFAS 109 *Accounting for Income Taxes* share a common approach—the temporary difference approach—the objective of which is to recognise the tax that would be payable or receivable if the entity's assets and liabilities were recovered or settled at their present carrying amount. However, the standards include different exceptions to the temporary difference approach. There are also differences between the standards relating to the recognition and measurement of deferred tax assets and liabilities and the allocation of tax to the components of comprehensive income and equity.

IN4 The boards decided that it would be appropriate to remove almost all of the exceptions to the temporary difference approach in IAS 12 and SFAS 109, resulting in simpler requirements based more on principle. They also decided on largely common requirements for the recognition and measurement of tax assets and liabilities. The decisions in the project would, if implemented in a standard, resolve the issues raised with the IASB by users of IAS 12.

IN5 The FASB had originally intended to publish proposals to amend SFAS 109 for the decisions made in the project. However, in September 2008 it announced that it would review its strategy for short-term convergence projects in the light of the possibility that some or all US public companies might be permitted or required to adopt IFRSs at some future date. As part of that review, it will solicit input from US constituents by issuing an Invitation to Comment containing the IASB's proposed replacement of IAS 12. At the conclusion of that review, the FASB will decide whether to undertake projects that would eliminate differences in the accounting for tax by adopting the IFRS.

IN6 The Basis for Conclusions accompanying the exposure draft includes a summary of the differences between the proposals in the exposure draft and US GAAP.

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Significant changes to IAS 12

IN7 The proposals in the exposure draft retain the fundamental requirements in IAS 12 to use the temporary difference approach to determine deferred tax assets and liabilities.

IN8 The proposed main changes from IAS 12 are:

(a) changes to the definition of tax basis. Tax basis would be defined as:

> the measurement under applicable substantively enacted tax law of an asset, liability or other item.

(b) an additional specification that the tax basis of an asset is determined by the tax deductions that would be available if the entity recovered the carrying amount of the asset by sale. This replaces the requirement in IAS 12 that the tax basis depends on how the entity expects to recover the carrying amount of an asset. But it is proposed that those expectations would determine whether any deferred tax asset or liability arises (see (c)) and, as required by IAS 12, may affect the measurement of any temporary difference.

(c) the introduction of an initial step in determining deferred tax assets and liabilities so that no deferred tax arises in respect of an asset or liability if there will be no effect on taxable profit when the entity recovers or settles its carrying amount.

(d) introduction of definitions of tax credit and investment tax credit as follows:

> *Tax credit* is a tax benefit that takes the form of an amount that reduces income tax payable.
>
> *Investment tax credit* is a tax credit that relates directly to the acquisition of depreciable assets.

(e) removal of the initial recognition exception in IAS 12. That exception prohibits an entity from recognising deferred tax assets and liabilities that arise when an asset or liability has a tax basis different from its initial carrying amount, except in a business combination or in a transaction affecting accounting or taxable profit. Instead, the exposure draft introduces a proposal for the initial measurement of assets and liabilities that have tax bases different from their initial carrying amounts. Such assets and liabilities are disaggregated into (i) an asset or liability excluding entity-specific tax effects and (ii) any entity-specific tax advantage or disadvantage. An entity would recognise and measure the former in accordance with IFRSs and recognise a deferred tax asset or liability for any resulting temporary difference between the carrying amount and the tax basis. If the consideration paid or received differs from the total recognised amounts of the acquired assets and liabilities (including deferred tax), an entity recognises the difference as an allowance against, or premium on, the deferred tax asset or liability.

(f) changes to the exception in IAS 12 from the temporary difference approach relating to a deferred tax asset or liability arising from investments in subsidiaries, branches, associates and joint ventures. The proposed exception is restricted to investments in foreign subsidiaries, joint ventures or branches that are essentially permanent in duration. No exception is proposed for associates.

(g) a proposal to recognise deferred tax assets in full, less, if applicable, a valuation allowance to reduce the net carrying amount to the highest amount that is more likely than not to be realisable against taxable profit. This approach replaces the existing single-step recognition of the portion of a deferred tax asset for which realisation is probable.

(h) additional guidance on assessing the realisability of deferred tax assets, including the treatment of significant expenses for any relevant tax planning strategies.

(i) a proposal that current and deferred tax assets and liabilities should be measured using the probability-weighted average amounts of possible outcomes assuming that the tax authorities will examine the amounts reported to them by the entity and have full knowledge of all relevant information. IAS 12 is silent on the treatment of uncertainty over tax amounts.

(j) clarification that 'substantively enacted' means that future events required by the enactment process historically have not affected the outcome and are unlikely to do so.

(k) a change to the requirements relating to the tax effects of distributions to shareholders. An entity would measure current and deferred tax assets and liabilities using the rate expected to apply when the tax asset or liability is realised or settled, including the effect of the entity's expectations of future distributions. This would replace the requirement in IAS 12 to use the undistributed rate.

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(l) adoption of the SFAS 109 requirements for the allocation of income tax expense to the components of comprehensive income and equity. In particular, some changes in tax effects that were initially recognised outside continuing operations would be recognised in continuing operations.

(m) classification of deferred tax assets and liabilities as either current or non-current on the basis of the financial reporting classification of the related non-tax asset or liability. IAS 1 *Presentation of Financial Statements* requires all deferred tax to be classified as non-current.

(n) clarification that the classification of interest and penalties is an accounting policy choice and hence must be applied consistently, and introduction of a requirement to disclose the chosen policy.

IN9 A table of concordance showing how IAS 12 and the exposure draft correspond is set out after the Basis for Conclusions. Examples developed by the IASB staff that illustrate some aspects of the proposals in the exposure draft are available on the IASB website (www.iasb.org).

Invitation to comment

The International Accounting Standards Board invites comments on all matters in this exposure draft, particularly on the questions set out below. Comments are most helpful if they:

(a) comment on the questions as stated

(b) indicate the specific paragraph or paragraphs to which the comments relate

(c) contain a clear rationale

(d) include any alternative the Board should consider, if applicable.

Respondents should submit comments in writing so as to be received no later than 31 July 2009.

Question 1 - Definitions of tax basis and temporary difference

The exposure draft proposes changes to the definition of tax basis so that the tax basis does not depend on management's intentions relating to the recovery or settlement of an asset or liability. It also proposes changes to the definition of a temporary difference to exclude differences that are not expected to affect taxable profit. (See paragraphs BC17–BC23 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

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Question 2 – Definitions of tax credit and investment tax credit

The exposure draft would introduce definitions of tax credit and investment tax credit. (See paragraph BC24 of the Basis for Conclusions.)

Do you agree with the proposed definitions? Why or why not?

Question 3 – Initial recognition exception

The exposure draft proposes eliminating the initial recognition exception in IAS 12. Instead, it introduces proposals for the initial measurement of assets and liabilities that have tax bases different from their initial carrying amounts. Such assets and liabilities are disaggregated into (a) an asset or liability excluding entity-specific tax effects and (b) any entity-specific tax advantage or disadvantage. The former is recognised in accordance with applicable standards and a deferred tax asset or liability is recognised for any temporary difference between the resulting carrying amount and the tax basis. Outside a business combination or a transaction that affects accounting or taxable profit, any difference between the consideration paid or received and the total amount of the acquired assets and liabilities (including deferred tax) would be classified as an allowance or premium and recognised in comprehensive income in proportion to changes in the related deferred tax asset or liability. In a business combination, any such difference would affect goodwill. (See paragraphs BC25–BC35 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

Question 4 – Investments in subsidiaries, branches, associates and joint ventures

IAS 12 includes an exception to the temporary difference approach for some investments in subsidiaries, branches, associates and joint ventures based on whether an entity controls the timing of the reversal of the temporary difference and the probability of it reversing in the foreseeable future. The exposure draft would replace these requirements with the requirements in SFAS 109 and APB Opinion 23 *Accounting for Income Taxes—Special Areas* pertaining to the difference between the tax basis and the financial reporting carrying amount for an investment in a foreign subsidiary or joint venture that is essentially permanent in duration. Deferred tax assets and liabilities for temporary differences related to such investments are not recognised. Temporary differences associated with branches would be treated in the same way as temporary differences associated with investments in subsidiaries. The exception in IAS 12 relating to investments in associates would be removed.

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The Board proposes this exception from the temporary difference approach because the Board understands that it would often not be possible to measure reliably the deferred tax asset or liability arising from such temporary differences. (See paragraphs BC39–BC44 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not? Do you agree that it is often not possible to measure reliably the deferred tax asset or liability arising from temporary differences relating to an investment in a foreign subsidiary or joint venture that is essentially permanent in duration? Should the Board select a different way to define the type of investments for which this is the case? If so, how should it define them?

Question 5 – Valuation allowances

The exposure draft proposes a change to the approach to the recognition of deferred tax assets. IAS 12 requires a one-step recognition approach of recognising a deferred tax asset to the extent that its realisation is probable. The exposure draft proposes instead that deferred tax assets should be recognised in full and an offsetting valuation allowance recognised so that the net carrying amount equals the highest amount that is more likely than not to be realisable against taxable profit. (See paragraphs BC52–BC55 of the Basis for Conclusions.)

Question 5A

Do you agree with the recognition of a deferred tax asset in full and an offsetting valuation allowance? Why or why not?

Question 5B

Do you agree that the net amount to be recognised should be the highest amount that is more likely than not to be realisable against future taxable profit? Why or why not?

Question 6 – Assessing the need for a valuation allowance

Question 6A

The exposure draft incorporates guidance from SFAS 109 on assessing the need for a valuation allowance. (See paragraph BC56 of the Basis for Conclusions.)

Do you agree with the proposed guidance? Why or why not?

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Question 6B

The exposure draft adds a requirement on the cost of implementing a tax strategy to realise a deferred tax asset. (See paragraph BC56 of the Basis for Conclusions.)

Do you agree with the proposed requirement? Why or why not?

Question 7 – Uncertain tax positions

IAS 12 is silent on how to account for uncertainty over whether the tax authority will accept the amounts reported to it. The exposure draft proposes that current and deferred tax assets and liabilities should be measured at the probability-weighted average of all possible outcomes, assuming that the tax authority examines the amounts reported to it by the entity and has full knowledge of all relevant information. (See paragraphs BC57–BC63 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

Question 8 – Enacted or substantively enacted rate

IAS 12 requires an entity to measure deferred tax assets and liabilities using the tax rates enacted or substantively enacted by the reporting date. The exposure draft proposes to clarify that substantive enactment is achieved when future events required by the enactment process historically have not affected the outcome and are unlikely to do so.

(See paragraphs BC64–BC66 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

Question 9 – Sale rate or use rate

When different rates apply to different ways in which an entity may recover the carrying amount of an asset, IAS 12 requires deferred tax assets and liabilities to be measured using the rate that is consistent with the expected manner of recovery. The exposure draft proposes that the rate should be consistent with the deductions that determine the tax basis, ie the deductions that are available on sale of the asset. If those deductions are available only on sale of the asset, then the entity should use the sale rate. If the same deductions are also available on using the asset, the entity should use the rate consistent with the expected manner of recovery of the asset. (See paragraphs BC67–BC73 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

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Question 10 – Distributed or undistributed rate

IAS 12 prohibits the recognition of tax effects of distributions before the distribution is recognised. The exposure draft proposes that the measurement of tax assets and liabilities should include the effect of expected future distributions, based on the entity's past practices and expectations of future distributions. (See paragraphs BC74–BC81 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

Question 11 – Deductions that do not form part of a tax basis

An entity may expect to receive tax deductions in the future that do not form part of a tax basis. SFAS 109 gives examples of 'special deductions' available in the US and requires that 'the tax benefit of special deductions ordinarily is recognized no earlier than the year in which those special deductions are deductible on the tax return'. SFAS 109 is silent on the treatment of other deductions that do not form part of a tax basis.

IAS 12 is silent on the treatment of tax deductions that do not form part of a tax basis and the exposure draft proposes no change. (See paragraphs BC82–BC88 of the Basis for Conclusions.)

Do you agree that the exposure draft should be silent on the treatment of tax deductions that do not form part of a tax basis? If not, what requirements do you propose, and why?

Question 12 – Tax based on two or more systems

In some jurisdictions, an entity may be required to pay tax based on one of two or more tax systems, for example, when an entity is required to pay the greater of the normal corporate income tax and a minimum amount. The exposure draft proposes that an entity should consider any interaction between tax systems when measuring deferred tax assets and liabilities. (See paragraph BC89 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

Question 13 – Allocation of tax to components of comprehensive income and equity

IAS 12 and SFAS 109 require the tax effects of items recognised outside continuing operations during the current year to be allocated outside continuing operations. IAS 12 and SFAS 109 differ, however, with respect to the allocation of tax related to an item that was recognised outside continuing operations in a prior year. Such items may arise from changes in the effect of

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uncertainty over the amounts reported to the tax authorities, changes in assessments of recovery of deferred tax assets or changes in tax rates, laws, or the taxable status of the entity. IAS 12 requires the allocation of such tax outside continuing operations, whereas SFAS 109 requires allocation to continuing operations, with specified exceptions. The IAS 12 approach is sometimes described as requiring backwards tracing and the SFAS 109 approach as prohibiting backwards tracing.

The exposure draft proposes adopting the requirements in SFAS 109 on the allocation of tax to components of comprehensive income and equity. (See paragraphs BC90–BC96 of the Basis for Conclusions.)

Question 13A

Do you agree with the proposed approach? Why or why not?

The exposure draft deals with allocation of tax to components of comprehensive income and equity in paragraphs 29–34. The Board intends those paragraphs to be consistent with the requirements expressed in SFAS 109.

Question 13B

Would those paragraphs produce results that are materially different from those produced under the SFAS 109 requirements? If so, would the results provide more or less useful information than that produced under SFAS 109? Why?

The exposure draft also sets out an approach based on the IAS 12 requirements with some amendments. (See paragraph BC97 of the Basis for Conclusions.)

Question 13C

Do you think such an approach would give more useful information than the approach proposed in paragraphs 29–34? Can it be applied consistently in the tax jurisdictions with which you are familiar? Why or why not?

Question 13D

Would the proposed additions to the approach based on the IAS 12 requirements help achieve a more consistent application of that approach? Why or why not?

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Question 14 – Allocation of current and deferred taxes within a group that files a consolidated tax return

IAS 12 is silent on the allocation of income tax to entities within a group that files a consolidated tax return. The exposure draft proposes that a systematic and rational methodology should be used to allocate the portion of the current and deferred income tax expense for the consolidated entity to the separate or individual financial statements of the group members. (See paragraph BC100 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

Question 15 – Classification of deferred tax assets and liabilities

The exposure draft proposes the classification of deferred tax assets and liabilities as current or non-current, based on the financial statement classification of the related non-tax asset or liability. (See paragraphs BC101 and BC102 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

Question 16 – Classification of interest and penalties

IAS 12 is silent on the classification of interest and penalties. The exposure draft proposes that the classification of interest and penalties should be a matter of accounting policy choice to be applied consistently and that the policy chosen should be disclosed. (See paragraph BC103 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

Question 17 – Disclosures

The exposure draft proposes additional disclosures to make financial statements more informative. (See paragraphs BC104–BC109 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

The Board also considered possible additional disclosures relating to unremitted foreign earnings. It decided not to propose any additional disclosure requirements. (See paragraph BC110 of the Basis of Conclusions.)

Do you have any specific suggestions for useful incremental disclosures on this matter? If so, please provide them.

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Question 18 – Effective date and transition

Paragraphs 50–52 of the exposure draft set out the proposed transition for entities that use IFRSs, and paragraph C2 sets out the proposed transition for first-time adopters. (See paragraphs BC111–BC120 of the Basis for Conclusions.)

Do you agree with these proposals? Why or why not?

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[Draft] International Financial Reporting Standard X *Income Tax* ([draft] IFRS X) is set out in paragraphs 1–54 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the [draft] IFRS. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. [Draft] IFRS X should be read in the context of its core principle and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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[Draft] International Financial Reporting Standard X *Income Tax*

Core principle

1 **An entity shall recognise tax liabilities, tax assets and *tax expense* for *current tax*, which is tax payable or refundable on *taxable profit* for the current and past periods. An entity shall also recognise tax liabilities, tax assets and tax expense for *deferred tax*, which is tax payable or recoverable on taxable profit for future periods as a result of past transactions or events. Such tax arises because of the difference between the amounts recognised for the entity's assets and liabilities in the statement of financial position and the recognition of those assets and liabilities by the tax authorities, and the carryforward of currently unused *tax losses* and *tax credits*.**

Scope

2 This [draft] IFRS establishes the accounting for income tax. Income tax includes all domestic and foreign tax that is based on taxable profit. Income tax for a parent or investor in an associate or joint venture also includes tax payable on distributions (for example, withholding tax) by the subsidiary on behalf of the parent, or by an associate or joint venture on behalf of the investor.

3 Taxable profit is often not the same as profit or loss. Nonetheless, taxable profit implies a net amount of income and expense rather than a gross amount or individual item.

4 This [draft] IFRS does not apply to government grants (see IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*) or *investment tax credits*. However, it applies to the accounting for *temporary differences* that may arise from such grants or investment tax credits.

Steps in accounting for income tax

5 An entity shall account for income tax by following the steps (a)–(i) below:

(a) recognise current tax, measured at an amount that includes the effect of the possible outcomes of a review by the tax authorities (paragraphs 6–8).

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(b) identify which assets and liabilities would be expected to affect taxable profit if they were recovered or settled for their present carrying amounts (paragraphs 10–13).

(c) determine the *tax basis* at the end of the reporting period of the assets and liabilities in (b), and of other items that have a tax basis. The tax basis is determined by the consequences of the sale of the assets or settlement of liabilities for their present carrying amounts (paragraphs 14–16).

(d) compute any temporary differences, unused tax losses and unused tax credits (paragraphs 17–19).

(e) recognise *deferred tax assets* and *liabilities* arising from the temporary differences, unused tax losses and unused tax credits (paragraphs 20–22).

(f) measure deferred tax assets and liabilities at an amount that includes the effect of the possible outcomes of a review by the tax authorities using tax rates that, on the basis of substantively enacted tax law at the end of the reporting period, are expected to apply when the deferred tax asset is realised or the deferred tax liability is settled (paragraphs 24–28).

(g) recognise a *valuation allowance* against deferred tax assets so that the net amount equals the highest amount that is more likely than not to be realisable against taxable profit (paragraph 23).

(h) allocate current and deferred tax to the related components of comprehensive income and equity, and classify tax assets as current or non-current (paragraphs 29–37).

(i) disclose the required information (paragraphs 40–49).

Current tax

6 **An entity shall recognise a current tax liability for tax payable on taxable profit for the current and past periods. If the amount paid for the current and past periods exceeds the amount payable for those periods, the entity shall recognise the excess as a current tax asset.**

7 **An entity shall recognise a current tax asset for the benefit of a tax loss that can be carried back to recover tax paid in a previous period.**

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8 An entity shall include in the amounts recognised in accordance with paragraphs 6 and 7 the effect of the possible outcomes of a review by the tax authorities, measured in accordance with paragraph 26.

Deferred tax

9 An entity shall recognise a deferred tax asset or liability for tax recoverable or payable in future periods as a result of past transactions or events. Such tax arises from the difference between the amounts recognised for the entity's assets and liabilities in the statement of financial position and the recognition of those assets and liabilities by the tax authorities, and the carryforward of currently unused tax losses and tax credits.

Assets and liabilities for which the recovery or settlement is not expected to affect taxable profit

10 If there will be no effect on taxable profit when the entity recovers the carrying amount of an asset or settles the carrying amount of a liability, no deferred tax arises in respect of the asset or liability. This will happen when:

(a) no ***taxable income*** **or amounts deductible from taxable income arise on the recovery or settlement of the carrying amount, or**

(b) equal taxable income and amounts deductible from taxable income arise, having a nil net effect, or

(c) a nil tax rate applies to any taxable or deductible amounts. In this case, although the recovery or settlement of the carrying amount may affect taxable profit, in practice the effect is the same as the situation described in (a).

11 In some tax jurisdictions, whether any of paragraph 10(a)–(c) applies depends on the manner in which the asset is recovered or liability is settled. If an entity expects to recover the carrying amount of an asset or settle the carrying amount of a liability in a manner that means that any of paragraph 10(a)–(c) applies, no deferred tax arises in respect of the asset or liability.

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12 In accordance with paragraphs 10 and 11, paragraphs 14–22 apply only to:

(a) assets and liabilities for which the entity expects the recovery or settlement of the carrying amount to affect taxable profit, and

(b) other items that have a tax basis (see paragraph 16).

13 An entity might expect to recover the carrying amount of an asset or settle the carrying amount of a liability in a period in which it expects to pay no current tax, for example because of tax losses. Nonetheless, if the entity expects the recovery or settlement of the carrying amount of an asset or liability to affect the amount of taxable profit in that period, a deferred tax asset or liability relating to the asset or liability may exist in accordance with paragraphs 14–22.

Tax basis

14 An entity shall determine the tax basis of an asset, liability or other item in accordance with substantively enacted law. If the entity files a consolidated tax return, the tax basis is determined by the tax law governing the consolidated tax return. If the entity files separate tax returns for different operations, the tax basis is determined by the tax laws governing each tax return.

15 The tax basis determines the amounts that will be included in taxable profit on recovery or settlement of the carrying amount of an asset or liability. Specifically:

(a) the tax basis of an asset equals the amount that would have been deductible against taxable income in arriving at taxable profit if the carrying amount of the asset had been recovered through sale at the end of the reporting period. If the recovery of the asset through sale does not give rise to taxable income, the tax basis shall be deemed to be equal to the carrying amount.

(b) the tax basis of a liability equals its carrying amount less any amounts deductible against taxable income (or plus any amounts included in taxable income) that would have arisen if the liability had been settled for its carrying amount at the end of the reporting period. In the case of deferred revenue, the tax basis of the resulting liability is its carrying amount, less any amount of revenue that will not be taxable in future periods.

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16 Some items have a tax basis but are not recognised as assets and liabilities. For example, research costs are recognised as an expense when they are incurred but may not be permitted as a deduction in determining taxable profit until a future period. Thus, the carrying amount of the research costs is nil and the amount that will be deducted in future periods is the tax basis. An equity instrument issued by the entity may also give rise to deductions in a future period. There is no asset or liability in the statement of financial position, but the tax basis is the amount of the future deductions.

Temporary differences

17 Temporary differences arise:

(a) when there is a difference between the carrying amounts and tax bases on the initial recognition of assets and liabilities, or at the time a tax basis is created for those items that have a tax basis but are not recognised as assets and liabilities.

(b) when a difference between the carrying amount and tax basis arises after initial recognition because income or expense is recognised in comprehensive income or equity in one reporting period but is recognised in taxable profit in a different period.

(c) when the tax basis of an asset or liability changes and the change will not be recognised in the asset or liability's carrying amount in any period.

18 There are two types of temporary difference:

(a) differences between the carrying amounts of individual assets and liabilities and their tax bases in the tax jurisdiction in which the assets, liabilities and tax basis reside. These include differences between the carrying amount of nil and the tax basis of items that have a tax basis but are not recognised as assets and liabilities.

(b) differences between the carrying amount of investments in a subsidiary or joint venture and the tax basis of those investments in the tax jurisdiction of the parent or investor (see paragraphs B1–B9).

19 Paragraphs 10–13 discuss the recovery or settlement of assets or liabilities that do not affect taxable profit. Those paragraphs apply to the recovery or settlement of individual assets and liabilities. Whether an entity expects to recover its investment in a subsidiary or joint venture without

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affecting taxable profit does not affect the recognition of deferred tax assets and liabilities relating to the individual assets and liabilities of the subsidiary or joint venture in the entity's consolidated financial statements.

Deferred tax liabilities and assets

20 Except as required by paragraph 21, an entity shall recognise:

(a) a deferred tax liability for all temporary differences that are expected to increase taxable profit in the future.

(b) a deferred tax asset for all temporary differences that are expected to reduce taxable profit in the future.

(c) a deferred tax asset for the carryforward of unused tax losses and unused tax credits.

21 An entity shall not recognise a deferred tax liability that arises on the initial recognition of goodwill, or any subsequent changes in that deferred tax liability. An entity shall recognise deferred tax liabilities and deferred tax assets for investments in subsidiaries and joint ventures in accordance with paragraphs B1–B9.

22 In recognising a deferred tax asset or liability, an entity shall apply the following paragraphs:

(a) for temporary differences arising on the initial recognition of an asset or liability, paragraphs B10–B13

(b) for temporary differences arising on the remeasurement of an asset or liability at fair value, paragraphs B14 and B15.

Valuation allowance

23 An entity shall recognise a valuation allowance against deferred tax assets so that the net amount equals the highest amount that is more likely than not to be realisable against taxable profit. In determining when to recognise a valuation allowance, an entity shall apply paragraphs B16–B25.

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Measurement

24 **An entity shall measure current tax assets and liabilities using the tax rates and tax laws that have been substantively enacted at the end of the reporting period.**

25 **An entity shall measure deferred tax assets and liabilities recognised in accordance with paragraph 20 at the tax rates that, on the basis of tax rates and tax laws that have been substantively enacted at the end of the reporting period, are expected to apply when the deferred tax asset is realised or the deferred tax liability is settled.**

26 Uncertainty about whether the tax authorities will accept the amounts reported to them by the entity affects the amount of current tax and deferred tax. An entity shall measure current and deferred tax assets and liabilities using the probability-weighted average amount of all the possible outcomes, assuming that the tax authorities will examine the amounts reported to them and have full knowledge of all relevant information. Changes in the probability-weighted average amount of all possible outcomes shall be based on new information, not a new interpretation by the entity of previously available information.

27 In measuring tax assets and liabilities, an entity shall apply the following paragraphs:

(a) on substantive enactment of tax rates, paragraph B26

(b) on a change in tax status, paragraph B27

(c) when different tax rates apply to different levels of income or different ways of recovering the asset, paragraphs B28–B30

(d) for the tax effects of distributions of profit or retained earnings to shareholders, paragraphs B31 and B32

(e) when tax is based on two or more tax systems, paragraph B33.

28 An entity shall not discount deferred tax assets and liabilities. However, this does not affect the determination of temporary differences, which are calculated by reference to a carrying amount even when the carrying amount is determined on a discounted basis.

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Presentation

Allocation of current and deferred tax to components of comprehensive income and equity

29 An entity shall recognise tax expense arising at the time of transactions and other events in the same component of comprehensive income (ie continuing operations, discontinued operations, or item in other comprehensive income) or equity in which it recognises the transaction or other event.

30 An entity shall determine the tax expense arising from transactions and other events it recognises in continuing operations without including any effect of items recognised outside continuing operations, except when determining the tax benefit arising from a loss in continuing operations. In that case, an entity shall include in the determination of the tax benefit arising from the loss in continuing operations the effect on that tax benefit of items recognised in all components of comprehensive income and equity.

31 An entity shall determine the tax expense arising from items it recognises outside continuing operations as the difference between the total tax expense including the tax effect of the item and the total tax expense excluding the tax effect of the item.

32 In determining the tax expense for each component of comprehensive income and equity, an entity shall apply the following paragraphs:

(a) for tax benefits, paragraphs B34 and B35

(b) for tax for groups filing a consolidated tax return, paragraph B37

(c) for deferred tax arising in a business combination, paragraphs B38–B40

(d) for tax arising from share-based payment transactions, paragraphs B41–B43.

33 An entity shall recognise subsequent changes in the amounts previously recognised as tax expense as follows:

(a) changes in a valuation allowance, in accordance with paragraph B36

(b) all other changes, in continuing operations.

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34 If the sum of the separately calculated tax expenses allocated to each component in accordance with paragraphs 29–33 does not equal the total tax expense, an entity shall:

(a) allocate to continuing operations the tax expense for continuing operations calculated in accordance with paragraphs 29–33.

(b) if there is only one component other than continuing operations, allocate the remaining tax expense to that component.

(c) if there is more than one component other than continuing operations, allocate the tax expense remaining after the amount allocated to continuing operations to the other components as follows:

  (i) Determine the effect on tax expense of the total loss for all loss items recognised outside continuing operations.

  (ii) Allocate the amount determined in (i) to each loss item pro rata to its individual tax effect.

  (iii) Determine the amount that remains, ie the difference between the amount to be allocated to all components other than continuing operations and the amount allocated to loss items recognised outside continuing operations.

  (iv) Allocate the amount determined in (iii) to each remaining item pro rata to its individual tax effect.

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As discussed in paragraph BC97 of the Basis for Conclusions on this exposure draft, paragraphs 29A–34A set out an alternative approach to the allocation of tax to comprehensive income and equity that the Board does not propose to adopt.

29A An entity shall recognise tax expense arising at the time of transactions and other events in the same component of comprehensive income (ie continuing operations, discontinued operations, or items of other comprehensive income) or equity as it recognises the transaction or other event. An entity shall recognise subsequent changes in the amounts previously recognised as tax expense in the same component as the tax expense was originally recognised, if practicable. If it is not practicable to determine in which component the tax expense was originally recognised, an entity shall recognise subsequent changes based on a reasonable pro rata allocation of the tax expense of the entity in the tax jurisdiction concerned, or other method that achieves a more appropriate allocation in the circumstances.

30A An entity shall determine the tax expense arising from transactions and other events recognised in continuing operations without considering any effect of items recognised outside continuing operations, except when determining the tax benefit arising from a loss in continuing operations. In that case, an entity shall consider in the determination of the tax benefit arising from the loss in continuing operations the effect on that tax benefit of items recognised in all components of comprehensive income and equity.

31A An entity shall determine the tax expense arising from items recognised outside continuing operations as the difference between the total tax expense including the tax effect of the item and the total tax expense excluding the tax effect of the item.

32A In recognising tax expense for each component of comprehensive income and equity, an entity shall apply the following paragraphs:

(a) for tax benefits, paragraphs B34A and B35A

(b) for changes in tax effects that were not originally recognised in comprehensive income or equity, paragraph B36A

(c) for tax for groups filing a consolidated tax return, paragraph B37

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(d) for deferred tax arising from a business combination, paragraphs B38–B40

(e) for tax arising from share-based payment transactions, paragraphs B41–B43.

33A [There is no equivalent to paragraph 33 in this approach.]

34A If the sum of the separately calculated tax expenses recognised in each component in accordance with paragraphs 29A–32A does not equal the total tax expense, an entity shall:

(a) allocate to continuing operations the tax expense for continuing operations calculated in accordance with paragraphs 29A–32A.

(b) if there is only one other component, allocate the remaining tax expense to that component.

(c) if there is more than one component other than continuing operations, allocate the tax expense remaining after the amount recognised in continuing operations to the other components as follows:

(i) Determine the effect on tax expense of the total loss for all loss items recognised outside continuing operations.

(ii) Allocate the amount determined in (i) to each loss item pro rata with the item's individual tax effect.

(iii) Determine the amount that remains, ie the difference between the amount to be allocated to all components other than continuing operations and the amount allocated to loss items recognised outside continuing operations.

(iv) Allocate the amount determined in (iii) to each remaining item pro rata to the item's individual tax effect.

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Tax assets and tax liabilities

35 In a classified statement of financial position, an entity shall disaggregate deferred tax liabilities and assets into a current amount and a non-current amount on the basis of the classification of the related asset or liability. An entity shall classify a deferred tax liability or asset that is not related to a recognised asset or liability on the basis of the date when the entity expects the temporary difference to reverse. An entity shall allocate any valuation allowance for a particular tax jurisdiction pro rata between current and non-current deferred tax assets for that tax jurisdiction.

Offset

36 An entity shall offset current tax assets against current tax liabilities when the entity:

(a) has a legally enforceable right to set off the amounts, and

(b) intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

An entity shall apply paragraphs B44 and B45 in determining whether it meets these requirements.

37 An entity shall offset deferred tax assets (net of any valuation allowances) against deferred tax liabilities as follows:

(a) the current amount of deferred tax assets against the current amount of deferred tax liabilities and

(b) the non-current amount of deferred tax assets against the non-current amount of deferred tax liabilities

when:

(c) the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and

(d) the deferred tax assets and the deferred tax liabilities relate to taxes levied by the same tax authority on either:

(i) the same taxable entity; or

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(ii) different taxable entities that intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

When an entity has a legally enforceable right of set-off and an intention to settle net for some periods but not for others, it shall apply paragraph B46.

Exchange differences on foreign tax liabilities or assets

38 IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires the effects of specified exchange differences to be recognised in profit or loss but does not specify how the effects of such differences should be classified. An entity shall make an accounting policy decision on whether to classify as tax expense the effects of such exchange differences on foreign tax liabilities and assets.

Interest and penalties

39 An entity shall make an accounting policy decision whether to classify interest and penalties payable to tax authorities as tax expense.

Disclosure

40 An entity shall disclose information that informs users of its financial statements about current and deferred tax consequences of recognised transactions and other events.

Analysis of tax expense recognised in profit or loss

41 An entity shall disclose separately the components of tax expense recognised in profit or loss. Components of tax expense include, for example:

(a) current tax expense in respect of taxable profit for the current period.

(b) any adjustments recognised for current tax of prior periods, including separately the effect of the possible outcomes of a review by the tax authorities, determined in accordance with paragraph 26.

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(c) the amount of deferred tax expense relating to the origination and reversal of temporary differences.

(d) the amount of deferred tax expense relating to changes in tax rates or the imposition of new taxes.

(e) the effect on deferred tax expense of any change in the effect of the possible outcomes of a review by the tax authorities, determined in accordance with paragraph 26.

(f) adjustments to deferred tax expense arising from a change in the tax status of the entity or its shareholders.

(g) any change in a valuation allowance, showing separately any change that arises from a tax benefit that reduces current tax expense.

(h) the amount of tax expense relating to changes in accounting policies and errors if they are included in profit or loss in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* or specific transitional requirements in another IFRS.

42 An entity shall disclose an explanation of the relationship between tax expense recognised in profit or loss and pre-tax profit or loss in either or both of the following forms:

(a) a numerical reconciliation of tax expense and the product of accounting profit multiplied by the applicable tax rate or rates, disclosing also how the applicable tax rates are computed.

(b) a numerical reconciliation of the average effective tax rate and the applicable tax rate, disclosing also how the applicable tax rate is computed.

43 The applicable tax rate is the rate of tax in the country in which the entity is domiciled, aggregating the tax rate for national taxes with the rates for any local taxes that are computed on a substantially similar level of taxable profit. The average effective tax rate is the tax expense recognised in profit or loss divided by pre-tax profit or loss.

44 An entity shall disclose an explanation of changes in the applicable tax rates from the previous reporting period.

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Tax expense recognised in other comprehensive income or equity

45 An entity shall disclose the aggregate current and deferred tax recognised in other comprehensive income and the aggregate current and deferred tax recognised directly in equity.

Analysis of changes in deferred tax assets and liabilities

46 An entity shall disclose for each type of temporary difference and for each type of unused tax losses and tax credits:

(a) the amount of deferred tax liabilities and deferred tax assets for each period presented.

(b) a numerical analysis of the change in deferred tax liabilities, and deferred tax assets, including separate disclosure of the items in paragraphs 41(c)–(f) and 45;

(c) the expiry date, if any, of temporary differences, unused tax losses and tax credits.

47 An entity shall disclose the amount of any valuation allowance, any change in the valuation allowance, and a description of any event or change in circumstances that causes that change.

Other disclosures

48 The entity shall disclose:

(a) for entities that pay tax at a higher or lower rate if part or all of profit or retained earnings is paid out as a distribution to shareholders, the entity's estimates relating to future distributions and their effect on the tax rate used to measure deferred tax assets and liabilities.

(b) for discontinued operations, tax expense relating to:

  (i) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operations; and

  (ii) pre-tax profit or loss of discontinued operations for the period.

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(c) the aggregate amount of temporary differences associated with investments in subsidiaries and interests in joint ventures, for which deferred tax liabilities have not been recognised (see paragraph B5).

(d) for transfers of assets and liabilities within a consolidated group between taxing jurisdictions with different tax rates:

   (i) deferred tax assets and deferred tax liabilities arising from such transfers.

   (ii) the net effect of such transfers on tax expense, either for all transfers or for only those transfers whose timing or terms are not customary for the consolidated group.

   (iii) the tax effects of any modifications since the end of the reporting period, including unwinding (reversal) of the terms of such transfers.

(e) for an entity that is a member of a group that files a consolidated tax return, in its individual or separate financial statements or consolidated financial statements of a subgroup:

   (i) the amount of any tax-related liabilities or assets due to or from other entities within the group and

   (ii) the principal features of the method for allocating current and deferred tax expense to members of the group and the nature and effect of any changes in that method during the periods presented.

(f) the entity's accounting policies for the classification of:

   (i) exchange differences on foreign tax assets and liabilities and

   (ii) interest and penalties payable to tax authorities.

(g) for an entity that is not subject to tax because its income is taxed directly to its owners, that fact and the aggregate difference between the tax bases and the carrying amounts of the entity's assets and liabilities.

49 An entity shall disclose information about the major sources of estimation uncertainties relating to tax to enable users of the financial statements to assess the possible financial effects of the estimation uncertainties and their timing (for example, the effects of unresolved disputes with the tax authorities), including:

(a) a description of the uncertainty; and

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(b) an indication of its possible financial effects on amounts recognised for tax and the timing of those effects.

Transition and effective date

50 An entity shall apply this [draft] IFRS in accordance with paragraphs 51 and 52 to the assets and liabilities in the opening statement of financial position for the first annual period starting on or after [date to be inserted after exposure]. An entity shall recognise any resulting net change in the assets and liabilities as an adjustment to retained earnings. An entity shall apply the amendments to all events and transactions thereafter.

51 In applying the amendments in that first opening statement of financial position, an entity shall make no transfers between retained earnings and other components of equity to restate cumulative amounts previously recognised in profit or loss, other comprehensive income or directly in equity.

52 In applying the amendments in that first opening statement of financial position, an entity shall treat assets and liabilities acquired or assumed in a transaction covered by paragraph B13(c) as if they had been acquired outside a business combination for their carrying amounts.

Withdrawal of other IFRSs

53 This [draft] IFRS supersedes IAS 12 *Income Taxes*.

54 This [draft] IFRS supersedes SIC-21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets* and SIC-25 *Income Taxes—Changes in the Tax Status of an Entity or its Shareholders*.

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Appendix A
Defined terms

This appendix is an integral part of the [draft] IFRS.

Current tax	Income tax payable (refundable) in respect of the **taxable profit (tax loss)** for the current period or past reporting periods.
Deferred tax	Income tax payable (recoverable) in respect of the **taxable profit (tax loss)** for future reporting periods as a result of past transactions or events.
Deferred tax assets	Income taxes recoverable in future reporting periods in respect of: (a) **temporary differences;** (b) the carryforward of unused tax losses; and (c) the carryforward of unused tax credits.
Deferred tax liabilities	Income taxes payable in future reporting periods in respect of **temporary differences**.
Investment tax credit	A tax credit that is directly related to the acquisition of depreciable assets.
Tax basis	The measurement, under applicable substantively enacted tax law, of an asset, liability or other item.
Tax credit	A tax benefit that takes the form of an amount that reduces income taxes payable.
Tax expense	The aggregate amount included in comprehensive income or equity for the reporting period in respect of **current tax** and **deferred tax**.
Taxable income	Income that is included in **taxable profit** determined in accordance with the rules established by the tax authorities.

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Taxable profit (tax loss)	The profit or loss for a reporting period upon which income taxes are payable or recoverable, determined in accordance with the rules established by the tax authorities. Taxable profit equals **taxable income** less amounts deductible from taxable income.
Temporary differences	Differences between the carrying amount of an asset, liability or other item in the financial statements and its tax basis that the entity expects will affect **taxable profit** when the carrying amount of the asset or liability is recovered or settled (or, in the case of items other than assets and liabilities, will affect taxable profit in the future).
Valuation allowance	The amount recognised against **deferred tax assets** so that the net amount equals the highest amount that is more likely than not to be realisable against **taxable profit**.

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Appendix B
Application guidance

This appendix is an integral part of the [draft] IFRS.

Investments in subsidiaries and joint ventures

B1 Temporary differences arise when the carrying amount of an investment in a subsidiary or a joint venture (namely the parent's or investor's share of the net assets of the subsidiary or investee, including the carrying amount of goodwill) differs from the tax basis of the investment, and the entity expects the recovery of the carrying amount of the investment to affect taxable profit. Such temporary differences may arise in various circumstances, for example:

(a) the existence of undistributed profits of subsidiaries or joint ventures

(b) changes in foreign exchange rates when a parent and its subsidiary have different functional currencies

(c) changes in the tax basis of the investment, eg indexation allowances.

B2 In consolidated financial statements, a temporary difference may arise from an investment in a subsidiary or joint venture in addition to temporary differences that arise within the subsidiary or joint venture from its individual assets and liabilities. That additional temporary difference may also differ from the temporary difference associated with the investment in the subsidiary or joint venture in the parent's separate financial statements because the carrying amount of the investment may differ in the two sets of financial statements.

B3 Similar additional temporary differences also can arise whenever there are tax consequences of remitting income from one part of an entity to another, for example when there are tax branches that are not separate subsidiaries. An entity shall treat such temporary differences in the same way as temporary differences on investments in subsidiaries.

B4 An entity shall recognise a deferred tax liability or asset for all temporary differences associated with investments in subsidiaries and interests in joint ventures unless the exceptions in paragraph B5 apply.

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B5 An entity shall not recognise a deferred tax asset or liability for a temporary difference between the carrying amount and the tax basis of an investment in a foreign subsidiary or a foreign joint venture to the extent that:

(a) the investment is essentially permanent in duration and

(b) it is apparent that the temporary difference will not reverse in the foreseeable future.

B6 An investment in a foreign subsidiary or foreign joint venture is essentially permanent in duration to the extent that the entity has evidence of specific plans for reinvestment of the foreign subsidiary's or joint venture's undistributed earnings demonstrating that remittance of the earnings to the parent or investor will be postponed indefinitely. Experience of the foreign subsidiary or joint venture and definite future programmes of operations and remittances are examples of the types of evidence required.

B7 If circumstances change and it becomes apparent that all or part of an investment in a foreign subsidiary or joint venture is no longer essentially permanent in duration, the entity shall recognise the related deferred tax asset or liability. Conversely, if it becomes apparent that all or part of an investment in a foreign subsidiary or joint venture has become essentially permanent in duration, the entity shall derecognise any related deferred tax asset or liability.

B8 When an entity loses control of a foreign subsidiary that was essentially permanent in duration, the entity shall recognise any deferred tax asset or liability related to any remaining investment in accordance with paragraphs B4 and B5 and shall recognise the resulting deferred tax expense in profit or loss.

B9 When an investment in a foreign entity becomes a subsidiary, an entity shall derecognise any deferred tax asset or liability related to the previous investment in that entity and shall recognise a deferred tax asset or liability related to the foreign subsidiary in accordance with paragraphs B4 and B5. The entity shall recognise any resulting change in the deferred tax asset or liability as tax expense in profit or loss.

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Temporary differences arising on initial recognition

B10 When a temporary difference arises on the initial recognition of an asset or a liability, an entity shall disaggregate the asset or liability into:

(a) the asset or liability excluding any entity-specific tax effects, ie the asset or liability with a tax basis available to market participants in a transaction for the individual asset or liability (ie not in a business combination) in that tax jurisdiction, and

(b) any entity-specific tax effects, ie the tax advantage or disadvantage arising from any difference between the tax basis described in (a) and the tax basis available to the entity.

B11 An entity shall recognise the asset or liability in paragraph B10(a) in accordance with other IFRSs.

B12 An entity shall recognise a deferred tax asset or liability for any resulting temporary differences between the initial carrying amount and the tax basis available to the entity.

B13 An entity shall account for the effect of recognising the asset or liability and the deferred tax asset or liability as follows:

(a) if the recognition of the asset or liability affects comprehensive income, equity or taxable profit, an entity shall recognise deferred tax income or tax expense in comprehensive income or equity in accordance with paragraphs 29–34.

(b) in a business combination, the recognition of the asset or liability and the deferred tax asset or liability affects the measurement of goodwill or a bargain purchase gain.

(c) in all other cases, an entity shall recognise any difference between the consideration paid and the total recognised amounts of the acquired assets and liabilities (including deferred taxes) as an allowance against, or premium in addition to, the deferred tax asset or liability. The entity shall reduce the allowance or premium pro rata with changes in the related deferred tax asset or liability and recognise the resulting tax expense in accordance with paragraphs 29–34. The entity shall present the allowance or premium within deferred tax in the statement of financial position. However, the entity shall not consider the allowance or premium when determining the need for or the measurement of a valuation allowance in accordance with paragraphs B16–B25.

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Temporary differences arising on remeasurement to fair value

B14 IFRSs permit or require some assets and liabilities to be remeasured to fair value after their initial recognition. Fair value is determined using the same assumption about the tax consequences of recovering or settling the asset or liability as would be used by other market participants.

B15 In some jurisdictions, the remeasurement of an asset or liability to fair value affects taxable profit for the current period. As a result, the tax basis of the asset or liability is adjusted and no temporary difference arises. In other jurisdictions, the remeasurement of an asset or liability does not affect taxable profit in the period of the remeasurement and, consequently, the tax basis of the asset or liability is not adjusted. The difference between the carrying amount of the remeasured asset or liability and its tax basis is a temporary difference that gives rise to a deferred tax liability or asset unless the entity expects to recover or settle the carrying amount without affecting taxable profit.

Valuation allowance

B16 Future realisation of the tax benefit of a temporary difference or carryforward of unused tax losses or tax credits depends on the existence of sufficient taxable profit of the appropriate character (eg taxable income or capital gain) within the carryback or carryforward period available under the tax law. An entity shall recognise a valuation allowance if, on the basis of the available evidence, it is more likely than not that there will not be sufficient taxable profit to realise the tax benefit. The deferred tax asset less the valuation allowance equals the highest amount that is more likely than not to be realisable against taxable profit.

B17 The following sources of taxable profit may be available to realise a tax benefit for temporary differences and unused tax losses and tax credits:

(a) future reductions in existing temporary differences that will result in future taxable amounts relating to the same taxation authority and the same taxable entity:

   (i) in the same period as the expected reduction in the temporary difference giving rise to the tax benefit; or

   (ii) in periods into which a tax loss arising from the reduction in (i) can be carried back or forward.

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However, in determining the existence of taxable profit available to realise a tax benefit, an entity shall not consider reductions in temporary differences for which, in accordance with paragraph B5, no deferred tax liability has been recognised.

(b) Future taxable profit (exclusive of future reductions in existing temporary differences) relating to the same taxation authority and the same taxable entity:

(i) in the same period as the expected reduction in a temporary difference giving rise to the tax benefit; or

(ii) in periods into which a tax loss arising from the reduction in (i) can be carried back or forward.

In evaluating whether it will have sufficient taxable profit in future periods to realise a tax benefit, an entity shall ignore taxable amounts expected to originate in future periods that will themselves give rise to temporary differences. This is because the deferred tax asset arising from such temporary differences will itself require future taxable profit in order to be utilised. An entity shall also ignore future distributions of earnings of a foreign subsidiary or foreign joint venture, except to the extent that a deferred tax liability has been recognised for existing undistributed earnings or earnings that have been remitted to the parent or investor in the past.

(c) tax planning strategies that would create taxable profit in appropriate periods.

B18 Tax planning strategies are actions (including elections for tax purposes) that:

(a) are feasible and rational,

(b) an entity would take in order to create or increase taxable profit in a particular period before the expiry of a tax loss or tax credit carryforward, and

(c) would result in the realisation of deferred tax assets.

For example, in some jurisdictions, taxable profit may be created or increased by:

(i) accelerating taxable amounts to utilise expiring carryforwards (eg electing to have interest income taxed on either a received or receivable basis; selling, and perhaps leasing back, assets that have

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appreciated but for which the tax basis has not been adjusted to reflect such appreciation).

(ii) deferring the claim for some deductions from taxable profit.

(iii) changing the character of taxable or deductible amounts (eg from being taxable as part of profit to being taxable as a capital gain or loss).

(iv) switching from tax-exempt to taxable investments, eg selling an asset that generates non-taxable profit in order to purchase another investment that generates taxable profit.

When tax planning strategies affect the amount of the valuation allowance, the entity shall include in their effect significant expenses or losses to implement those strategies, net of any recognisable tax benefits associated with those expenses or losses.

B19 At the end of each reporting period, an entity shall adjust the amount of the valuation allowance to the extent that it has become more likely than not that future taxable profit will allow more or less of the deferred tax asset to be realised. For example, a change in trading conditions may make it more likely or less likely that the entity can generate sufficient taxable profit in the future for the deferred tax asset to be realised. Another example is when an entity reassesses deferred tax assets at the date of a business combination or subsequently (see paragraphs B39 and B40).

Evidence available for the sources of taxable profit

B20 Evidence available about each of the possible sources of taxable profit noted in paragraph B17 will vary for different tax jurisdictions and, possibly, from period to period. If evidence about one or more sources of taxable profit is sufficient to support a conclusion that it is more likely than not that taxable profit will be available to utilise temporary differences and unused tax losses and tax credits, an entity need not consider other sources. However, consideration of each source is required to determine the amount of the valuation allowance to be recognised.

B21 An entity shall consider all available evidence, both positive and negative, to determine whether, on the basis of the weight of that evidence, it is more likely than not that taxable profits will be available. Ordinarily, information about an entity's present financial position and its results of operations for the current and preceding years is readily available. That historical information is supplemented by all currently available information about future years. Sometimes, however, historical

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information may not be available (eg start-up operations) or it may not be as relevant (eg if there has been a recent change in circumstances) in which case other evidence is required to support a conclusion that it is more likely than not that taxable profits will be available for the entity to utilise temporary differences and unused tax losses and credits.

B22 The existence of unused tax losses or tax credits is strong evidence that future taxable profit may not be available. Other examples of negative evidence include, but are not limited to, the following:

(a) losses expected in early future years by a currently profitable entity.

(b) uncertain circumstances that, if unfavourably resolved, would adversely affect future operations and profit on a continuing basis.

(c) a carryback or carryforward period that is so brief that it would limit realisation of tax benefits if a significant temporary difference is expected to reduce to zero in a single year or the entity operates in a traditionally cyclical business.

B23 Therefore, when an entity has a history of recent losses or there is other negative evidence, it shall recognise a valuation allowance against the deferred tax asset arising from unused tax losses or tax credits so that the net amount equals the amount for which it has sufficient temporary differences to give rise to taxable profit in the future or for which there is convincing other evidence that sufficient taxable profit will be available.

B24 Examples of other evidence that might support a conclusion that a valuation allowance is not needed despite negative evidence include, but are not limited to, the following:

(a) existing contracts or firm sales backlog that will produce more than enough taxable income to realise the deferred tax asset on the basis of existing sales prices and cost structures.

(b) an excess of unrecognised asset value over the tax basis of the entity's net assets sufficient to realise the deferred tax asset.

(c) a strong earnings history exclusive of any loss that created the deferred tax asset coupled with evidence indicating that the loss results from identifiable causes that are unlikely to recur.

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B25 An entity shall use judgement in considering the relative effect of negative and positive evidence. The weight given to the potential effect of negative and positive evidence shall be commensurate with the extent to which it can be objectively verified. The more negative evidence that exists the more positive evidence is necessary and the more difficult it is to conclude that the valuation allowance should be less than the full amount of the deferred tax asset.

Measurement

Substantive enactment

B26 In some jurisdictions, substantive enactment is achieved only on enactment. In other jurisdictions actions by the government relating to tax rates and tax laws have the substantive effect of actual enactment, which may follow the actions by a period of several months. An entity shall regard tax rates as substantively enacted when future events required by the enactment process historically have not affected the outcome and are unlikely to do so. In the US tax jurisdiction, substantive enactment is achieved only on enactment.

Change in tax status

B27 An entity shall recognise the effect of an election for a voluntary change in tax status on the approval date or, if approval is not necessary, on the filing date of the final required document. An entity shall recognise the effect of a change in tax status that results from a change in tax law on the date that the tax law is substantively enacted.

Different tax rates apply to different levels of income or different ways of recovering the asset

B28 When different tax rates apply because of the level of taxable profit, an entity shall measure deferred tax assets and liabilities using average rates that are expected to apply to the expected taxable profit of the periods in which the temporary differences are expected to reduce, rather than marginal rates.

B29 Paragraph 15 requires the tax basis to be determined by the deductions that are available on the sale of an asset. If those deductions are available only on sale, an entity shall measure deferred tax assets and liabilities at the tax rate that is applicable to the sale. If the same deductions are

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available for the sale or use of the asset, an entity shall measure the deferred tax asset or liability at the rate that is applicable to how the entity expects to recover or settle the carrying amount of its asset or liability.

B30 If an asset is revalued in accordance with IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets* and is not depreciated, for example land or intangible assets with indefinite useful lives, that fact means that the entity expects to recover the carrying amount only by sale. Similarly, for an investment property that is measured at fair value in accordance with IAS 40 *Investment Property*:

(a) if the investment property would not be depreciated if IAS 16 applied, the entity expects to recover the carrying amount only through sale.

(b) if it would be depreciated if IAS 16 applied, the entity assesses whether it expects to recover the carrying amount through use or sale.

Tax effects of distributions

B31 In some jurisdictions, tax is payable at a higher or lower rate if part or all of the profit or retained earnings is paid out as a distribution to shareholders. In these circumstances, an entity shall measure current and deferred tax assets and liabilities using the rate expected to apply when the tax asset or liability is realised or settled, including the effect of the entity's expectations of future distributions. In other jurisdictions, tax may be refundable or payable if part or all of the profit or retained earnings is paid out as a dividend to shareholders. In those circumstances, the measurement of current and deferred tax assets and liabilities shall include the effect of the entity's expectations of future distributions.

B32 When determining its expectations of future distributions, an entity shall consider past experience and whether it expects to have the intention and ability to make distributions for the period in which the deferred tax asset or liability is expected to be realised or settled. If the entity does not expect to make distributions, it shall use the rate applicable to undistributed amounts and shall not anticipate the effect of future distributions.

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Tax based on two or more systems

B33 In some jurisdictions, an entity may be required to pay tax based on one of two or more tax systems, for example, when an entity is required to pay the greater of the normal corporate income tax and a minimum amount. In such cases, an entity shall determine the applicable tax rate in a manner consistent with the tax law while considering any interaction between the alternative systems.

Allocation of current and deferred tax

Recognition of tax benefits

B34 An entity shall recognise the tax benefit from a deferred tax asset in the same component of comprehensive income or equity as the event or transaction giving rise to the deferred tax asset. The entity shall also recognise in that same component the effect of a valuation allowance recognised at the same time as the deferred tax asset.

B35 The event or transaction giving rise to the deferred tax asset is the event or transaction giving rise to the temporary difference, tax loss or tax credit, not the source of the taxable income against which any tax benefit is recovered or expected to be recovered. In particular, if an entity recognises a pre-tax loss in continuing operations and realises the resulting tax benefit against taxable profit in another component, the entity shall recognise a tax benefit in continuing operations and tax expense in the other component. This may result in an allocation of tax benefit to continuing operations and tax expense to that other component, even if total tax expense for that reporting period is nil.

B36 An entity shall recognise a change in a valuation allowance as follows:

(a) in accordance with paragraph B40, if the valuation allowance relates to deferred tax acquired in a business combination.

(b) in equity, if the valuation allowance relates to deferred tax assets arising from transactions with equity holders in their capacity as equity holders (other than distributions to equity holders).

(c) in all cases other than those described in (a) and (b):

(i) if income in the current year causes a reduction in the valuation allowance, in the component in which the income is recognised, and

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(ii) if a change in circumstances causes a change in judgement about the recoverability of deferred tax assets in future years, in continuing operations.

As discussed in paragraph BC97 of the Basis for Conclusions on this exposure draft, paragraphs B34A–B36A set out an alternative approach to the allocation of tax to comprehensive income and equity that the Board does not propose to adopt.

Recognition of tax benefits

B34A An entity shall recognise the tax benefit from a deferred tax asset in the same component of comprehensive income or equity as the event or transaction giving rise to the deferred tax asset. The entity shall also recognise in that same component the effect of a valuation allowance, both initially and subsequently.

B35A The event or transaction giving rise to the deferred tax asset is the event or transaction giving rise to the temporary difference, tax loss or tax credit, not the source of the taxable income against which any tax benefit is recovered or expected to be recovered. In particular, if an entity recognises a pre-tax loss in continuing operations and realises the resulting tax benefit against taxable profit in another component, the entity shall recognise (a) a tax benefit in continuing operations and (b) tax expense in the other component. This may result in an allocation of tax benefit to continuing operations and tax expense to that other component, even if total tax expense for that reporting period is nil.

Changes in tax effects that were not originally recognised in comprehensive income or equity

B36A An entity shall recognise changes in tax effects that were not originally recognised in comprehensive income or equity in continuing operations or discontinued operations as appropriate.

Groups with a consolidated tax return

B37 If a group of entities files a consolidated tax return, the financial statements of each entity within the group shall include an allocation of the consolidated tax expense. If the group does not charge or pay the entity for the allocated tax expense, the entity shall recognise both the tax expense and an equal amount of capital contribution or distribution. The allocation shall be systematic, rational and consistent with the broad principles established by this [draft] IFRS. An example of such a method is one that allocates current and deferred tax to members of the group by applying this [draft] IFRS to each member as if it were a separate taxpayer.* Examples of methods that are not consistent with the broad principles established by this [draft] IFRS include:

(a) a method that allocates only current tax payable to a member of the group that has taxable temporary differences.

(b) a method that allocates deferred taxes to a member of the group using a method fundamentally different from the temporary difference approach described in this [draft] IFRS.

(c) a method that allocates no current or deferred tax expense to a member of the group that has taxable income if the consolidated group has no current or deferred tax expense.

Deferred tax arising from a business combination

B38 Temporary differences may arise in a business combination. In accordance with IFRS 3 *Business Combinations* (as revised in 2008), an entity recognises any resulting deferred tax assets (and related valuation allowances) and deferred tax liabilities as identifiable assets and liabilities at the acquisition date. Consequently, those deferred tax assets and deferred tax liabilities affect the amount of goodwill or the bargain purchase gain that the entity recognises. However, in accordance with paragraph 21 of this [draft] IFRS, an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.

B39 As a result of a business combination, the probability of there being sufficient taxable profit to realise a pre-acquisition deferred tax asset of the acquirer could change. An acquirer may consider it more likely than not that it will realise its own deferred tax asset that required a valuation allowance before the business combination. For example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree. Alternatively, as a result of the business combination it may no longer be more likely than not that

* In that situation, the sum of the amounts allocated to individual members of the group may not equal the consolidated amount. That may also be the result when there are transactions between members of the group. The criteria are satisfied, nevertheless, after giving effect to the type of adjustments (including eliminations) normally present in preparing consolidated financial statements.

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future taxable profit will allow the deferred tax asset to be realised. In such cases, the acquirer recognises a change in the related valuation allowance in the period of the business combination but does not include it in the accounting for the business combination. Therefore, the acquirer does not take the change into account in measuring the goodwill or bargain purchase gain it recognises in the business combination.

B40 If an entity acquires deferred tax assets in a business combination, it may need to recognise valuation allowances against those assets when it initially accounts for the business combination. If those valuation allowances subsequently change, the entity shall recognise those changes as follows:

(a) If the changes arise within the measurement period as defined in IFRS 3 and result from new information about facts and circumstances that existed at the acquisition date, the entity shall apply the changes to reduce the carrying amount of any goodwill related to that acquisition. If the carrying amount of that goodwill reaches zero, the entity shall recognise any remaining changes in profit or loss.

(b) All other changes in a valuation allowance shall be recognised in accordance with paragraph B36(b) and (c).

Current and deferred tax arising from share-based payment transactions

B41 In some tax jurisdictions, an entity receives a tax deduction for remuneration paid in shares, share options or other equity instruments of the entity. The amount of that tax deduction may differ from the related cumulative remuneration expense, and may arise in a later accounting period. For example, in some jurisdictions, an entity recognises an expense for the consumption of employee services received as consideration for share options granted, in accordance with IFRS 2 *Share-based Payment*, and receives a tax deduction only when the share options are exercised, with the measurement of the tax deduction based on the entity's share price at the date of exercise.

B42 As with the research costs discussed in paragraph 16 of this [draft] IFRS, there is a difference between the tax basis of the employee services received to date (being the amount the tax authorities will permit as a deduction in future periods in respect of services received to date) and the carrying amount of nil in the statement of financial position. That

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difference is a temporary difference that results in a deferred tax asset. If the amount the tax authorities will permit as a deduction in future periods is not known at the end of the period, it shall be estimated on the basis of information available at the end of the period. For example, if the tax deduction in future periods depends upon the entity's share price at a future date, the measurement of the deductible temporary difference shall be based on the entity's share price at the end of the period.

B43 As noted in paragraph B41, the tax deduction (or estimated future tax deduction, measured in accordance with paragraph B42) may differ from the related cumulative remuneration expense. If the tax deduction (or estimated future tax deduction) exceeds the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, the entity shall recognise the excess of the associated current or deferred tax directly in equity.

Presentation

B44 An entity normally has a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income tax levied by the same tax authority and the tax authority permits the entity to make or receive a single net payment.

B45 In consolidated financial statements, an entity shall offset a current tax asset of one entity within the group against a current tax liability of another entity within the group if the entities concerned have a legally enforceable right to make or receive a single net payment and the entities intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously.

B46 In rare circumstances, an entity may have a legally enforceable right of set-off, and an intention to settle net, for some periods but not for others. In such rare circumstances, detailed scheduling may be required to establish reliably whether the deferred tax liability of one taxable entity will result in increased tax payments in the same period in which a deferred tax asset of another taxable entity will result in decreased payments by that second taxable entity.

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Appendix C
Amendments to other IFRSs

The amendments in this [draft] appendix shall be applied for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies this [draft] IFRS for an earlier period, these amendments shall be applied for that earlier period. Amended paragraphs are shown with the new text underlined and deleted text struck through.

C1 In International Financial Reporting Standards (including International Accounting Standards and Interpretations), references to IAS 12 *Income Taxes* are amended to IFRS X *Income Tax*, unless otherwise stated in this appendix.

C2 In IFRS 1 *First-time Adoption of International Financial Reporting Standards*, (as revised in 2008), paragraphs B1 and D1 are amended and paragraph B8, a heading and paragraphs D24–D26 are added:

B1 An entity shall apply the following exceptions:

(a) ...

(b) hedge accounting (paragraphs B4–B6)~~, and~~;

(c) non-controlling interests (paragraph B7)~~.~~; and

(d) recognition of income tax in comprehensive income and equity (paragraph B8).

B8 IFRS X *Income Tax* paragraphs 29–34 set out requirements for the recognition of income tax expense in comprehensive income and equity. Some amounts that are recognised outside profit or loss are presented in a separate component of equity and are subsequently recognised in profit or loss on the disposal of related assets and liabilities. An entity shall not apply these requirements retrospectively. An entity shall deem the amounts recognised outside profit or loss to be zero at the date of transition to IFRSs.

D1 An entity may elect to use one or more of the following exemptions:

(a) ...

(m) financial assets or intangible assets accounted for in accordance with IFRIC 12 *Service Concession Arrangements* (paragraph D22); ~~and~~

(n) borrowing costs (paragraph D23)~~.~~; and

(o) deferred tax (paragraphs D24–D26).

Income tax

D24 An entity applies IFRS X *Income Tax* to temporary differences between the carrying amounts of the assets and liabilities in its opening IFRS statement of financial position and their tax bases. An entity with a transition date before [date IFRS X issued] may elect to apply IAS 12 *Income Taxes* for periods presented that begin before [date IFRS X issued].

D25 When a temporary difference arises on the initial recognition of an asset or liability, IFRS X requires an entity to disaggregate the asset or liability into:

(a) the asset or liability excluding any entity-specific tax effects and

(b) any entity-specific tax effects.

D26 A first-time adopter need not comply retrospectively with this requirement. Instead the first-time adopter may:

(a) recognise the asset or liability excluding any entity-specific tax effects at the date of the opening IFRS statement of financial position in accordance with the other requirements of this standard and

(b) recognise a deferred tax asset or liability for any resulting temporary difference.

C3 In IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* paragraph 33(b)(ii) and (b)(iv) is amended as follows:

33(b)(ii) the related income tax expense as required by paragraph ~~81(h) of IAS 12~~ 48(b)(i) of IFRS X.

33(b)(iv) the related income tax expense as required by paragraph ~~81(h) of IAS 12~~ 48(b)(ii) of IFRS X.

C4 In IAS 1 *Presentation of Financial Statements*, paragraph 56 is deleted and paragraph 56A added, as follows:

56 [Deleted] ~~When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position, it shall not classify deferred tax assets (liabilities) as current assets (liabilities).~~

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56A An entity shall classify deferred tax assets and liabilities in the statement of financial position in accordance with IFRS X *Income Tax*.

C5 In IAS 32, paragraphs 35, 37 and 39 are amended as follows:

35 Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be debited by the entity directly to equity~~, net of any related income tax benefit~~. Transaction costs of an equity transaction shall be accounted for as a deduction from equity~~, net of any related income tax benefit~~. <u>Income tax benefits related to distributions and transaction costs shall be accounted for in accordance with IFRS X *Income Tax*.</u>

37 An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. The transaction costs of an equity transaction are accounted for as a deduction from equity ~~(net of any related income tax benefit)~~ to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognised as an expense.

39 The amount of transaction costs accounted for as a deduction from equity in the period is disclosed separately ~~under~~ <u>in accordance with</u> IAS 1. ~~The related amount of income taxes recognised directly in equity is included in the aggregate amount of current and deferred income tax credited or charged to equity that is disclosed under IAS 12 *Income Taxes*.~~

C6 In IAS 34 *Interim Financial Reporting*, paragraph B20 is amended as follows, paragraph B21 is deleted and paragraph B21A is added:

B20 The benefits of a tax loss carryback are reflected in the interim period in which the related tax loss occurs. ~~IAS 12 provides that 'the benefit relating to a tax loss that can be carried back to recover current tax of a previous period shall be recognised as an asset'. A corresponding reduction of tax expense or increase of tax income is also recognised.~~ <u>An entity recognises a tax asset and reduction in tax expense for such losses in accordance with IFRS X.</u>

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B21 [Deleted] ~~IAS 12 provides that 'a deferred tax asset shall be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised'. IAS 12 provides criteria for assessing the probability of taxable profit against which the unused tax losses and credits can be utilised. Those criteria are applied at the end of each interim period and, if they are met, the effect of the tax loss carryforward is reflected in the computation of the estimated average annual effective income tax rate.~~

B21A An entity recognises a deferred tax asset for unused tax losses and unused tax credits in accordance with IFRS X. An entity assesses the need for a valuation allowance against any deferred tax assets in accordance with IFRS X at the end of each interim period.

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Amendments to guidance on other IFRSs

The following amendments to guidance on other IFRSs is necessary in order to ensure consistency with IFRS X. New text is underlined and deleted text is struck through.

A1 In the guidance on implementing IFRS 1, paragraphs IG5 and IG6 are deleted and IG Example 2 is amended as follows:

(g) recognises a net deferred tax liability of CU6 (CU20 at 30 per cent) arising from:

(i) the ~~taxable~~ temporary difference of CU50 (CU200 less CU150) associated with the identifiable assets acquired and non-pension liabilities assumed, less

(ii) the ~~deductible~~ temporary difference of CU30 (CU30 less nil) associated with the pension liability.

The entity recognises the resulting increase in the deferred tax liability as a deduction from retained earnings (paragraph C4(k) of the IFRS). If a ~~taxable~~ temporary difference arises from the initial recognition of goodwill, entity B does not recognise the resulting deferred tax liability (paragraph ~~15(a)~~ <u>21</u> of ~~IAS 12 *Income Taxes*~~ <u>IFRS X *Income Tax*</u>).

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Approval by the Board of *Income Tax* published in March 2009

The exposure draft *Income Tax* was approved for publication by the thirteen members of the International Accounting Standards Board.

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March 2009

Basis for Conclusions
Exposure Draft ED/2009/2

Income Tax

Comments to be received by 31 July 2009

International Accounting Standards Board®

Basis for Conclusions on Exposure Draft

INCOME TAX

Comments to be received by 31 July 2009

ED/2009/2

This Basis for Conclusions accompanies the proposed International Financial Reporting Standard (IFRS) set out in the exposure draft *Income Tax* (see separate booklet). Comments on the draft IFRS and its accompanying documents should be submitted in writing so as to be received by **31 July 2009.** Respondents are asked to send their comments electronically to the IASB website (www.iasb.org), using the 'Open to Comment' page.

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Basis for Conclusions on Exposure Draft *Income Tax*

Introduction

BC1 This Basis for Conclusions summarises the considerations of the International Accounting Standards Board in reaching the conclusions in the exposure draft *Income Tax*. Individual Board members gave greater weight to some factors than to others.

BC2 The Board undertook this project for two reasons. First, the Board has received many requests to clarify various aspects of IAS 12 *Income Taxes*. Second, the Board and the US Financial Accounting Standards Board (FASB) agreed to consider the accounting for income tax as part of their convergence project.

BC3 IAS 12 and SFAS 109 *Accounting for Income Taxes* share a common approach—the temporary difference approach. Because of the limited scope of the convergence project, the boards did not discuss whether the temporary difference approach should be replaced. They have no plans to consider other approaches at this time.

BC4 However, although IAS 12 and SFAS 109 both use the temporary difference approach, there are differences in their application. These differences can result in substantial differences in the amounts recognised for income tax. The boards' aim was to achieve convergence by eliminating exceptions to the temporary difference approach, resulting in a higher quality, principle-based standard for both boards.

BC5 The boards reached common decisions on almost all issues that were within the scope of the project. The FASB had originally intended to publish proposals to amend SFAS 109 for the decisions made in the project. However, in September 2008 it announced that it would review its strategy for short-term convergence projects in the light of the possibility that some or all US public companies might be permitted or required to adopt International Financial Reporting Standards (IFRSs) at some future date. As part of that review, it will invite views from US constituents by issuing an invitation to comment containing the IASB's proposed replacement of IAS 12. After that review, it will decide whether to undertake a project to eliminate differences in the accounting for tax by adopting the replacement for IAS 12.

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BC6 Paragraphs BC130–BC134 summarise the differences between the proposals in the exposure draft and US generally accepted accounting principles (GAAP).

Overview of principles and of this Basis for Conclusions

BC7 The principles underlying the temporary difference approach and the proposals in the exposure draft are set out below, with an outline of how the issues discussed in this Basis for Conclusions relate to those principles.

Recognition principle 1 – account for income tax effects of past transactions and events

BC8 The temporary difference approach accounts for income tax effects of past transactions and events by recognising the income tax recoverable or payable in the future when the entity recovers its recognised assets and settles its recognised liabilities.

BC9 It is assumed that the recognised assets and liabilities will be recovered or settled in the future for their carrying amount at the end of the reporting period. If the carrying amount of an asset or a liability differs from its tax basis, the amount recovered or settled will differ from the amount that will be deductible or taxable. If such a difference gives rise to income tax payable or recoverable, it is a temporary difference and the resulting obligation to pay or right to recover the income tax in the future is a deferred tax liability or asset. Deferred tax assets are also recognised for income tax recoverable in the future because of unused tax losses and tax credits.

BC10 In relation to this principle, the Basis for Conclusions discusses:

(a) what is income tax? (paragraphs BC15 and BC16)

(b) the definitions needed to support the temporary difference approach, ie tax basis, temporary difference, tax credit and investment tax credit (paragraphs BC36–BC38)

(c) the following exceptions that the Board proposes to the temporary difference approach:

  (i) deferred tax liabilities that arise on the initial recognition of goodwill (paragraphs BC36–BC38)

  (ii) deferred tax assets and liabilities for investments in foreign subsidiaries and joint ventures (paragraphs BC39–BC44)

(d) why the Board does not propose exceptions for temporary differences arising on:

  (i) the initial recognition of assets and liabilities in specified situations (paragraphs BC25–BC35)

  (ii) intragroup transfers of non-monetary assets (paragraphs BC45–BC49)

  (iii) specified exchange differences arising on foreign non-monetary assets (paragraphs BC50 and BC51).

Recognition principle 2 – recognise a valuation allowance to reduce deferred tax assets to the amount that is more likely than not to be recovered.

BC11 Temporary differences and unused tax losses and tax credits will give rise to recoverable income tax in the future only if there is sufficient taxable profit in the future to utilise them. Hence, a valuation allowance is recognised in order to reduce the carrying amount of deferred tax assets less the valuation allowance to the highest amount that is more likely than not to be realisable against taxable profit (paragraphs BC52–BC56).

Measurement requirements

BC12 The amount of tax recoverable or payable on the future recovery or settlement of assets and liabilities, and for unused tax losses and credits, depends on many factors. The Board did not set a high level measurement objective. Instead, the exposure draft proposes specifying the following requirements, which are discussed below:

(a) uncertainty about whether the tax authorities will accept the amounts reported to them by the entity is included in the measurement of tax assets and liabilities by using the probability-weighted average of expected outcomes, assuming that the tax authorities review the amounts reported to them (paragraphs BC57–BC63).

(b) tax law is that substantively enacted at the reporting date (paragraphs BC64–BC66).

(c) if the tax rate depends on the level of income of the entity, the applicable tax rate is the average rate expected to apply given the expected profit (unchanged from IAS 12).

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(d) if the tax rate depends on the manner of recovery of an asset, the applicable tax rate is the rate consistent with deductions that determine the tax basis, ie the deductions that arise on the sale of the asset. If the same deductions can also be obtained by using the asset, but different rates apply to recovery by sale and recovery by use, then both rates are consistent with the deductions that determine the tax basis. In this case, the applicable rate is determined by the entity's expected manner of recovery (paragraphs BC67–BC73).

(e) if distributions to shareholders have tax effects, tax assets and liabilities include the effect of expected future distributions (paragraphs BC74–BC81).

(f) the exposure draft is silent on the effect of expected future deductions that are not part of a tax basis or related to distributions to shareholders (paragraphs BC82–BC88).

Allocation principle

BC13 On initial recognition, tax expense is allocated to the same component (ie continuing operations, discontinued operations, other comprehensive income or equity) as the item giving rise to the tax. Subsequent changes in tax are recognised in continuing operations, with specified exceptions (paragraphs BC90–BC99).

Other requirements

BC14 The following are also discussed below:

(a) classification (paragraphs BC101–BC103)

(b) disclosures (paragraphs BC104–BC110)

(c) transition (paragraphs BC111–BC120)

(d) the costs and benefits of the proposed changes from IAS 12 (paragraphs BC121–BC129).

Scope

BC15 In 2006 the International Financial Reporting Interpretations Committee (IFRIC) received a request to clarify what tax was income tax and therefore within the scope of IAS 12. The IFRIC rejected the request because of the variety of tax that exists worldwide and the need for judgement in determining whether some tax is income tax. However, the IFRIC observed that IAS 12 applies to income tax, which is defined as tax that is based on taxable profit. This implies, first, that not all tax is within the scope of IAS 12 and secondly that, because *taxable profit* is not the same as accounting profit, tax does not need to be based on an amount that is exactly accounting profit for it to be within the scope of IAS 12. This second point is also implied by the requirement in IAS 12 to disclose an explanation of the relationship between tax expense and accounting profit. The IFRIC further noted that the term 'taxable profit' implies a notion of a net rather than gross amount. Lastly, the IFRIC observed that any tax that is not within the scope of IAS 12 is within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

BC16 The Board concluded that those observations would be helpful guidance to include in the proposed IFRS.

Definitions

Definitions of tax basis and temporary difference

BC17 IAS 12 and SFAS 109 use similar but different terms—*tax base* and *tax basis*—for the same notion. The Board decided to converge on *tax basis*.

BC18 IAS 12 has a definition of tax base that is based on amounts deductible for tax. If different amounts are deductible depending on the manner of recovery or settlement of the asset or liability, the tax base used depends on the expected manner of recovery or settlement. Furthermore, for assets and liabilities that will be recovered or settled without tax consequences, the tax base is defined as being equal to the carrying amount.

BC19 SFAS 109 does not have an explicit definition of tax basis. However, in practice, under US GAAP there is a notion that the tax basis is the amount that would be recognised in a statement of financial position prepared using the applicable tax rules of the relevant jurisdiction. Tax basis does not generally depend on the expected manner of recovery or settlement. Moreover, under US GAAP a difference between carrying amount and tax basis is a temporary difference only if there will be tax consequences of recovering the asset or settling the liability.

BC20 The Board understands that the notion of tax basis is well understood and applied consistently under US GAAP. The Board concluded that the definition of tax basis used in practice under US GAAP was clearer and

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less open to different interpretations than the definition of tax base in IAS 12. Therefore, the Board proposes to adopt the definition of tax basis used in US GAAP.

BC21 The Board is also aware of problems arising in practice in determining the tax basis of an asset when there are different tax consequences of selling the asset and using the asset. To resolve those problems, the Board proposes to require the tax basis of an asset to be determined by tax deductions that are available if the asset is sold at the reporting date. This requirement is more specific than the definition of tax basis used in US GAAP, but in most cases will result in a tax basis consistent with that used under US GAAP. The tax basis may differ from that used under US GAAP when the deductions available on sale differ from the cost of the asset less tax deductions received so far plus any tax indexation allowance.

BC22 Under the proposals in the exposure draft, the tax basis does not depend on management's expectations of how the carrying amount of the asset will be recovered. But the Board concluded that considering whether the recovery or settlement of an asset or liability would affect taxable profit was an appropriate initial step before starting the deferred tax methodology proposed by the exposure draft. Therefore, under the proposals, management expectation does play a role in an initial threshold for the recognition of deferred tax assets and liabilities. If the entity expects to recover an asset or settle a liability without causing any effect on taxable profit, as set out in paragraphs 10 and 11 of the exposure draft, then no deferred tax asset or liability arises. This is also consistent with US GAAP.

BC23 Management's expectations can also affect the measurement of deferred tax assets and liabilities, as discussed in paragraphs BC67–BC73.

Definitions of tax credit and investment tax credit

BC24 IAS 12 does not define the terms *tax credit* or *investment tax credit*. It excludes from its scope the accounting for investment tax credits, and prescribes different accounting for tax credits and tax deductions. This has led to questions about how some tax benefits should be classified. The exposure draft proposes definitions of tax credit and investment tax credit that converge with US GAAP. The Board acknowledges that the definitions focus on the way in which the tax authorities express the benefit. Because similar economic benefits could be expressed as either tax credits or tax deductions, this means that similar economic benefits may be accounted for in different ways. The Board concluded that it was

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beyond the scope of this project to include a comprehensive reconsideration of the accounting for tax credits and tax deductions. Nonetheless, clear definitions would make the new IFRS easier to use by removing doubt over the required treatment for tax benefits.

Exceptions from the temporary difference approach

Initial recognition exception

BC25 IAS 12 prohibits recognition of a deferred tax liability or deferred tax asset for temporary differences that arise from the initial recognition of an asset or liability in a transaction that:

(a) is not a business combination, and

(b) at the time of the transaction affects neither accounting nor taxable profit.

IAS 12 also prohibits an entity from recognising subsequent changes in such an unrecognised deferred tax asset or liability. SFAS 109 does not include an exception from the temporary difference approach for temporary differences that arise on the initial recognition of an asset or liability.[*]

BC26 The Board proposes to eliminate the exception that IAS 12 makes and so create a more principled standard and more consistent treatment of deferred tax. The resulting IFRS should also be easier to understand and apply. Many questions arise in practice on how the initial recognition exemption should be applied.

BC27 The Board considered how an entity should account for the acquisition outside a business combination of an asset with an initial tax basis different from its initial carrying amount. It first discussed the simultaneous equations method prescribed in US GAAP by EITF Issue No. 98-11 *Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combination*. In considering that approach, the Board discussed particular fact patterns in the application of EITF 98-11 that can result in the recognition of a deferred credit in the statement of financial position. The Board was troubled by the recognition of a deferred credit that does not represent a liability, but rather results from a computational requirement. It therefore rejected the approach in EITF 98-11.

* The only exception is for taxable temporary differences arising on the initial recognition of goodwill (see paragraphs BC36–BC38).

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BC28 The Board proposes that any entity-specific tax effects should not affect the carrying amount of an asset or liability. Accordingly, it proposes that an entity should separate the asset or liability that results in an initial temporary difference into:

(a) the asset or liability excluding any entity-specific tax effects, and

(b) any entity-specific tax effects.

BC29 Measuring the asset or liability in paragraph BC28(a) in accordance with applicable IFRSs results in a carrying amount for the asset or liability that is consistent with the carrying amount of other assets and liabilities, and is not affected by any entity-specific tax effects. The Board acknowledges that there may be difficulties in assessing what the amount measured in accordance with applicable IFRSs would have been had the same tax basis been available to the entity as to a market participant. The Board considered whether the carrying amount on initial recognition should be fair value, because that would give a clear measurement objective. But the Board rejected such a proposal because this project is not the place in which to consider whether to introduce new fair value measurements. The Board thinks that entities would be able to estimate how entity-specific tax effects have affected the transaction price.

BC30 Next, a deferred tax asset or liability is recognised for the temporary difference between the carrying amount of the asset or liability and the tax basis available to the entity. This establishes a deferred tax asset or liability that is consistent with the other deferred tax assets or liabilities recognised in accordance with IAS 12.

BC31 A problem arises if the sum of the carrying amounts of the recognised asset or liability and the deferred tax asset or liability does not equal the price for the transaction in which the entity acquired the asset or assumed the liability. This problem does not arise if the recognition of the asset or liability affects comprehensive income or equity, for example internally generated assets or liabilities. In those cases, the effect of the recognition of the deferred tax asset or liability is recognised in comprehensive income or equity. The problem also does not arise if the initial temporary difference arises from deductions that affect taxable profit, because the effect of the temporary difference will be offset by an effect on current tax. Lastly, a problem does not arise if the transaction is a business combination, because any difference between the transaction price and the sum of the recognised amounts affects goodwill.

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BC32 But if the transaction does not affect comprehensive income, equity or taxable profit at the time of the transaction and is not a business combination, there can be a difference between the sum of the amounts recognised as described in paragraphs BC29 and BC30 and the transaction price. This is the group of temporary differences that is covered by the initial recognition exception in IAS 12.

BC33 In such cases, a premium or allowance must be recognised to make the sum of the recognised amounts equal the transaction price. That premium or allowance is an anomaly that arises because the methodology in IAS 12 does not measure deferred tax assets and liabilities at fair value or at a price established by an exchange transaction for the tax asset or tax liability. Because that premium or allowance relates to the measurement of the tax assets and liabilities in accordance with IAS 12, the Board proposes to recognise it as part of the deferred tax asset or liability.

BC34 The Board noted that when the same tax basis is available to the entity and to market participants, the practical effect of the proposed requirements on initial recognition is the same as the existing initial recognition exception. But many of the practical problems with the initial recognition exception relate to difficulties in distinguishing between subsequent changes in an unrecognised initial difference (the effect of which is not recognised) and the creation of new temporary differences (the effect of which is recognised). Recognising the effect of the original temporary difference and an offsetting premium or allowance makes tracking subsequent changes easier.

BC35 Given that the premium or allowance is an anomaly under the temporary difference approach, the Board considered whether immediate recognition of the premium or allowance in comprehensive income would result in the most consistent approach. Doing so would remove the anomaly as quickly as possible without effects in subsequent periods. The Board rejected this approach on the grounds that the acquisition of an asset or liability in an arm's length transaction could be assumed to be an exchange of equal value and hence the recognition of tax gain or loss would be inappropriate. Instead, the Board proposes that the premium or allowance should be recognised in comprehensive income pro rata with changes in the deferred tax asset or liability to which it relates.

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Goodwill

BC36 Both IAS 12 and SFAS 109 prohibit the recognition of a deferred tax liability for a temporary difference arising on the initial recognition of goodwill when the carrying amount of goodwill exceeds its tax basis. However, both standards require the recognition of a deferred tax asset for a temporary difference arising when the tax basis of goodwill exceeds its carrying amount.

BC37 The Board noted that requiring the recognition of a deferred tax liability arising on the initial recognition of goodwill would be consistent with:

(a) the objective of removing as many exceptions from the temporary difference approach as possible;

(b) the treatment of temporary differences arising on initial recognition when the tax basis of goodwill exceeds its carrying amount; and

(c) the treatment of taxable temporary differences arising on goodwill after its initial recognition.

BC38 However, the Board also noted that the initial measurement of goodwill is a residual amount arising after measuring at fair value the identifiable assets and liabilities in a business combination. Recognising a deferred tax liability on the initial recognition of goodwill simply adjusts the amount of the residual. The Board therefore proposes not to eliminate the exception.

Investments in subsidiaries, branches, associates and joint ventures

BC39 The recovery of investments in subsidiaries, branches, associates and joint ventures may give rise to tax consequences in addition to those arising from the recovery or settlement of the individual assets or liabilities within those investments. For example, tax may be payable or refundable on the payment of distributions from a subsidiary to its parent and tax may be payable on the sale of the investment in the subsidiary. Investments in subsidiaries, branches, associates and joint ventures have a tax basis in the investor's tax jurisdiction in respect of these taxes. Temporary differences between the tax basis and the carrying amount of the investment, often called outside basis differences, may arise.

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BC40 IAS 12 includes an exception to the temporary difference approach for some investments in subsidiaries, branches, associates and joint ventures that is based on whether an entity controls the timing of the reversal of the temporary difference and the probability of it reversing in the foreseeable future.

BC41 SFAS 109 and APB Opinion 23 *Accounting for Income Taxes—Special Areas* prohibit the recognition of a deferred tax liability or asset for the difference between carrying amount and the tax basis of an investment in a foreign subsidiary or a foreign corporate joint venture that is essentially permanent in duration.

BC42 The Board considered whether to retain an exception for investments in subsidiaries, branches, associates and joint ventures. The Board concluded that, in principle, the exceptions in IAS 12 should not be carried into the new IFRS because they have no conceptual basis. The ability to control the timing of the reversal of a temporary difference does not mean that the temporary difference does not exist or does not give rise to a deferred tax asset or liability.

BC43 However, on the basis of information given by experts, the Board concluded that the calculation of the amount of deferred taxes for permanently reinvested unremitted earnings of foreign subsidiaries and joint ventures is so complex that the costs of doing so outweigh the benefits. The Board therefore proposes to converge with the requirements in SFAS 109 and APB Opinion 23 relating to temporary difference on foreign subsidiaries and joint ventures.

BC44 As discussed in paragraph BC22, if an entity expects to recover an asset or settle a liability without affecting taxable profit, then no deferred tax asset or liability arises. The Board considered the situation in which the entity expects to recover an investment in a subsidiary or joint venture without affecting taxable profit. The Board concluded that such an expectation should result in no deferred tax arising for any temporary difference on the investment in the subsidiary or joint venture but should not affect the recognition of deferred tax for temporary differences on individual assets and liabilities in the subsidiary or joint venture. Deferred tax assets and liabilities that arise on temporary differences on individual assets and liabilities in the subsidiary should be assessed in the context of their recovery or settlement by the subsidiary, not in the context of the recovery of the investment of the subsidiary by the parent. This approach is generally consistent with US GAAP.

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Intragroup transfers of assets

BC45 An intragroup asset transfer (such as the sale of inventory, intangible assets or depreciated property) between tax jurisdictions is often a taxable event. Such a transaction may result in a taxable gain or loss in the selling jurisdiction and establish a new tax basis in the buyer's tax jurisdiction. Paragraph 9(e) of SFAS 109 requires taxes paid by the seller on intragroup profits to be deferred, and prohibits the recognition of a deferred tax asset for the difference between the tax basis of the assets in the buyer's tax jurisdiction and their carrying amounts in the consolidated financial statements. IAS 12 does not provide a similar exception.

BC46 The Board noted that the tax consequences of an intragroup sale of inventory or other assets between group entities in different tax jurisdictions involve two parties outside the group entity—the selling company's tax authority and the buying company's tax authority. Recognising the tax consequences of the transaction is a faithful representation of the economic events of the period. Additionally, not recognising the tax consequences would be an exception to the temporary difference approach.

BC47 Some argue that applying the temporary difference approach to intragroup asset transfers is inconsistent with the existing requirements to eliminate intragroup transactions on consolidation. However, the Board observed that (a) the payment of income tax and (b) the change in tax jurisdiction are events that involve the entity and an external party. It concluded that application of the temporary difference approach did not create a conflict with consolidation accounting.

BC48 Others argue that the results of recognising the tax consequences are counter-intuitive. For example, if an asset is transferred at an amount higher than its carrying amount to a jurisdiction with a higher tax rate, tax income will be recognised even though if the asset is later sold outside the group at an amount higher than the transfer amount, the entity will pay tax at a higher rate than if the transfer had not happened. However, the assumption underlying the temporary difference approach is that the entity will recover the carrying amount of the asset. If that assumption is valid, the group entity has paid tax in one jurisdiction in exchange for an expected higher tax benefit in another. The group entity has made a tax gain on the transfer that should be recognised.

BC49 The Board concluded that there should be no exception to the temporary difference approach for intragroup transfers. Additional disclosures relating to intragroup transfers are discussed in paragraph BC108.

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Foreign non-monetary assets

BC50 Paragraph 9(f) of SFAS 109 prohibits recognition of a deferred tax asset or liability for differences related to assets and liabilities that are remeasured from the local currency into the functional currency using historical exchange rates and result from (a) changes in exchange rates or (b) indexing for tax purposes. In contrast, IAS 12 requires recognition of a deferred tax liability or asset for such temporary differences.

BC51 Consistently with the objective of eliminating exceptions to the temporary difference approach, the Board proposes no exception for such differences.

Recognition of deferred tax assets

BC52 Under IAS 12, a deferred tax asset is recognised only if it is 'probable' that it will be realised. Under SFAS 109, all deferred tax assets are recognised and a valuation allowance is recognised to the extent that it is 'more likely than not' that the deferred tax assets will not be realised.

BC53 The Board proposes to adopt the valuation allowance approach in SFAS 109. The Board noted that this change would have no effect on the net amount recognised for the sum of the deferred tax asset and valuation allowance. However, separating the recognition of the asset from the process of assessing its recoverability is more consistent with the discussion of elements and recognition in the *Framework for the Preparation and Presentation of Financial Statements*.

BC54 On the meaning of the term 'probable', the Board noted that in some jurisdictions that apply IFRSs it is generally understood to denote a higher likelihood than the term 'more likely than not'. The Board considered what the term should mean in the context of the recognition and measurement of a deferred tax asset.

BC55 The Board proposes to replace the term 'probable' in IAS 12 by 'more likely than not'. That is consistent with the use of the term 'probable' in IAS 37 and IFRS 3 *Business Combinations* (as revised in 2008) and with the recognition threshold in SFAS 109.

BC56 Both IAS 12 and SFAS 109 include guidance on the realisability of deferred tax assets. The Board considers that all the guidance in the two standards is useful. Hence, the exposure draft combines the guidance. This includes guidance on accounting for significant expenses to implement a tax planning strategy. IAS 12 is silent on this topic.

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Measurement

Uncertain tax positions

BC57 In June 2006 the FASB issued an Interpretation (FIN 48 *Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109*) on uncertain tax positions. FIN 48 requires an entity to recognise tax benefits it has claimed only if it is more likely than not that the tax authorities will accept the claim. If a tax benefit meets the recognition threshold, the amount recognised is the maximum amount that is more likely than not to be accepted by the tax authorities.

BC58 IAS 12 is silent on how to treat any uncertainty relating to amounts submitted to the tax authorities. The Board considered the Interpretation issued by the FASB but noted that it was not consistent with the Board's thinking behind the proposed amendments to IAS 37 published in June 2005. Applying that reasoning, the Board concluded that an entity has a liability to pay more tax if the tax authority does not accept the amounts submitted. Consistently with the approach taken in the proposed amendments to IAS 37, no probability-based recognition threshold is applied. Rather, the uncertainty is included in the measurement of the tax assets and liabilities. That is done by measuring current and deferred tax assets and liabilities using the probability-weighted average of all possible outcomes.

BC59 FIN 48 requires an entity to assume that the tax authorities will review the amounts submitted when recognising and measuring tax benefits. The alternative would be to require entities to include their assessment of whether the tax authorities will review the amount in the recognition and measurement of tax assets and liabilities. The Board agreed with the approach in FIN 48.

BC60 The Board's proposed measurement is not the same as fair value or the settlement value required by IAS 37. No adjustment is made for risk and deferred tax assets and liabilities are not discounted amounts. Consideration of such issues is outside the scope of the convergence project on income tax. Nonetheless, the Board believes that the use of a probability-weighted average of all possible outcomes, without any probability-based recognition threshold, provides more relevant information than an approach that uses a probability-based recognition threshold. No possible outcomes are ignored in the measurement.

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BC61 Both boards acknowledged the desirability of convergence on this issue. Divergent treatment of the uncertainty could have a significant effect on the tax amounts recognised in the financial statements. The boards observed, however, that the divergence arises from different approaches to uncertainty more generally in IFRSs and US GAAP. The boards are addressing these differences in the joint conceptual framework project and do not think they can be resolved in a convergence project on income tax.

BC62 The Board also noted that an expected outcome approach is not used in assessing the need for a valuation allowance (see paragraphs BC52–BC56). The Board does not think it is appropriate in a convergence project to extend such an approach to an established aspect of IAS 12 that is already aligned with US GAAP. In contrast, the proposed treatment of uncertainty relating to tax is a new proposal on an issue not addressed currently in IAS 12 and on which the Board does not wish to adopt a treatment inconsistent with its most recent thinking.

BC63 Some contend there are few amounts reported to the tax authorities over which there is no uncertainty. They argue that it would be unduly onerous to use a probability-weighted average of the expected outcomes in all cases, even when the possibility of an outcome different from the amount reported is remote. However, the Board does not intend entities to seek out additional information for the purposes of applying this aspect of the proposed IFRS. Rather, it proposes only that entities do not ignore any known information that would have a material effect on the amounts recognised.

Enacted and substantively enacted rates

BC64 IAS 12 requires an entity to measure its deferred taxes using the tax rates and tax laws that have been 'enacted or substantively enacted by the end of the reporting period'. Paragraph 18 of SFAS 109 requires the use of the 'enacted tax rate(s) expected to apply' and paragraph 27 indicates that changes in tax laws or tax rates should be recognised 'in the period that includes the enactment date'.

BC65 IAS 12 notes that, in some jurisdictions, announcements of tax rates and tax laws by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. The Board concluded that it would be inappropriate in such cases to wait for actual enactment. To do so would be giving undue weight to an event (the enactment) that may have a formal or ceremonial role but is extremely unlikely to affect a previously made decision. The Board proposes to clarify that 'substantive enactment' is achieved

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when any future steps in the enactment process will not change the outcome. By 'will not', the Board does not mean 'cannot'. That would make substantive enactment the same as enactment. Rather, it means that the future steps in the enactment process are steps that historically have not affected the outcome.

BC66 The Board noted that in the US the effect of the President's power of veto is that the point when any future steps in the enactment process will not change the outcome is always only at enactment.

Expected manner of recovery or settlement

BC67 IAS 12 requires an entity to measure deferred tax liabilities and assets using the tax rate that is consistent with the expected manner of recovery or settlement of the asset or liability. In practice there has been some diversity in the application of this requirement.

BC68 The amended definition of a tax basis means that the tax basis does not depend on the expected manner of recovery or settlement of the asset or liability (see paragraphs BC17–BC23).

BC69 That raises the question of what rate should be applied in order to measure any resulting deferred tax asset or liability. First, the Board decided that the tax rate used to measure the deferred tax asset or liability must be consistent with the tax basis. Use of an inconsistent rate would not provide a useful measure of the deferred tax asset or liability. So, if the deductions that determine the tax basis are available only on sale, the Board proposes that the tax rate applicable to sale must be used. However, the same deductions may also be available for the use of the asset. In that case, measuring the deferred tax asset or liability at the rate that is applicable to the expected manner of recovery provides the most useful information. This is consistent with the requirements in US GAAP on which rate to use.

BC70 The proposals reflect the view that the tax basis is a matter of fact that establishes whether a temporary difference, and hence a deferred tax asset or liability, exists. But the measurement of any deferred tax asset or liability may be affected by management expectations on the manner of recovery or settlement of the related asset or liability giving rise to the temporary difference.

BC71 The Board noted arguments that the proposed approach to the role of management expectations in the recognition and measurement of deferred tax assets and liabilities was inconsistent and confusing. Those holding this view note that in many jurisdictions, it is difficult to argue

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that the tax basis is any more a matter of fact than the tax rate. The tax authority does not require the creation of a tax balance sheet as such. Rather, it specifies what deductions are available in what circumstances, just as it does with the tax rate. In such jurisdictions it is difficult to justify a different approach to management expectations for the deductions (ie tax basis) and the rate.

BC72 The Board acknowledges these arguments. However, the Board noted that a balance had to be drawn between requirements that were clear and straightforward to apply in the different tax jurisdictions that exist globally and more complex requirements that have proved to be difficult to implement. The Board concluded that the proposals would be easier to apply and result in more consistent treatment across tax jurisdictions than the IAS 12 requirements. They will also usually have the same outcome as practice under US GAAP.

BC73 The Board also proposes to include in the IFRS the requirements in SIC-21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets*. As SIC-21 explains, the 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. This is because the asset is not depreciated, and hence no part of its carrying amount is expected to be recovered (ie consumed) through use. Thus, deferred tax associated with non-depreciable assets reflects the tax consequences of selling the assets.

Distributed or undistributed rate

BC74 The Board discussed whether the tax effects of future distributions should be included in the measurement of tax assets and liabilities. Distributions can have tax effects because, in some jurisdictions, incremental income tax must be paid (or a benefit is received) when the income is distributed to shareholders.

BC75 IAS 12 requires the use of the tax rate applicable to undistributed profits in measuring deferred tax assets and liabilities. The tax consequences of the distribution are recognised when a liability to make the distribution is recognised.

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BC76 SFAS 109 is silent on distributed and undistributed rate issues. Two EITF Abstracts address the impact of dual rate structures outside the US:

> No. 95-10 *Accounting for Tax Credits Related to Dividend Payments in Accordance with FASB Statement No. 109*
>
> No. 95-20 *Measurement in the Consolidated Financial Statements by a Parent of the Tax Effects Related to the Operations of a Foreign Subsidiary That Receives Tax Credits Related to Dividend Payments.*

BC77 That guidance requires the use of the undistributed rate in a subsidiary's separate financial statements. In consolidated financial statements, it requires a rate consistent with the entity's application of the indefinite reversal criteria of APB Opinion 23 (ie it requires use of the tax rate applicable to distributed earnings if earnings are remitted to the parent or the tax rate applicable to undistributed earnings if they are not). Practice has developed under US GAAP of using the higher of the distributed or undistributed rate.

BC78 Some argue that an entity's financial statements should report to the shareholders the beneficial interests that are available to them, taking into account any 'gate' (in this case, a tax authority) that those beneficial interests have to pass through before the benefit can be realised by shareholders. That gate may be advantageous or disadvantageous from a shareholder's perspective.

BC79 Others argue that before the entity has a liability to make the distribution (ie before there is a present obligation to make the distribution), it cannot have a liability to pay any additional income tax relating to the distribution. There is no present obligation. The event that triggers the income tax consequence of the distribution is the distribution.

BC80 In considering the issue, the Board assessed the impact of not anticipating the effect of distributions on specific entities. These entities, eg real estate investment trusts and co-operative societies in some jurisdictions, are in effect tax-exempt because of tax rate reductions or tax deductions relating to distributions and a policy of distributing all or almost all of their available reserves. The Board concluded that useful information would not result from requiring such entities to measure their tax assets and liabilities without taking into account the effect of expected future distributions.

BC81 The Board therefore concluded that the effect of expected future distributions should be included in the measurement of tax assets and liabilities. Requiring the use of either the undistributed rate in all circumstances or the distributed rate in all circumstances would lead to unrealistic measures in some cases. Including the effect of expected distributions is consistent with the general approach of using the rate expected to apply in measuring deferred tax assets and liabilities. In order to ensure that the entities use realistic expectations, the Board proposes that, when determining future expectations of distributions, an entity should consider past experience and whether it expects to have the intention and ability to make distributions for the period in which the deferred tax asset or liability is expected to be realised or settled.

Special deductions

BC82 Special deductions are specific tax deductions that SFAS 109 requires to be recognised no earlier than the period in which they are deductible. Paragraph 231 of SFAS 109 states that 'The tax benefit of statutory depletion and other types of special deductions such as those for Blue Cross-Blue Shield and small life insurance companies in future years should not be anticipated for purposes of offsetting a deferred tax liability for taxable temporary differences at the end of the current year.'

BC83 IAS 12 specifies the treatment of tax deductions that form part of the tax basis of an asset or liability. It does not explicitly discuss the treatment of any other tax deductions.

BC84 The Board noted the following:

(a) Because of the global application of IFRSs the Board could not adopt an approach that listed specific items as special deductions.

(b) A deduction that relates to the amount that would be realised on the sale of an asset or on the settlement of a liability is part of the tax basis of the asset or liability. Special deductions are other deductions that do not form part of a tax basis.

(c) Special deductions could be unrelated to specific assets or liabilities and could have economic effects similar to tax rate reductions. For example, a deduction of 10 per cent of taxable profit is economically the same as a tax rate reduction of 10 per cent of the normal rate.

(d) Under both IAS 12 and SFAS 109, the tax rate used to measure deferred tax assets and liabilities is the rate expected to apply when the asset is realised or the liability is settled. For example, if different tax rates apply to different levels of taxable income (graduated rates), the expected average graduated rate is used.

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If different rates apply depending on how an asset or liability is recovered or settled, the rate that is used reflects the expected manner of recovery or settlement.

BC85 The Board considered that it was not possible in a short time to establish a clear principle to determine which possible future tax reductions (whether rate reductions or deductions) should be reflected in the rate used to measure the deferred tax assets and liabilities and which should not. A comprehensive review of special deductions would add a significant amount of time to the project. The Board therefore identified three possible approaches:

(a) Define special deductions as deductions that do not form part of a tax basis and require an entity not to anticipate special deductions.

(b) Define special deductions as deductions that do not form part of a tax basis and require an entity to include estimated special deductions in the determination of the effective tax rate used to measure deferred tax assets and liabilities.

(c) Stay silent on the issue of special deductions.

BC86 Approach (a) would achieve consistency with the treatment of the special deductions listed in US GAAP. But there are other deductions that would meet the proposed definition and whose effects are recognised in practice in the US. Approach (a) would not achieve convergence on those deductions. Furthermore, it would be inconsistent with the treatment of tax rate reductions prescribed by both IAS 12 and SFAS 109.

BC87 Approach (b) achieves consistency with the treatment of tax rate reductions. As noted above, some special deductions may be very similar to tax rate reductions. But treating all special deductions as tax rate reductions would be a substantial change in practice.

BC88 Given this, the Board proposes approach (c). IAS 12 is silent on special deductions and the Board is not aware of any problems arising in practice. That does not mean there is consistent treatment in practice or that problems will not arise in the future. However, if the IFRS is silent, entities will have the choice of being consistent with practice under existing US GAAP. Any other approach will either take considerable time to develop or cause divergence in some cases from existing US GAAP.

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Alternative minimum taxation

BC89 Some income tax jurisdictions have alternative minimum tax computations. Paragraph 19 of SFAS 109 includes requirements on the tax rate to be used when alternative tax systems exist. IAS 12 does not give any guidance on alternative tax systems. To ensure consistent treatment of such tax systems, the Board proposes to include those requirements of SFAS 109 in the IFRS.

Allocation

Allocation of tax to components of comprehensive income and equity

BC90 IAS 12 and SFAS 109 require the tax effects of items credited or charged outside continuing operations during the current year to be allocated outside continuing operations. IAS 12 and SFAS 109 differ, however, with respect to the allocation of tax related to an item that was recognised outside continuing operations in a prior year. Such items may arise from changes in the effect of uncertainty over the amounts reported to the tax authorities, changes in assessments of recovery of deferred tax assets or changes in tax rates, laws, or the taxable status of the entity. IAS 12 requires the allocation of such changes in tax outside continuing operations, whereas SFAS 109 requires allocation to continuing operations, with specified exceptions. The IAS 12 approach is sometimes described as requiring backwards tracing and the SFAS 109 approach as prohibiting backwards tracing.

BC91 The Board noted that in some situations backwards tracing seems the obvious treatment and prohibiting it seems to produce counter-intuitive results. This is particularly the case when the event that causes tax to arise in the current year is such that the only item recognised in relation to that event is the tax. For example, a change in the tax rate gives rise only to a tax amount to be recognised. No related non-tax amount is recognised in the current period. This means that the natural home for the tax seems to be the component of comprehensive income or equity in which the original item was recognised.

BC92 However, the Board also noted that in other situations, it seems intuitive to prohibit backwards tracing. If the same event causes both a tax amount and a non-tax amount to arise in the current year, the natural home for the tax amount seems to be the component of comprehensive income or equity in which the non-tax amount is recognised.

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For example, suppose a loss carryforward had arisen in a previous period and a valuation allowance for the full amount of the resulting deferred tax asset had been recognised at that time. In the current period, taxable gains beyond those previously expected reduce the valuation allowance. The tax benefit recognised because of the reduction in the valuation allowance could be regarded as belonging to the component in which the original loss had been recognised or to the component in which the taxable gain is recognised in the current period. In this case, it seems simpler to recognise the benefit in the component of comprehensive income or equity in which the taxable gain is recognised in the current period, ie not to trace backwards.

BC93 The Board also noted that in some cases backwards tracing would be difficult, or result in arbitrary allocations. For example, consider loss carryforwards that arose from losses recognised in different components of comprehensive income or equity. The tax authority does not distinguish between the different loss carryforwards. At the time the losses arose, 100 per cent valuation allowances were recognised in relation to the resulting deferred tax assets because the likelihood of their realisation was low. In a subsequent period, the assessment of the realisation of the total deferred tax assets changes and the total valuation allowance is reduced. There is no non-arbitrary way of allocating the benefit arising from the reduction in the total valuation allowance to the different components of comprehensive income or equity in which the losses were originally recognised.

BC94 Lastly the Board noted that IAS 12 does not specify how to make the required allocation to the different components of comprehensive income and equity. For example, it does not specify what should be done if the tax relating to the individual components does not add up to the total tax for the entity because of cross-cutting effects. Nor does it state whether tax benefits arising from tax losses should be allocated to the source of the loss or the source of the realisation of the benefit. IAS 12 acknowledges that difficulties can arise in making the allocation in some situations and requires a reasonable pro rata allocation, or other method that achieves a more appropriate allocation.

BC95 The Board considered whether:

(a) to continue with the existing approach in IAS 12;

(b) to converge with the requirements in SFAS 109; or

(c) to develop a new approach to tax allocation that makes a principled distinction between those cases when backwards tracing should be required and those when it should be prohibited.

BC96 The Board concluded that a new approach to the allocation of tax to components of profit or loss and equity would take too long to develop fully to be part of this convergence project. Any new approach would also be likely to contain some arbitrary elements, simply because of the nature of allocation. Given the context of a convergence project, the Board decided to adopt the allocation approach in SFAS 109 because it is a more fully specified method than that in IAS 12.

BC97 However, the Board is aware that that the SFAS 109 requirements are complex, can be difficult to use and, as noted above, can seem to give counter-intuitive results. The Board has simplified the requirements as much as possible without changing the basic approach. In order to explore the issue fully in the exposure draft and get as much information as possible from respondents, the Board has also developed an approach based on the IAS 12 requirements with additional guidance to cover the gaps described in paragraph BC94 (see paragraphs 29A–34A and B34A–B36A). The invitation to comment asks questions on both approaches.

Allocation of changes in tax uncertainty

BC98 The draft IFRS proposes that changes in uncertainty over the amounts that the tax authorities will accept are treated as remeasurements of tax assets and liabilities (see paragraphs BC57–BC63). Consistently with the other allocation requirements, the Board therefore proposes to allocate the effects to continuing operations, regardless of the component in which the tax was originally recognised. FIN 48 and SFAS 109 do not specifically address this issue.

SIC-25 Income Taxes—Changes in the Tax Status of an Entity or its Shareholders

BC99 The Board proposes to amend the guidance in SIC-25 to be consistent with the revised allocation approach and to incorporate it into the new IFRS.

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Allocation of tax to entities within a consolidated tax group

BC100 Paragraph 40 of SFAS 109 provides guidance on allocating tax to entities within a consolidated tax group. SFAS 109 does not require a single allocation method, but requires the allocation method to be systematic, rational and consistent with the broad principles established by that standard. The Board decided that the requirements in SFAS 109 were a useful constraint on the treatment of tax in the separate financial statements of entities and proposes to include such guidance in the new IFRS.

Classification

Classification of deferred tax assets and liabilities in the statement of financial position

BC101 SFAS 109 requires deferred tax assets and liabilities to be classified as current or non-current on the basis of the classification of the underlying asset or liability. IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires deferred tax assets and liabilities to be classified as non-current, regardless of the classification of the underlying asset or liability giving rise to the temporary difference.

BC102 The Board concluded that classification of a deferred tax asset or liability consistently with the classification of the underlying asset or liability gave more useful information.

Classification of interest and penalties

BC103 FIN 48 states that the classification of interest and penalties payable to the tax authority is a matter of accounting policy choice that should be disclosed. The Board decided that this was a helpful requirement and should be included in the new IFRS. FIN 48 also requires disclosure of the amount of penalties and interest. The Board proposes not to require this disclosure. If interest and penalties are material, paragraph 97 of IAS 1 requires their disclosure. The Board noted that materiality depends on the nature of the item as well as its size.

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Disclosures

BC104 The Board considered disclosures from the standpoint of convergence, so that users would have comparable information under each standard. It considered (a) existing disclosure requirements that are in either IAS 12 or SFAS 109 but not in both and (b) new disclosure requirements that may be necessary as a result of decisions reached in the project.

Existing disclosures in one standard but not the other

BC105 The Board proposes not to include in the new IFRS the following disclosure requirements in IAS 12:

(a) the effect of changes in tax rates or laws substantively enacted after the end of the reporting period. This requirement is redundant because it is required by IAS 10 *Events after the Reporting Period*.

(b) the amount of a deferred tax asset and the nature of the evidence supporting its recognition when:

   (i) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and

   (ii) the entity has suffered a loss in either the current or the preceding period in the tax jurisdiction to which the deferred tax asset relates.

   The Board concluded that this disclosure was something that auditors might wish to consider rather than relevant information for users of the financial statements.

BC106 The Board proposes to amend the requirement for an explanation of the relationship between tax expense and accounting profit to eliminate the option of aggregating separate reconciliations using the domestic rate in each individual jurisdiction. Instead the reconciliation must use the domestic rate in the parent company jurisdiction. This approach is consistent with that required in SFAS 109 and results in the effects of differences between the parent company's domestic rate and other rates being shown clearly as a reconciling item.

BC107 The Board decided that the following disclosures in SFAS 109 but not IAS 12 would provide relevant information that was cost-beneficial to prepare:

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(a) adjustments for a change in the tax status of an entity and tax benefits allocated directly to contributed capital or to goodwill, as examples of significant components of tax income or expense that should be disclosed.

(b) for entities not subject to income tax because their income is taxed directly to their owners, a requirement to disclose that fact and the net difference between tax basis and carrying amounts.

(c) for an entity that is a member of a group that files a consolidated tax return, disclosures in its individual or separate financial statements about the allocations of the consolidated tax effects.

New disclosures

BC108 When discussing the exception to the temporary difference approach in SFAS 109 for intragroup transfers of non-monetary assets (see paragraphs BC45–BC49), the Board noted concerns about possible perceptions of earnings management. In response to those concerns, the Board proposes to add requirements for disclosures about those transfers.

BC109 As part of the financial statement presentation project, users of financial statements informed the Board that they would find it useful to be able to reconcile total tax expense for a period to current tax payable for the period. The Board noted that the difference between the two was essentially the deferred tax expense. The Board concluded that further analysis of changes in deferred tax assets and liabilities would provide the information required. The Board therefore proposes a numerical reconciliation of the opening and closing amounts of deferred tax assets and liabilities, for each type of temporary difference and for each type of unused tax losses and tax credits.

BC110 The Board also considered possible disclosures relating to unremitted foreign earnings beyond those in either IAS 12 or SFAS 109. It does not propose to require additional disclosures because it identified no disclosures that would be both useful and practicable. The invitation to comment on the exposure draft asks respondents to supply specific suggestions for useful incremental disclosures.

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Transition

Transitional arrangements for entities that already apply IFRSs

BC111 If an IFRS does not include specific transitional arrangements, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires changes in accounting policy to be applied retrospectively unless it is impracticable to do so. In determining whether the proposals in the exposure draft would require specific transitional arrangements, the Board considered what information would be required for retrospective application and whether retrospective application would require the use of judgements that could be affected by hindsight.

BC112 Retrospective application of the proposals in general requires information at the date of the opening statement of financial position of the earliest period presented and subsequently. For the most part, no information is required for earlier dates because the deferred tax assets and liabilities depend solely on the carrying amount and tax basis of asset and liabilities at the end of the reporting period, assessments of the rates at that date and assessments of recoverability at that date. However, information is required for earlier dates in relation to two proposals as follows:

(a) The elimination of the initial recognition exception will change the carrying amount of some of the assets and liabilities that were subject to the exception. The exposure draft proposes that such assets and liabilities are recognised at an amount that excludes any entity-specific tax effects. For assets and liabilities that are not remeasured at fair value, retrospective application would require entities to determine the initial carrying amount and any subsequent depreciation. Furthermore, entities would need to determine whether a valuation allowance would have been recognised for any deferred tax assets, because that would affect the allocation of tax between profit or loss, other comprehensive income and equity (see (b) below).

(b) The proposed amendments include changes in the allocation of tax between profit or loss, other comprehensive income and equity. Retrospective application of those amendments would require information from earlier dates in order to determine the amount of tax that would have been recognised in other comprehensive income or equity. This amount needs to be known for disclosure and subsequent recognition in profit or loss of amounts previously recognised in other comprehensive income.

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BC113 The Board also identified two issues that could require judgements that could be affected by hindsight if the date of the opening statement of financial position for the earliest period presented is before the revised standard is issued. They are:

(a) the proposals relating to uncertainty over the amounts and rates underlying the tax amounts.

(b) the need to assess whether a valuation allowance is needed for any deferred tax assets that would be recognised under the proposals but are not recognised in accordance with IAS 12.

BC114 Given those factors, the Board proposes that the amendments should be applied to the assets and liabilities in the opening statement of financial position for the first period beginning after the new IFRS is issued and to all events and transactions thereafter. Any adjustment arising on the application to that first statement of financial position would be recognised in retained earnings.

BC115 Furthermore, in applying the amendments to the assets and liabilities in the opening statement of financial position:

(a) if assets and liabilities currently are subject to the initial recognition exemption and are not remeasured at fair value, they should be treated as if they had been acquired for their carrying amount at the date of the opening statement of financial position. In other words, the entity should assess whether its specific tax position would affect their initial carrying amounts measured in accordance with IFRSs, for example their cost. The entity would then apply paragraphs B10–B13 on the basis of that assessment.

(b) re-analysis of the cumulative amounts recognised in comprehensive income and equity should not be allowed.

Transitional arrangements for first-time adopters with a date of transition after the new IFRS is issued

BC116 There are no special transitional arrangements for IAS 12 in IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Retrospective application is required. As noted above, first-time adopters would not need to collect information from before the date of opening statement of financial position of the first period presented (ie the date of transition to IFRSs), except in relation to

(a) the carrying amounts of assets and liabilities that would have given rise to a temporary difference on initial recognition, and

(b) the cumulative amounts of tax that would have been recognised directly in equity.

Other than for these items, first-time adopters whose date of transition to IFRSs is *later* than when the new IFRS is issued should have no problem in applying the amendments retrospectively.

BC117 In relation to (a) the Board concluded that the carrying amounts of such assets and liabilities should be determined as if the assets and liabilities had been acquired for their carrying amounts at the date of transition to IFRSs.

BC118 In relation to (b) the Board concluded that the requirements for the allocation of tax among components of profit or loss and equity should be applied prospectively from the date of transition to IFRSs. An entity should deem the amounts recognised outside profit or loss to be zero at the date of transition to IFRSs.

First-time adopters with a date of transition before the new IFRS is issued

BC119 For first-time adopters whose date of transition to IFRSs is before the new IFRS is issued, the same matters relating to the proposals on uncertain tax positions and valuation allowances will arise as for entities that already apply IFRSs (see paragraph BC113).

BC120 The Board therefore considered whether these first-time adopters should apply IAS 12 for any periods presented that start before the date of issue of the IFRS. However, such a requirement could require entities to apply IAS 12 for a comparative period only, before applying the new IFRS thereafter. The costs of doing this could exceed the benefits. The Board therefore proposes to allow first-time adopters the option of applying the new IFRS to all periods presented or of applying IAS 12 for any periods presented that start before the date of issue of the IFRS.

Analysis of costs and benefits of the new IFRS

BC121 The Board noted that a quantitative analysis of the costs and benefits of the new IFRS was not possible. The Board considered a qualitative analysis that compared:

(a) any new information that preparers of financial statements would need to obtain to comply with the proposed IFRS,

(b) the benefits to preparers in terms of an IFRS that is easier to understand and apply, and

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(c) the benefits to users of more useful information.

BC122 The Board noted that entities would need to generate new information to comply with the proposals that eliminate exceptions to the temporary difference approach, ie in relation to:

(a) temporary differences arising on the initial recognition of assets and liabilities outside a business combination that do not affect accounting or taxable profit at the time of initial recognition,

(b) temporary differences on domestic subsidiaries and joint ventures, and

(c) temporary differences on all associates.

BC123 As noted in paragraph BC29, the Board acknowledges that there may be difficulties assessing the proposed carrying amounts of assets and liabilities that give rise to a temporary difference on initial recognition. However, as also noted in paragraph BC29, the Board thinks that entities would be able to make such an assessment. The benefits of eliminating the exceptions are (a) an IFRS that is clear and easier to use than IAS 12 and (b) more consistent recognition of tax in financial statements.

BC124 The Board noted that when the FASB required the recognition of temporary differences for domestic subsidiaries and joint ventures, it stated that any increase in cost or complexity from requiring the prospective recognition of deferred tax liabilities arising from domestic subsidiaries and joint ventures would be minimal. Experience from the US indicates that this has been the case. The benefits of the proposed change are (a) a standard that is clear and easier to use and (b) more consistent recognition of tax in financial statements.

BC125 Regarding temporary differences arising on investments in associates (paragraph BC122(c)), the Board noted that IAS 12 already requires deferred tax to be recognised for temporary differences on associates unless the investor is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. IAS 12 also notes that an investor in an associate does not control the associate and is usually not in a position to determine its dividend policy. IAS 12 goes on to state that, in the absence of an agreement requiring the profits of the associate not to be distributed in the foreseeable future, deferred tax will be recognised. So, the proposal to recognise deferred tax arising from all temporary differences on associates will not affect many entities. Furthermore, in US GAAP there is no exception from recognising deferred tax relating to temporary differences arising on investments in associates. The Board is not aware of concerns about the costs of complying with this aspect of US GAAP. The benefits of the proposed change are (a) an IFRS that is clear and easier to use than IAS 12 and (b) more consistent recognition of tax in financial statements.

BC126 New information would also be required in some cases to comply with the proposals on tax allocation. Because changes in tax effects originally recognised in equity are recognised in income, the tax originally recognised in equity needs to be tracked until the item giving rise to it is recycled. Under IAS 12, a change in tax may eliminate the original tax effect in equity, obviating the need to track it in future. However, the proposed requirements on tax allocation would often require less information because changes in tax would not need to be tracked back to the source of the original tax. Indeed, the benefit of the proposed changes is that they would not require backwards tracing, which can sometimes be complex and costly.

BC127 Lastly, new calculations will be needed to comply with the proposals relating to uncertainty on tax amounts. Entities will need to determine the probability-weighted average outcome. The benefit of this approach is that none of the possible outcomes is ignored in the amounts recognised in the financial statements. The information in the financial statements is more complete.

BC128 Except in these cases, any new information required by the proposed changes is minimal. Overall, the Board takes the view that the benefits of the proposals outweigh their costs.

BC129 The Board also considered the cost and benefits of rewriting IAS 12. The rewrite does not involve any changes in the requirements beyond those analysed above. Users of the new IFRS would need time to accustom themselves to the new version, but the cost of that time should be outweighed by the benefit of using an IFRS that is clearer and more understandable.

Summary of the treatment of differences between IAS 12 and practice under US GAAP

BC130 The differences between IAS 12 and practice under US GAAP are summarised below, as follows:

(a) differences eliminated by the proposals in the exposure draft

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(b) differences that the FASB tentatively decided to eliminate before its decision not to publish proposed amendments to SFAS 109 (see paragraph BC5)

(c) differences considered in the project but not eliminated

(d) differences not considered in the project.

BC131 The following differences between IAS 12 and practice under US GAAP would be eliminated by the proposals in the exposure draft:

(a) definitions of tax basis and temporary differences, and the role of management expectations in the recognition and measurement of deferred tax. Although the proposed requirement to determine the tax basis of an asset by reference to the consequences of sale is more specific than the definition of tax basis used in US GAAP, in most cases it will result in a tax basis consistent with that used under US GAAP (see paragraphs BC17–BC23)

(b) definitions of investment tax credit (see paragraph BC24)

(c) the treatment of temporary differences on investments in subsidiaries, associates and joint ventures (see paragraphs BC39–BC44), except as noted in paragraph BC133(a)

(d) the approach to the recognition of deferred tax assets and the assessment of when it is more likely than not that there will be sufficient taxable profit to utilise the assets (see paragraphs BC52–BC56)

(e) the allocation of tax to components of comprehensive income and equity (see paragraphs BC90–BC99)

(f) the allocation of tax to entities within a consolidated tax group (see paragraph BC100)

(g) the treatment of alternative minimum tax systems (see paragraph BC89)

(h) the classification of deferred tax assets and liabilities in the statement of financial position (see paragraphs BC101 and BC102).

BC132 The following differences between IAS 12 and practice under US GAAP would have been eliminated by the FASB's tentative decisions in the project before its decision not to publish proposed amendments to SFAS 109:

(a) the treatment of temporary differences that arise on the initial recognition of acquired assets (see paragraphs BC25–BC35)

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(b) the treatment of deferred tax on intragroup transfers on non-monetary assets (see paragraphs BC45–BC49)

(c) the treatment of deferred tax on foreign non-monetary assets (see paragraphs BC50 and BC51)

(d) the effect of substantively enacted but not enacted tax laws (see paragraphs BC64–BC66)

(e) the treatment of the tax effects of future distributions (see paragraphs BC74–BC81).

BC133 The following differences between IAS 12 and practice under US GAAP were considered but not eliminated:

(a) the treatment of deferred tax assets arising on investments in domestic subsidiaries and corporate joint ventures that are essentially permanent in duration and for which it is not apparent that the temporary difference will reverse in the foreseeable future, for which there is an exception under US GAAP but for which the exposure draft proposes no exception (see paragraphs BC39–BC44)

(b) the treatment of special deductions and investment tax credits (see paragraphs BC82–BC89)

(c) the treatment of uncertain tax positions (see paragraphs BC57–BC63).

BC134 The following differences between IAS 12 and practice under US GAAP were not addressed in the project:

(a) the treatment of share-based payments

(b) the special transitional procedures in SFAS 109 for temporary differences related to deposits in statutory reserve funds by US steamship enterprises

(c) the exception in SFAS 109 for leveraged leases.

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Appendix A
[Draft] Amendments to the Basis for Conclusions on other IFRSs

This appendix notes that all references to IAS 12 in Bases for Conclusions will be footnoted to indicate that IAS 12 is superseded by IFRS X. This appendix also contains the following [draft] amendment to the Basis for Conclusions on IFRIC 7 Applying the Restatement Approach under IAS 29 *Financial Reporting in Hyperinflationary Economies in order to ensure consistency with IFRS X.*

A1 In the Basis for Conclusions on IFRIC 7 *Applying the Restatement Approach under IAS 29* Financial Reporting in Hyperinflationary Economies, a footnote is added to paragraph BC24 as follows:

IAS 12 was superseded by IFRS X in [date to be inserted]. IFRS X requires the same accounting as was described in paragraph 18 of Appendix A of IAS 12.

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Appendix B
Explanatory material from IAS 12

B1 IAS 12 was issued in 1996 by the Board's predecessor, the former IASC. IASC did not provide a basis for its conclusions. Instead, some of the paragraphs in the standard itself give the reasoning for the requirements of the standard. In this project the Board has not considered every aspect of IAS 12. It focused on eliminating differences between IAS 12 and US GAAP and on clarifying issues that were causing problems in practice. The Board's reasoning for the changes proposed are set out in the main body of the Basis for Conclusions.

B2 In revising IAS 12, the Board wishes the new IFRS to contain only requirements, like other IFRSs. However, it does not wish to lose the explanatory material that relates to matters not considered in this project. That explanatory material is therefore set out below. It has been brought forward unamended from IAS 12.

On the recognition of current tax liabilities and current tax assets

B3 When a tax loss is used to recover current tax of a previous period, an entity recognises the benefit as an asset in the period in which the tax loss occurs because it is probable that the benefit will flow to the entity and the benefit can be reliably measured.

On the recognition of deferred tax liabilities for taxable temporary differences

B4 It is inherent in the recognition of an asset that its carrying amount will be recovered in the form of economic benefits that flow to the entity in future periods. When the carrying amount of the asset exceeds its tax base, the amount of taxable economic benefits will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability. As the entity recovers the carrying amount of the asset, the taxable temporary difference will reverse and the entity will have taxable profit. This makes it probable that economic benefits will flow from the entity in the form

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of tax payments. Therefore, IAS 12 requires the recognition of all deferred tax liabilities, except in certain circumstances described in paragraphs 15 and 39.*

On the recognition of deferred tax assets for deductible temporary differences

B5 It is inherent in the recognition of a liability that the carrying amount will be settled in future periods through an outflow from the entity of resources embodying economic benefits. When resources flow from the entity, part or all of their amounts may be deductible in determining taxable profit of a period later than the period in which the liability is recognised. In such cases, a temporary difference exists between the carrying amount of the liability and its tax base. Accordingly, a deferred tax asset arises in respect of the income taxes that will be recoverable in the future periods when that part of the liability is allowed as a deduction in determining taxable profit. Similarly, if the carrying amount of an asset is less than its tax base, the difference gives rise to a deferred tax asset in respect of the income taxes that will be recoverable in future periods.

B6 The reversal of deductible temporary differences results in deductions in determining taxable profits of future periods. However, 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. Therefore, an entity recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised.

On the prohibition against discounting deferred tax assets and liabilities

B7 The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each temporary difference. In many cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between entities. Therefore, IAS 12 does not require or permit the discounting of deferred tax assets and liabilities.

* These references are to paragraphs in IAS 12. For the equivalent requirements in IFRS X, see the table of concordance.

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Table of Concordance

This table shows how the contents of the proposed IFRS X and IAS 12 *Income Taxes* correspond. Paragraphs are treated as corresponding if they broadly address the same matter even through the guidance may differ.

Paragraph of IAS 12	Draft IFRS X	Paragraph of IAS 12	Draft IFRS X	Paragraph of IAS 12	Draft IFRS X
Objective	1	20	B14 and B15	37	B19
1	2	21	21	38	B1
2	2	21A	21	39	B4 and B5
4	4	21B	20	40	No equivalent requirement
5	Appendix A	22	B10–B13	41	No equivalent requirement
6	Appendix A	23	B10–B13	42	No equivalent requirement
7	15	24	20 and 21	43	No equivalent requirement
8	15	25	Basis for Conclusions B5	44	B4 and B5
9	16	26	No equivalent requirement	45	23
10	No equivalent requirement	27	Basis for Conclusions B6	46	24
11	14	28	B18	47	25
12	6	29	B18	48	B26
13	7	30	B18	49	B28
14	Basis for Conclusions B3	31	B23	51	B29
15	20 and 21	32A	B38	52	B29
16	Basis for Conclusions B4	33	No equivalent requirement	52A	B31 and B32
17	17	34	20 and 23	52B	No equivalent requirement
18	17	35	B23	53	28
19	B38	36	B17	54	Basis for Conclusions B7

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Paragraph of IAS 12	Draft IFRS X	Paragraph of IAS 12	Draft IFRS X	Paragraph of IAS 12	Draft IFRS X
55	28	68B	B42	81	42–48
56	B19	68C	B43	82	No equivalent requirement
57	29 and 33	71	36	82A	48(a)
58	29 and 33	72	B44	84	No equivalent requirement
59	No equivalent requirement	73	B45	85 and 86	42
60	33	74	37	87	No equivalent requirement
61A	29	75	No equivalent requirement	87A	48(a)
62–65A	No equivalent requirement	76	B46	87B	No equivalent requirement
66	B38	77 and 77A	No equivalent requirement	87C	No equivalent requirement
67	B39	78	38	88	49
68	B40	79	41	89–95	Transitional requirements for IAS 12
68A	B41	80	41		

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INCOME TAX

Draft flow chart and illustrative examples

prepared by the IASB's staff

March 2009

The following flow chart and illustrative examples have been prepared by the IASB's staff to illustrate the proposals in the IASB's exposure draft *Income Tax,* on which comments are invited by 31 July 2009. Subject to any views received on the exposure draft the staff intend to publish similar examples when the IASB issues the standard resulting from that exposure draft.

The IASB has not approved the following material.

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Computation of deferred tax liabilities and assets

Paragraph 5 of the [draft] IFRS summarises the steps involved in accounting for deferred tax liabilities and assets. They are set out in the following flow chart.

Identify which assets and liabilities would be expected to affect taxable profit if they were recovered or settled for their present carrying amount.

↓

Determine the tax basis at the end of the reporting period of all those assets and liabilities, and of other items that have a tax basis.

↓

Compute any temporary differences, unused tax losses and unused tax credits.

↓

Recognise deferred tax assets and liabilities arising from the temporary differences, unused tax losses and unused tax credits.

↓

Measure deferred tax assets and liabilities at an amount that includes the effect of the possible outcomes of a review by the tax authorities, using rates that, on the basis of substantively enacted tax law at the end of the reporting period, are expected to apply when the deferred tax asset is realised or the deferred tax liability is settled.

↓

Recognise a valuation allowance against deferred tax assets so that the net amount equals the highest amount that is more likely than not to be realisable against taxable profit.

↓

Allocate current and deferred tax to the related components of comprehensive income and equity and classify tax assets as current or non-current.

↓

Disclose the required information.

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Assets and liabilities for which the recovery or settlement is not expected to affect taxable profit

Paragraph 10 of the [draft] IFRS states that if the entity expects to recover the carrying amount of an asset or settle the carrying amount of a liability without affecting taxable profit, no deferred tax arises in respect of the asset or liability. The following example illustrates such assets and liabilities.

Example 1

1 An entity accrues fines and penalties. They are not deductible for tax purposes.

The settlement of the liability does not affect taxable profit so no deferred tax arises.

2 An entity owns an investment property that is measured in accordance with the fair value model in IAS 40 *Investment Property* and would not be depreciated if it were accounted for in accordance with IAS 16 *Property, Plant and Equipment*. No tax is payable or recoverable on the proceeds of sale.

In accordance with paragraph B30, the entity expects to recover the carrying amount of the asset through sale. No deferred tax asset or liability arises in respect of the investment property.

Tax basis and temporary differences

Tax basis is defined as the measurement, under applicable substantively enacted existing tax law, of an asset, liability or other item. Paragraph 15 of the [draft] IFRS specifies that

(a) the tax basis of an asset equals the amount that would have been deductible against taxable income in arriving at taxable profit if the carrying amount of the asset had been recovered through sale at the end of the reporting period. If the recovery of the asset through sale does not give rise to taxable income, the tax basis shall be deemed to be equal to the carrying amount.

(b) the tax basis of a liability equals its carrying amount less any amounts deductible against taxable income (or plus any amounts included in taxable income) that would have arisen if the liability had been settled for its carrying amount at the end of the reporting period. In the case of deferred revenue, the tax basis of the resulting liability is its carrying amount, less any amount of revenue that will not be taxable in future periods.

Paragraph 17 of the [draft] IFRS states that temporary differences arise:

(a) when there is a difference between the carrying amounts and tax bases of assets and liabilities on the initial recognition, or at the time the tax basis is created for those items that have a tax basis but are not recognised as assets and liabilities.

(b) when a difference between the carrying amount and tax basis arises after initial recognition because income or expense is recognised in comprehensive income or equity in one reporting period but is recognised in taxable profit in a different period.

(c) when the tax basis of an asset or liability changes and the change will not be recognised in the asset or liability's carrying amount in any period.

The following examples illustrate these requirements.

Example 2—Initial recognition of assets and liabilities

1 The liability component of a compound financial instrument (eg a convertible bond) is measured at a discount to the amount repayable on maturity (see IAS 32 *Financial Instruments: Presentation*). The discount is not deductible in determining taxable profit (tax loss). If the liability were settled for its carrying amount, a taxable gain would arise equal to the difference between the carrying amount and the amount repayable on maturity. The tax basis of the liability is therefore equal to the amount repayable on maturity. (See example 6 below for a numerical example.)

2 An asset is recognised at fair value in a business combination and no equivalent adjustment is made for tax purposes. The tax basis of the asset is the same as it was before the business combination.

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3 A liability is recognised at its fair value in a business combination and the related expense is deducted in determining taxable profit in a later period. If the liability is settled for its fair value, deductions equal to fair value would be available, so the tax basis is nil.

4 Goodwill is not deductible for tax purposes. Its tax basis is therefore nil. However, in accordance with paragraph 21 of the [draft] IFRS no deferred tax is recognised for this temporary difference.

Example 3–A difference between the carrying amount and tax basis arises after initial recognition because income or expense is recognised in comprehensive income or equity in one reporting period but is recognised in taxable profit in a different period

1 An entity purchases equipment and receives a tax deduction in the current period equal to the cost of the equipment.

The tax basis of the equipment is nil.

2 An asset is depreciated faster or slower for tax purposes than in the financial statements.

The tax basis is cost less the tax depreciation and will therefore differ from the carrying amount.

3 Deductions of 15 per cent of the cost of an asset are available in each of up to ten years if the asset is used in a particular way. Deductions of 10 per cent of cost are available in each of up to ten years if the asset is used in any other way. Deductions of cost are available on sale with deductions of 10 per cent previously claimed repayable.

The tax basis of the asset is cost less any 10 per cent deductions already received. So for example, if the asset cost CU100[*] and were used in the specified particular way for three years, the tax basis after three years would be CU70.

4 The net realisable value of an item of inventory, or the recoverable amount of an item of property, plant or equipment, is less than the previous carrying amount and an entity therefore reduces the carrying amount of the asset, but that reduction is ignored for tax purposes until the asset is sold.

The tax basis of the asset does not include the impairment.

5 Financial assets or investment property are remeasured at fair value but no equivalent adjustment is made for tax purposes.

The tax basis of the assets is equal to the initial tax basis, usually cost.

6 An entity makes a loan. No tax is payable on repayment of the principal amount or the proceeds of its sale.

The tax basis of the loan receivable is equal to its carrying amount and there is no temporary difference on initial recognition.

7 Interest revenue is received in arrears and is included in accounting profit or loss on an effective interest rate basis but is included in taxable profit on a cash basis. If the accrued interest were sold for its carrying amount, tax would be payable on the proceeds with no tax deductions.

The tax basis of the interest receivable is nil.

8 A loan payable was measured on initial recognition at fair value less transaction costs, and is measured subsequently at amortised cost. For tax purposes, the transaction costs were deducted when the loan was first recognised. If the loan were settled for its carrying amount, a taxable gain equal to the difference between the proceeds of the loan (the original fair value) and the amortised cost would arise.

The tax basis of the loan payable is the original fair value, so the temporary difference is the amount of transaction costs, less the cumulative amount amortised to accounting profit under the effective interest method.

9 Prepaid expenses have already been deducted on a cash basis in determining the taxable profit of the current or previous periods.

The tax basis of the prepaid expenses is nil.

* In this guidance monetary amounts are denominated in ‘currency units (CU)’.

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10 An entity recognises accrued expenses. The related expense will be deducted for tax purposes on a cash basis.

If the accrued expenses were settled for the carrying amount, tax deductions equal to the carrying amount would be available. The tax basis of the accrual is therefore nil.

11 An entity recognises accrued expenses. The recognised expense is deductible for tax purposes.

If the accrued expenses were settled for the carrying amount, no tax deductions would be available. The tax basis of the accrual is therefore equal to the carrying amount.

12 Pension costs are deducted in determining accounting profit or loss as service is provided by the employee, but are not deducted in determining taxable profit until the entity pays either retirement benefits or contributions to a fund.

If the pension liability were settled for the carrying amount, tax deductions equal to the carrying amount would be available. The tax basis of the pension liability is therefore nil.

13 Research costs (or organisation or other start-up costs) are recognised as an expense in determining accounting profit or loss but are not permitted as a deduction in determining taxable profit until a later period.

The tax basis of the research costs equals the amount that will be available as a deduction against taxable profit in the future.

14 Development costs have been capitalised and will be amortised to profit or loss but were deducted in determining taxable profit in the period in which they were incurred.

The tax basis of the development cost asset is nil.

15 Revenue and the related cost of goods sold are included in accounting profit or loss when goods are delivered but are included in taxable profit when cash is collected.

This gives rise to:

(a) a temporary difference on the receivable (which has a tax basis of nil) and

(b) a temporary difference on the inventories sold (the inventory has a carrying amount of nil but still has the same tax basis as before the sale).

16 Unrealised profits or losses resulting from intragroup transfers of non-monetary assets are eliminated from the consolidated financial statements.

The tax basis of the non-monetary assets is determined by the tax jurisdiction into which they are transferred, and will usually be equal to the transfer price.

17 Retained earnings of subsidiaries, associates and joint ventures are included in consolidated retained earnings, but income taxes will be payable if the profits are distributed to the reporting parent.

The tax basis of the investment in the subsidiary, associate or joint venture does not include the amounts included in the financial statement consolidated retained earnings.*

18 Investments in foreign subsidiaries or foreign joint ventures are affected by changes in foreign exchange rates.

The tax basis of the investments does not include the effect of the changes in foreign exchange rates.

19 Non-monetary assets are restated in terms of the measuring unit current at the end of the reporting period (see IAS 29 *Financial Reporting in Hyperinflationary Economies*) and no equivalent adjustment is made for tax purposes.

The tax basis of the assets does not include the restatement.

20 Income is deferred in the statement of financial position but has already been included in taxable profit in the current period or prior periods.

The tax basis of the deferred revenue is nil.

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* The exposure draft proposes an exception prohibiting the recognition of deferred tax assets and liabilities for some of these temporary differences relating to foreign subsidiaries and joint ventures.

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Example 4—Changes in the tax basis of an asset or liability that will not be recognised in its carrying amount

1 An entity purchases an asset and receives no tax deductions in the current period. However, deductions equal to an indexed cost are available when the asset is sold. The tax basis of the asset is equal to indexed cost at each reporting date.

2 The non-monetary assets and liabilities of an entity are measured in its functional currency but the taxable profit or tax loss is determined in a different currency. The tax basis of the assets and liabilities are translated into the functional currency and change as exchange rates change, resulting in temporary differences.

Calculation of temporary difference on the initial recognition of assets and liabilities, and subsequent changes

Paragraphs B10–B13 set out the requirements when a temporary difference arises on the initial recognition of an asset or liability. The following examples illustrate those requirements, and the recognition of subsequent changes.

Outside a business combination and affecting equity (paragraph B13(a))

Example 5—Deductions on an equity instrument

An entity purchases an option on its own shares for CU100 and classifies it as an equity instrument. For tax purposes, the cost of the option will be deductible against future taxable profits at some point in the future (for example, when the option is exercised, or expires, or on redemption of the underlying instrument). The tax rate is 40 per cent.

The deductions form a tax basis of an item for which there is no asset or liability carrying amount. There is a temporary difference of CU100, which gives rise to a deferred tax asset of CU40. The entity recognises the effect of the deferred tax asset in equity. Dr equity 100, Cr cash 100 for the purchase of the option and Dr deferred tax asset 40, Cr equity to recognise the deferred tax asset.

Example 6—Compound financial instrument

An entity issues a non-interest-bearing convertible loan for CU1,000 on 31 December 20X4 repayable at par on 1 January 20X8. The tax authorities do not allow the entity to claim any deductions relating to repayment of CU1,000. In other words, the tax basis of the instrument as a whole is CU1,000. In accordance with IAS 32 *Financial Instruments: Presentation* the entity classifies the instrument's liability component as a liability and the equity component as equity. Subsequently, the entity recognises imputed interest expense to increase the carrying amount of the loan to CU1,000 over the period to repayment. In other words, the financial instrument is accounted for as an interest-bearing liability and an equity option. If a market participant took out an interest-bearing liability, it would receive tax deductions for the interest. The tax rate is 40 per cent.

The fair value of the liability assuming the tax basis that would be available to market participants, ie assuming that the interest is tax-deductible, is CU751. The tax basis of the instrument as a whole is CU1,000. The resulting temporary differences, deferred tax liability and deferred tax income are as follows:

	20X4	20X5	20X6	20X7
	CU	CU	CU	CU
Carrying amount of liability component	751	826	909	1,000
Tax basis of liability component	1,000	1,000	1,000	1,000
Taxable temporary difference	249	174	91	–
Opening deferred tax liability at 40%	0	100	70	37
Deferred tax charged to equity	100	–	–	–
Deferred tax income	–	(30)	(33)	(37)
Closing deferred tax liability at 40%	100	70	37	–

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The difference between the tax basis of the instrument and its carrying amount creates a temporary difference. A deferred tax liability is recognised. The debit side of the double entry is recognised in equity because the transaction that causes the temporary difference is the recognition of CU249 of the proceeds as an equity component.

Therefore, the amounts recognised at initial recognition are as follows:

	CU
Liability component	751
Deferred tax liability	100
Equity component (CU249 less CU100)	149
	1,000

Subsequent changes in the deferred tax liability are recognised in the income statement as tax income.

	20X4	20X5	20X6	20X7
	CU	CU	CU	CU
Interest expense (imputed discount)	–	75	83	91
Deferred tax income	–	(30)	(33)	(37)
	–	45	50	54

Outside a business combination and not affecting comprehensive income, equity or taxable profit (paragraph B13(c))

Example 7—Tax basis depends on cost to first owner

An entity acquires an industrial building for CU1,950. The building is depreciated on a straight-line basis over 20 years for financial reporting purposes. According to tax law, tax deductions of 4 per cent of the original cost to the first owner are available for 25 years against income generated from use of the asset. In other words, if the building is sold by one owner to another, the tax deductions associated with the asset are not the cost of the building to the subsequent owner, but the original cost less any tax deductions already received by previous owners. The entity pays tax of 30 per cent on taxable income.

The tax basis of the building is CU1,728 on acquisition, and all market participants would get the same tax basis. The original cost of the building was CU1,800 and the previous owner received tax deductions of CU72 before sale. The entity recognises the following for financial reporting purposes on initial recognition:

Dr Building	CU1,950	
Dr Deferred tax liability—discount	CU67	
Cr Deferred tax liability		CU67((CU1,950 – CU1,728) × 30%)
Cr Cash		CU1,950

The entity receives tax deductions of CU72 for each year of use. As a result, the tax basis of the asset reduces by CU72 annually. The difference between the carrying amount and the tax basis of the asset is a temporary difference because recovery of the carrying amount of the asset would result in taxable amounts. The discount on the deferred tax liability is recognised in profit or loss as the related tax is realised.

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Example 8—Intangible assets with indefinite lives in a shell company where the tax consequences depend on whether the shares in the company are sold or whether the asset is used or sold as an individual asset

An entity acquires a shell company with a single asset, an internally generated brand for CU1,143. The entity treats the acquisition as an asset acquisition because there is no business associated with the acquired brand. Market participants acquiring such a brand as an individual asset would receive a tax basis equal to the cost of the brand. The fair value of the brand assuming such a tax basis is CU1,143. The brand is an intangible asset with an indefinite life carried at cost less impairment. Two years later, the recoverable amount of the brand is CU1,000 and the resulting impairment has been recognised.

According to tax law, if the shell company sells the brand as an individual asset, the shell company cannot deduct the cost of the brand taxable income (ie the tax basis of the brand is nil). Income or sales proceeds are taxable at 30 per cent. However, if the shares of the shell company are sold, a deduction equal to the cost of the shares is available to offset against sales proceeds. Capital gains (losses) generated on sale of the business are also taxable (deductible) at 30 per cent.

On initial recognition, the entity recognises the brand at the cost it would have if it had a tax basis equal to that available to market participants, ie CU1,143. The entity also recognises a deferred tax liability of CU343 (CU1,143 – 0 × 30%) arising from the difference between the carrying amount and the actual tax basis of nil. A premium is recognised for the difference between the carrying amounts of the recognised asset and tax liability and the cost of the brand. The following table shows the amounts before and after the impairment.

	On acquisition	After impairment	Gains/ (losses)
	CU	CU	CU
Brand	1,143	1,000	(143)
Deferred tax liability related to the brand	(343)	(300)	43
Premium	343	300	(43)
Cost/recoverable amount	1,143	1,000	(143)

Example 9—Non-taxable government grant

A non-taxable government grant of CU40 related to an asset costing CU100 is deducted in arriving at the carrying amount of the asset in the financial statements but, for tax purposes, is not deducted from the tax basis. A market participant would have expected to pay CU100 for the asset and to obtain a tax basis equal to cost. The tax rate is 30 per cent.

The entity recognises the asset at CU100 less the grant of CU40, ie at CU60. There is a temporary difference of CU40, giving rise to a deferred tax asset of CU12. The entity recognises an allowance of CU12 so that the total amounts recognised equal the purchase consideration less the grant.

Alternatively, under IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* the government grant could be recognised as deferred income. In this case, the carrying amount of the asset and the tax basis are both CU100 and no temporary difference arises. However, there is a temporary difference between the carrying amount of the deferred income of CU40 and its tax basis of nil. Whichever method of presentation an entity adopts, the entity recognises a deferred tax asset and a purchase allowance.

Example 10—Finance lease

An entity enters into a finance lease. The tax authority gives deductions equal in amount and timing to the lease payments. If the entity acquired the asset, its tax basis would be equal to cost and if the entity took out a loan, the tax basis of the loan would equal the proceeds. The fair value of the asset assuming a tax basis equal to its cost is CU100. The tax rate is 30 per cent.

The entity recognises the asset and the lease liability at CU100. The tax basis of the asset is nil and the tax basis of the lease liability is nil. The entity recognises a deferred tax liability of CU30 for the temporary difference on the asset and a deferred tax asset of CU30 for the temporary difference on the lease liability. The net sum of the amounts recognised for the asset, lease liability, deferred tax asset and deferred tax liability equals nil, so no premium or allowance arises.

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As part of a business combination (paragraph B13(b))

Example 11—Deferred tax assets and liabilities for identifiable net assets and the investment in the subsidiary

On 1 January 20X5 entity A acquired 100 per cent of the shares of entity B at a cost of CU600. At the acquisition date the tax basis of A's investment in B is CU600. Reductions in the carrying amount of goodwill are not deductible for tax purposes, and the cost of the goodwill would also not be deductible if B were to dispose of its underlying business. The tax rate in A's tax jurisdiction is 30 per cent and the tax rate in B's tax jurisdiction is 40 per cent.

The following table sets out the fair value of the identifiable assets acquired and liabilities assumed (excluding deferred tax assets and liabilities) by A, together with their tax bases in B's tax jurisdiction and the resulting temporary differences.

	Amounts recognised at acquisition	Tax basis	Temporary differences
	CU	CU	CU
Property, plant and equipment	270	155	115
Accounts receivable	210	210	–
Inventory	174	124	50
Retirement benefit obligations	(30)	–	(30)
Accounts payable	(120)	(120)	–
Fair value of the identifiable assets acquired and liabilities assumed, excluding deferred tax	504	369	135

The deferred tax asset arising from the retirement benefit obligations is offset against the deferred tax liabilities arising from the property, plant and equipment and inventory (see paragraph 36 of the [draft] IFRS).

No deduction is available in B's tax jurisdiction for the cost of the goodwill. Therefore, the tax basis of the goodwill in B's jurisdiction is nil. However, paragraph 21 of the [draft] IFRS prohibits the recognition of a deferred tax liability on the initial recognition of goodwill.

The carrying amount of its investment in B in A's consolidated financial statements is made up as follows:

	CU
Fair value of identifiable assets acquired and liabilities assumed, excluding deferred tax	504
Deferred tax liability (CU135 at 40%)	(54)
Fair value of identifiable assets acquired and liabilities assumed	450
Goodwill	150
Carrying amount	600

Because, at the acquisition date, the tax basis in A's tax jurisdiction, of A's investment in B is CU600, there is no temporary difference in A's tax jurisdiction for the investment.

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During 20X5 B's equity (incorporating the fair value adjustments made as a result of the business combination) changed as follows:

	CU
At 1 January 20X5	450
Retained profit for 20X5 (net profit of CU150, less dividend payable of CU80)	70
At 31 December 20X5	520

A recognises a liability for any withholding tax or other taxes that it will incur on the accrued dividend receivable of CU80.

At 31 December 20X5 the carrying amount of A's underlying investment in B, excluding the accrued dividend receivable, is as follows:

	CU
Net assets of B	520
Goodwill	150
Carrying amount	670

The temporary difference associated with A's underlying investment is CU70. This amount is equal to the cumulative retained profit since the acquisition date.

Unless B is a foreign subsidiary and A's investment is essentially permanent in duration, A recognises a deferred tax liability for the temporary difference.

Example 12—Intangible asset with an indefinite life where the tax consequences are different depending on whether the asset is sold as part of a business, or used or sold as an individual asset

The fact pattern is the same as in example 8 except that the acquisition is regarded as a business combination. An entity acquires a subsidiary with an internally generated brand. Market participants acquiring such a brand as an individual asset would receive a tax basis equal to the cost of the brand. The fair value of the brand assuming such a tax basis is CU1,143. The brand is an intangible asset with an indefinite life and is carried at cost less impairment. At the end of year 2, the recoverable amount of the brand is CU1,000.

According to tax law, if the subsidiary sells the brand as an individual asset, the cost of the brand cannot be offset against taxable income (ie the tax basis of the brand is nil). Income or sales proceeds are taxable at 30 per cent. However, if the subsidiary is sold, a deduction of the cost of the business is available to offset against sales proceeds. Capital gains (losses) generated on sale of the business are also taxable (deductible) at 30 per cent.

On initial recognition, the brand would be recognised at fair value. A deferred tax liability of CU343 (CU1,143 – 0 × 30%) arising from the temporary difference would be recognised as part of the allocation of cost of the business combination to the identifiable assets and liabilities of the entity. There may also be an amount recognised in goodwill because the purchase price will reflect the possibility that the entity has of paying less tax by selling the brand as part of the business. The following tables show the simplified amounts that would result if the brand were the only asset and the amount that the entity paid for the subsidiary is determined on the assumption that the brand will be recovered through sale of the subsidiary.

	On acquisition	After impairment	Gains/ (losses)
	CU	CU	CU
Brand	1,143	1,000	(143)
Deferred tax liability related to the brand	(343)	(300)	43
Identifiable net assets of subsidiary	800	700	(100)

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Goodwill	343	300	(43)
Carrying amount of subsidiary	1,143	1,000	(143)
Deferred tax asset related to the investment in the subsidiary	–	43 ((1,143 -1,000) × 0.3)	43
Total	1,143	1,043	(100)

The deferred tax liability related to the brand is determined without reference to the possibility of recovering the brand through sale of the subsidiary. Next, it is necessary to consider whether there is a temporary difference relating to the investment in the subsidiary. In particular, in year 2, the carrying amount of the investment in the subsidiary reduces by CU143 because of the impairment of the brand. This may give rise to a temporary difference. If so, that would result, in total, in deferred tax income of CU86: CU43 from the impairment of the brand and CU43 from the reduction in the carrying amount of the subsidiary. In the above example, the amount originally recognised in goodwill reflected the entity's expectation of recovering the asset through the sale of the investment. Some of that amount is written off at the time of the impairment, offsetting some of the recognised tax benefit. In practice, any impairment of the goodwill will be determined in accordance with IAS 36 *Impairment of Assets* and may not have such a result.

Example 13—Replacement awards in a business combination

On January 20X1 Entity A acquired 100 per cent of Entity B. Entity A pays cash consideration of CU400 to the former owners of Entity B.

At the acquisition date Entity B had outstanding employee share options with a market-based measure of CU100. The share options were fully vested. As part of the business combination Entity B's outstanding share options are replaced by share options of Entity A (replacement awards) with a market-based measure of CU100 and an intrinsic value of CU80. The replacement awards are fully vested. In accordance with paragraphs B56–B62 of IFRS 3 *Business Combinations* (as revised in 2008), the replacement awards are part of the consideration transferred for Entity B. A tax deduction for the replacement awards will not arise until the options are exercised. The tax deduction will be based on the share options' intrinsic value at that date. Entity A's tax rate is 40 per cent. Entity A recognises a deferred tax asset of CU32 (CU80 intrinsic value × 40%) on the replacement awards at the acquisition date.

Entity A measures the identifiable net assets obtained in the business combination (excluding deferred tax assets and liabilities) at CU450. The tax base of the identifiable net assets obtained is CU300. Entity A recognises a deferred tax liability of CU60 ((CU450–CU300) × 40%) on the identifiable net assets at the acquisition date.

The tax basis of A's investment in B is equal to the cash consideration of CU400. There is a temporary difference of CU100 compared with the carrying amount of CU500. Entity A recognises a deferred tax liability of CU40.

Goodwill is calculated as follows:

	CU
Cash consideration	400
Market-based measure of replacement awards	100
Total consideration transferred	500
Identifiable net assets, excluding deferred tax assets and liabilities	(450)
Deferred tax asset on replacement awards	(32)
Deferred tax liability on identifiable net assets	60
Deferred tax liability on investment in B	40
Goodwill	118

Reductions in the carrying amount of goodwill are not deductible for tax purposes. In accordance with paragraph 21 of the [draft] IFRS, Entity A recognises no deferred tax liability for the temporary difference associated with the goodwill recognised in the business combination.

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The accounting entry for the business combination is as follows:

	CU	CU
Dr Goodwill	118	
Dr Identifiable net assets	450	
Dr Deferred tax asset	32	
Cr Cash		400
Cr Equity (replacement awards)		100
Cr Deferred tax liability		100

On 31 December 20X1 the intrinsic value of the replacement awards is CU120. Entity A recognises a deferred tax asset of CU48 (CU120 × 40%). Entity A recognises deferred tax income of CU16 (CU48 – CU32) from the increase in the intrinsic value of the replacement awards. The accounting entry is as follows:

	CU	CU
Dr Deferred tax asset	16	
Cr Deferred tax income		16

If the replacement awards had not been tax deductible under substantively enacted tax law, Entity A would not have recognised a deferred tax asset on the acquisition date. If any subsequent events result in a tax deduction related to the replacement award, Entity A would account for them in the deferred tax income or expense of the period in which the subsequent event occurred.

Paragraphs B56–B62 of IFRS 3 provide guidance on determining which portion of a replacement award is part of the consideration transferred in a business combination and which portion is attributable to future service and thus a post-combination employee benefit expense. Deferred tax assets and liabilities on the latter are accounted for in accordance with the general principles as illustrated in Example 21.

This example does not cover subsequent changes in the temporary difference on A's investment in B.

Assets and liabilities remeasured at fair value (paragraphs B14 and B15)

Example 14—Investment property when trading gains are taxable and capital gains are not taxable

An entity acquires real estate at a cost of CU1,000. The property is held for investment and carried at fair value with changes in fair value recognised in profit or loss in accordance with IAS 40.

The tax law states that rental income generated from real estate assets is taxed at 20 per cent. Tax depreciation of the real estate cannot be deducted against the rental income generated. For sales of real estate, the investor has a tax status of trading in real estate or not trading in real estate. If the tax authorities treat the investor as engaged in trading of real estate, any profits (losses) on sale of the real estate are subject to 20 per cent tax (tax relief). If the tax authorities treat the investor as not engaged in trading real estate, no capital gains tax is payable.

The tax basis of the real estate depends on whether the investor is engaged in trading real estate. The tax basis is determined by the tax status of the entity.

Scenario 1: Investor is engaged in trading of real estate

The tax basis of the real estate is CU1,000 (because CU1,000 of tax deductions would be available on the sale of the asset).

A temporary difference will arise when the carrying amount of the asset is remeasured to a fair value different from the tax basis of CU1,000. That basis difference is a temporary difference because the recovery of the carrying amount has tax consequences for the entity.

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The amounts reported for financial reporting and tax purposes (ignoring income generated by the asset) are as follows:

Investment property	Initial	Year 1	Year 2	Year 3	Year 4
	CU	CU	CU	CU	CU
Carrying amount	1,000	1,050	1,150	1,100	900
Tax basis	1,000	1,000	1,000	1,000	1,000
Difference	0	50	150	100	(100)
Deferred tax asset (liability) @ 20%	0	(10)	(30)	(20)	20
Deferred tax expense	0	10	20	(10)	(40)
Income statement effect					
Fair value movements	0	(50)	(100)	50	200
Current tax	0	0	0	0	0
Deferred tax	0	10	20	(10)	(40)
	0	(40)	(80)	40	160
Effective tax rate		20%	20%	20%	20%

If the asset is sold, the deferred tax liability would be derecognised and would reduce the tax expense on any taxable gain.

If the investor expects to recover the asset through use (rental income), deferred tax would be recognised as shown above. At the end of its useful life, it is assumed that because a tax deduction is available upon sale, the investor would sell the asset for a nominal amount, thus generating a taxable loss that could be offset against other taxable income.

Scenario 2: The investor is not engaged in trading real estate

The tax basis is determined by the consequences of sale. No taxable gain or loss arises on sale so the tax basis always equals the carrying amount.

Example 15–tax is not payable on sales proceeds in excess of an asset's cost

An entity acquires an asset. If the asset is used, the income generated is taxable and tax deductions of 20 per cent of cost are available in each of the first five years of use. If the asset is sold, taxable income arises equal to the proceeds up to the original cost. No taxable income arises for proceeds in excess of the asset's original cost. Deductions are available against taxable income arising on sale of cost less deductions already received. The tax rate applicable to sale and use is 30 per cent. The asset is remeasured at fair value in accordance with IAS 16. The asset cost CU100 and has a carrying amount of CU150 after two years.

The tax basis after two years is CU60. The temporary difference is CU90. If the entity expects to recover the carrying amount of the asset through use, a deferred tax liability of CU27 (CU90 × 30 per cent) arises. If the entity expects to recover the carrying amount of the asset by sale, a tax rate of 30 per cent applies to the part of the temporary difference that relates to the original cost, ie CU40 (CU100–CU60) and a tax rate of nil applies to the remainder of the temporary difference. A deferred tax liability of CU12 (CU40 × 30 per cent) arises.

Tax rates (paragraph B29)

Paragraph B29 requires an entity to measure deferred tax assets and liabilities at the tax rate that is applicable to the sale, if the deductions underlying the tax basis are available only on sale. If the same deductions are also available for the use of the asset, paragraph B29 requires an entity to measure the deferred tax asset or liability at the rate that is applicable to the manner in which the entity expects to recover or settle the carrying amount of its asset or liability. The following examples illustrate this.

Example 16—Different deductions available on sale and use

An entity acquires an asset for CU100. Deductions of 150 per cent are available over ten years if the asset is used. If the asset is sold, deductions of 100 per cent of cost are available but all previous deductions received for use must be returned. The tax rate applicable to use is 30 per cent and the tax rate applicable to sale is 20 per cent. The entity expects to recover the carrying amount of the asset through use over ten years.

The tax basis of the asset is determined by the consequences of recovery through sale. After two years the carrying amount of the asset is CU80 and the tax basis is CU70 (CU100 less the deductions of CU30 already received). There is a temporary difference of CU10. The deductions available on use are not the same as the deductions available on sale, so the deferred tax liability is measured at the sale rate of 20 per cent.

Example 17—Same deductions available on sale and use

The cost of an asset of CU100 is deductible for tax purposes on a straight-line basis over ten years while the asset is being used. On sale, a deduction is available of cost less the tax depreciation previously received. A tax rate of 30 per cent applies to the income generated from the use of the assets and a tax rate of 25 per cent applies to the taxable profit on sale. The entity's financial reporting depreciation is based on an expected service life of 12 years and a residual value of CU40. The entity has used the asset for two years.

At the end of the second year the asset's depreciated carrying amount is CU90. The tax basis of the asset is cost less tax depreciation already received, ie CU80. This results in a temporary difference of CU10. The temporary difference will increase to CU50 until the end of the ten-year tax-deductible period and will reverse through use over the following two years back to CU40 with the balance reversing on the sale of the asset. The same deductions are available on recovery of the asset through sale and use. The entity therefore determines the rate that is applicable to the expected manner of recovery of the carrying amount. CU10 of the temporary difference reverses through use and is measured at 30 per cent and CU40 reverses through sale and is measured at 25 per cent.

Uncertainty whether the tax authorities will accept the amounts reported to them by the entity (paragraph 26)

Paragraph 26 of the [draft] IFRS requires an entity to measure current and deferred tax assets and liabilities using the probability-weighted average amount of all the possible outcomes, assuming that the tax authorities will review the amounts reported and have full knowledge of all relevant information. The following example illustrates this.

Example 18

An entity reports taxable profit of CU1,000 to the tax authority. The effect of uncertainty over the amounts reported is immaterial except in relation to two deductions. The entity assesses the possible outcomes of those deductions as follows:

Possible outcome	**Probability of outcome occurring**	**Probability-weighted outcome**
Deduction A (reported amount CU3,000)		
CU3,000	80%	CU2,400
CU0	20%	CU0
Probability-weighted average		CU2,400

Deduction B (reported amount CU900)		
CU900	60%	CU540
CU200	40%	CU80
Probability-weighted average		CU620

The entity measures its current tax liability based on taxable profit of CU1,880 (CU1,000 plus reported deductions of CU3,000 and CU900 less those deductions measured at CU2,400 and CU620).

Allocation of tax

Paragraph B34 requires an entity to recognise the tax benefit from a deferred tax asset in the same component of comprehensive income or equity as the event or transaction giving rise to the deferred tax asset. It also requires an entity to recognise the effect of a valuation allowance recognised at the same time as the deferred tax asset in that same component.

Paragraph B36(c) requires the entity to recognise a change in a valuation allowance as follows:

(a) if income in the current year causes a reduction in the valuation allowance, in the component in which the income is recognised and

(b) if a change in circumstances causes a change in judgement about the recoverability of deferred tax assets in future years, in continuing operations.

The following example illustrates these requirements.

Example 19—Allocation of tax benefits

An entity recognises profit of CU100 from continuing operations and a loss of CU150 in other comprehensive income (OCI). The tax rate is 30 per cent. CU100 of the CU150 loss can be offset against the profit from continuing operations in determining taxable profit. The remaining CU50 loss can be carried forward and utilised against future taxable profits. The entity assesses that it is more likely than not that there will not be sufficient taxable profits in the future and recognises a valuation allowance for the full amount of the deferred tax asset. The next year, the entity recognises a gain of CU20 in OCI that leads to taxable profit against which some of the loss carryforward can be used and which the entity had not expected in assessing the valuation allowance previously. The entity now reassesses the need for a valuation allowance and concludes that it is not needed because the entity expects further gains in OCI. The entity therefore recognises a tax benefit of CU15.

The allocation of the tax amounts is set out below.

	Year 1	Year 2
Continuing operations	100	0
Tax	(30)	9
Other comprehensive income	(150)	20
Tax in OCI	30	6

Example 20—Allocation of tax expense to components of comprehensive income other than continuing operations

Paragraph 34 sets out the requirements for allocating tax to components of comprehensive income if the sum of the separately calculated tax expenses allocated to each component in accordance with paragraphs 29–33 does not equal the total tax expense. This example illustrates those requirements.

Facts

An entity's statement of comprehensive income before recognising income tax is as follows:

	CU
Loss from continuing operations	(150)
Loss from discontinued operations	(400)
Other comprehensive income—actuarial gain on pension liability	25
Other comprehensive income—loss on available-for-sale security	(45)

The entity pays tax at 40 per cent. It has paid tax on taxable profit of CU100 in prior periods to which it can carry back losses. Its temporary differences at the beginning and end of the period are:

	Opening temporary difference/ loss carryforward **CU**	Closing temporary difference/ loss carryforward **CU**
Non-pension liabilities in continuing operations	100	50
Fixed assets in continuing operations	(300)	(200)
Operating loss carryforward from discontinued operations	–	400
Pension liabilities	25	–
Available-for-sale securities	75	120
Total	**(100)**	**370**
Deferred tax asset/liability before valuation allowance	(40)	148
Valuation allowance	–	(148) note 1
Net deferred tax (liability)/asset	(100)	–

Note 1—the entity does not expect taxable profit in the future beyond that created by the reversal of the temporary differences on the fixed assets. It therefore recognises a valuation allowance to reduce the net deferred tax asset to nil.

Calculation of total tax expense

The entity recognises total current tax income of CU40 resulting from the loss carryback of CU100.

The entity also recognises total deferred tax income of CU40 arising from the reduction in the deferred tax liability from CU100 to nil.

Allocation to continuing operations

The entity first calculates the tax that would have been recognised had there been only continuing operations during the period. In that case, the entity would have recognised current tax income of CU40 arising from the carryback of CU100 of the loss from continuing operations. There is no remaining current tax to allocate to other components.

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The entity would also have the following temporary differences:

	Opening temporary difference CU	Closing temporary difference CU
Non-pension liabilities in continuing operations	100	50
Fixed assets in continuing operations	(300)	(200)
Discontinued operations	–	– [note 1]
Pension liabilities	25	25 [note 1]
Available-for-sale securities	75	75 [note 1]
Total	(100)	(50)
Deferred tax (liability)/asset before valuation allowance	(40)	(20)
Valuation allowance	–	–
Net deferred tax (liability)/asset	(40)	(20)

Note 1—This table ignores items recognised in the period outside continuing operations. The objective is to assess the tax effect for the period if no items were recognised outside continuing operations in the period. So, in the table, the temporary differences on items recognised outside continuing operations do not change during the period.

The deferred tax liability reduces over the period from CU40 to CU20 because of items recognised in continuing operations. The entity therefore recognises deferred tax income of CU20 in continuing operations.

That leaves deferred tax income of CU20 to be allocated to the items recognised outside profit or loss. The tax expense arising from each item is calculated as the difference between the total tax expense including the tax effect of the item and total tax expense excluding the tax effect of the item.

Tax expense arising from discontinued operations

The deferred tax expense excluding discontinued operations would arise from the following temporary differences:

	Opening temporary difference CU	Closing temporary difference CU
Non-pension liabilities in continuing operations	100	50
Fixed assets in continuing operations	(300)	(200)
Pension liabilities	25	–
Available-for-sale securities	75	120
Total	(100)	(30)
Deferred tax (liability)/asset before valuation allowance	(40)	(12)
Valuation allowance	–	–
Net deferred tax (liability)/asset	(40)	(12)

Excluding discontinued operations results in a deferred tax liability of CU12, rather than nil. The deferred tax income arising from discontinued operations is therefore CU12.

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Tax expense arising from the change in pension liability recognised in other comprehensive income

The deferred tax expense excluding the effect of the change in pension liability recognised in OCI would arise from the following temporary differences:

	Opening temporary difference CU	Closing temporary difference CU
Non-pension liabilities in continuing operations	100	50
Fixed assets in continuing operations	(300)	(200)
Operating loss carryforward from discontinued operations	–	400
Pension liabilities	25	25
Available-for-sale securities	75	120
Total	(100)	395
Deferred tax (liability)/asset before valuation allowance	(40)	158
Valuation allowance	–	(158)
Net deferred tax (liability)/asset	(100)	–

Excluding the effect of the change in the pension liability recognised in OCI does not change the closing net deferred tax asset of nil. The deferred tax expense arising from the change in the pension liability recognised in OCI is therefore nil.

Tax expense arising from change in value of available-for-sale securities recognised in OCI

The deferred tax expense excluding the effect of the change in value of available-for-sale securities recognised in OCI would arise from the following temporary differences:

	Opening temporary difference CU	Closing temporary difference CU
Non-pension liabilities in continuing operations	100	50
Fixed assets in continuing operations	(300)	(200)
Operating loss carryforward from discontinued operations	–	400
Pension liabilities	25	–
Available-for-sale securities	75	75
Total	(100)	325
Deferred tax (liability)/asset before valuation allowance	(40)	130
Valuation allowance	–	(130)
Net deferred tax (liability)/asset	(100)	–

Excluding the effect of the change in the value of available-for-sale securities recognised in OCI does not change the closing net deferred tax asset of nil. The deferred tax expense arising from the change in the value of available-for-sale securities recognised in OCI is therefore nil.

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Allocation of tax expense not allocated to continuing operations

The tax expense arising from the items recognised outside continuing operations in accordance with the previous calculations is as follows:

Discontinued operations	CU12
Changes in pension liability recognised in OCI	nil
Changes in value of available-for-sale securities recognised in OCI	nil

But the remaining tax expense to be recognised is CU20. That amount is allocated to the items recognised outside continuing operations pro rata to their individual tax effects. So, in this example it is allocated in full to discontinued operations.

Summary of allocation

	Current tax	Deferred tax	Total tax income
	CU	CU	CU
Continuing operations	40	20	60
Discontinued operations	–	20	20
Changes in pension liability recognised in OCI	–	–	–
Changes in available-for-sale securities recognised in OCI	–	–	–
Total	40	40	80

Example 21–Share-based payment transactions (paragraphs B41–B43)

In accordance with IFRS 2 *Share-based Payment*, an entity has recognised an expense for the consumption of employee services received as consideration for share options granted. A tax deduction will not arise until the options are exercised, and the deduction is based on the options' intrinsic value at exercise date.

As explained in paragraph B41, the difference between the tax basis of the employee services received to date (being the amount the tax authorities will permit as a deduction in future periods in respect of those services), and the carrying amount of nil, is a temporary difference that results in a deferred tax asset. Paragraph B42 requires that, if the amount the taxation authorities will permit as a deduction in future periods is not known at the end of the period, it should be estimated, on the basis of information available at the end of the period. If the amount that the tax authorities will permit as a deduction in future periods is dependent upon the entity's share price at a future date, the measurement of the temporary difference should be based on the entity's share price at the end of the period. Therefore, in this example the estimated future tax deduction (and hence the measurement of the deferred tax asset) should be based on the options' intrinsic value at the end of the period.

As explained in paragraph B43, if the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, paragraph B43 requires that the excess of the associated current or deferred tax should be recognised directly in equity.

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The entity's tax rate is 40 per cent. The options were granted at the start of year 1, vested at the end of year 3 and were exercised at the end of year 5. Details of the expense recognised for employee services received and consumed in each accounting period, the number of options outstanding at each year-end, and the intrinsic value of the options at each year-end, are as follows:

	Employee services expense	Number of options at year-end	Intrinsic value per option
	CU		CU
Year 1	188,000	50,000	5
Year 2	185,000	45,000	8
Year 3	190,000	40,000	13
Year 4	0	40,000	17
Year 5	0	40,000	20

The entity recognises a deferred tax asset and deferred tax income in years 1–4 and current tax income in year 5 as follows. In years 4 and 5, some of the deferred and current tax income is recognised directly in equity, because the estimated (and actual) tax deduction exceeds the cumulative remuneration expense.[a]

Year 1

Deferred tax asset and deferred tax income:

(CU50,000 × 5 × ⅓[a] × 0.40) =	CU33,333

(a) The tax basis of the employee services received is based on the intrinsic value of the options, and those options were granted for three years' services. Because only one year's services have been received to date, it is necessary to multiply the options' intrinsic value by one-third to arrive at the tax basis of the employee services received in year 1.

The deferred tax income is all recognised in profit or loss, because the estimated future tax deduction of CU83,333 (CU50,000 × 5 × ⅓) is less than the cumulative remuneration expense of CU188,000.

Year 2	CU	CU
Deferred tax asset at year-end:		
(CU45,000 × 8 × ⅔ × 0.40) =	96,000	
Less deferred tax asset at start of year	(33,333)	
Deferred tax income for year		62,667[b]

(b) This amount consists of the following:

Deferred tax income for the temporary difference between the tax basis of the employee services received during the year and their carrying amount of nil:		
(CU45,000 × 8 × ⅓ × 0.40)	48,000	
Tax income resulting from an adjustment to the tax basis of employee services received in previous years:		
(a) increase in intrinsic value: (CU45,000 × 3 × ⅓ × 0.40)	18,000	
(b) decrease in number of options: (CU5,000 × 5 × ⅓ × 0.40)	(33,333)	
Deferred tax income for year		62,667

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The deferred tax income is all recognised in profit or loss, because the estimated future tax deduction of CU240,000 (CU45,000 × 8 × ⅔) is less than the cumulative remuneration expense of CU373,000 (CU188,000 + CU185,000).

Year 3	CU
Deferred tax asset at year-end:	
(CU40,000 × 13 × 0.40) =	208,000
Less deferred tax asset at start of year	(96,000)
Deferred tax income for year	112,000

The deferred tax income is all recognised in profit or loss, because the estimated future tax deduction of CU520,000 (CU40,000 × 13) is less than the cumulative remuneration expense of CU563,000 (CU188,000 + CU185,000 + CU190,000).

Year 4	CU	CU
Deferred tax asset at year-end:		
(CU40,000 × 17 × 0.40) =	272,000	
Less deferred tax asset at start of year	(208,000)	
Deferred tax income for year		64,000

The deferred tax income is recognised partly in profit or loss and partly directly in equity as follows:

Estimated future tax deduction (CU40,000 × 17) =	680,000	
Cumulative remuneration expense	563,000	
Excess tax deduction		117,000
Deferred tax income for year	64,000	
Excess recognised directly in equity (CU117,000 × 0.40) =	46,800	
Recognised in profit or loss		17,200

Year 5	CU	CU
Deferred tax expense (reversal of deferred tax asset)	272,000	
Amount recognised directly in equity (reversal of cumulative deferred tax income recognised directly in equity)	46,800	
Amount recognised in profit or loss		225,200
Current tax income based on intrinsic value of options at exercise date (CU40,000 × 20 × 0.40) =	320,000	
Amount recognised in profit or loss (CU563,000 × 0.40) =	225,200	
Amount recognised directly in equity		94,800

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Summary

	Statement of comprehensive income				Statement of financial position	
	Employee services expense	Current tax expense (income)	Deferred tax expense (income)	Total tax expense (income)	Equity	Deferred tax asset
	CU	**CU**	**CU**	**CU**	**CU**	**CU**
Year 1	188,000	0	(33,333)	(33,333)	0	33,333
Year 2	185,000	0	(62,667)	(62,667)	0	96,000
Year 3	190,000	0	(112,000)	(112,000)	0	208,000
Year 4	0	0	(17,200)	(17,200)	(46,800)	272,000
Year 5	0	(225,200)	225,200	0	46,800	0
					(94,800)	
Totals	563,000	(225,200)	0	(225,200)	(94,800)	0

Disclosure of tax reconciliation

Paragraph 42 of the [draft] IFRS requires the disclosure of a tax reconciliation. The following example illustrates such a reconciliation.

Example 22

In 20X2 an entity has accounting profit in its own jurisdiction (country A) of CU1,500 (20X1: CU2,000) and in country B of CU1,500 (20X1: CU500). The tax rate is 30 per cent in country A and 20 per cent in country B. In country A, expenses of CU100 (20X1: CU200) are not deductible for tax purposes.

	20X1	20X2
	CU	CU
Accounting profit	2,500	3,000
Tax at the domestic rate of 30%	750	900
Tax effect of expenses that are not deductible for tax purposes	60	30
Effect of lower tax rates in country B	(50)	(150)
Tax expense	760	780

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