IFRS

STAFF PAPER

January 2019

IASB® meeting

Project	**Deferred tax related to assets and liabilities arising from a single transaction (Proposed amendments to IAS 12)**
Paper topic	Transition requirements and other considerations

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

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

Introduction

1. At its meeting in October 2018, the International Accounting Standards Board (Board) decided to propose a narrow-scope amendment to IAS 12 *Income Taxes*. The proposed amendments would narrow the scope of the initial recognition exemption in paragraphs 15 and 24 of IAS 12 so that it would not apply to the extent that, on the initial recognition of a transaction, an entity would recognise equal amounts of deferred tax assets and liabilities.

2. As explained in Agenda Paper 12A for this meeting, the objective of this paper is to provide our analysis and recommendations on transition for the proposed amendments. Appendix A to this paper also provides our analysis of particular questions raised by Board members during the Board's October 2018 meeting.

Structure

3. The paper is structured as follows:

   (a) summary of recommendations;

   (b) transition requirements; and

   (c) early application.

4. This paper has two appendices:

   (a) Appendix A—Analysis of other matters; and

The International Accounting Standards Board is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRS Standards. For more information visit www.ifrs.org.

(b) Appendix B—Outcomes of applying (or not applying) the proposed transition relief.

Summary of recommendations

5. We recommend that the Board:

   (a) require entities to apply the proposed amendments retrospectively applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, entities would be permitted to assess whether the requirements in IAS 12 to recognise deferred tax assets are met only at the date of transition (transition relief);

   (b) provide the transition relief for first-time adopters, ie first-time adopters would be permitted to assess whether the requirements in IAS 12 to recognise deferred tax assets are met only at the date of transition to IFRSs;

   (c) permit earlier application of the proposed amendments; and

   (d) not change the proposed amendments with respect to the other matters discussed in paragraphs 27–28 of this paper.

Transition requirements

6. We considered transition requirements for:

   (a) entities already applying IFRS Standards (paragraphs 7–20); and

   (b) first-time adopters (paragraphs 21–24).

Transition for entities already applying IFRS Standards

7. Paragraph 19(b) of IAS 8 requires an entity to apply a change in accounting policy retrospectively if the change arises on initial application of an IFRS Standard that does not contain specific transition requirements. We therefore considered whether an entity should apply this requirement in IAS 8 when first applying the proposed amendments or whether the Board should instead provide specific transition requirements.

8. The proposed amendments require an entity to recognise deferred tax assets and liabilities for any transaction that gives rise to both deductible and taxable temporary differences, to the extent the amounts recognised for the temporary differences are the same. Applying the proposed amendments retrospectively means that, in theory, an entity would be required to go back to the date on which it first recognised the transaction that gave rise to these temporary differences. However, we think that in practice—and other than for the purpose of assessing whether the requirements to recognise a deferred tax asset are met (which we consider further in paragraphs 11–20 of this paper)—entities would only have to:

   (a) consider the amount of temporary differences that exist at the beginning of the earliest comparative period presented (transition date); and

   (b) calculate the deferred tax by applying the applicable tax rates at that date to those temporary differences.

   This is because a deferred tax asset or liability at any given date reflects the existing temporary differences at that date.

9. Furthermore, paragraphs A6–A10 of Appendix A to this paper explain that, for situations in which the proposed amendments would be applicable, the temporary differences at any given date would equal the carrying amount of the related asset or liability. Therefore, we think applying the proposed amendments retrospectively would not be unduly difficult—entities would be able to determine the temporary differences at the transition date with reference to the carrying amount of related assets and liabilities at that date.

10. However, assessing whether the requirements to recognise a deferred tax asset are met may be difficult—paragraphs 11–17 of this paper discuss this further.

Assessing the requirements to recognise a deferred tax asset

11. Paragraph 24 of IAS 12 requires an entity to recognise deferred tax assets only '…to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised…'. This requirement (recoverability requirement) ensures that an entity recognises a deferred tax asset only when it is probable that it will be able to recover that deferred tax asset.

12. Applying the proposed amendments, an entity would recognise deferred tax assets and liabilities for transactions that give rise to both deductible and taxable temporary differences, but only to the extent it recognises equal amounts of deferred tax assets and liabilities. This means that, on initial recognition of a transaction, if an entity does not recognise a deferred tax asset because it does not meet the recoverability requirement, it would also not recognise a deferred tax liability.

13. Accordingly, applying the proposed amendments retrospectively in accordance with IAS 8 would mean that an entity would have to assess whether it meets the recoverability requirement at the time it initially recognised the transaction that gave rise to the temporary differences. For leases this would be the lease commencement date, and for decommissioning obligations this would the date on which the entity initially recognised the decommissioning liability applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. For both leases and decommissioning obligations, that assessment date could be some considerable time ago, for example 30 years or more ago. In those cases, the assessment could be (a) impracticable without the use of hindsight; or (b) unduly difficult.

14. IAS 8 does not require an entity to apply a change retrospectively to the extent retrospective application is impracticable (for example, when doing so would require the use of hindsight[1]). However, to address situations in which it may be unduly difficult to assess the recoverability requirement retrospectively, we think the Board could provide a transition relief that would permit an entity to assess the recoverability requirement only at the transition date.

15. Applying the transition relief, an entity would consider whether it meets the recoverability requirement only at the transition date, instead of at the date of the particular transaction. Accordingly, for temporary differences that arose from the same transaction and exist at the transition date, an entity would:

    (a) recognise a deferred tax asset to the extent it meets the recoverability requirement; and

[1] Paragraph 53 of IAS 8 states that 'hindsight should not be used when applying a new accounting policy to (…) a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period'.

(b) recognise a deferred tax liability up to the amount that it recognises as a deferred tax asset.

16. Appendix B to this paper includes an example of how an entity would apply the transition relief.

17. As explained in Agenda Paper 12B for the October Board meeting (October Agenda Paper), we expect situations in which an entity is unable to recognise deferred tax assets to not occur frequently. However, we think providing the transition relief would be helpful because it could significantly reduce the complexity of applying the proposed amendments when these situations do occur.

Should the transition relief be optional or mandatory?

18. We considered whether the Board should require, instead of permit, entities to apply the transition relief. Making the transition relief mandatory could reduce the overall complexity of the proposed amendments and increase comparability across entities.

19. However, because there is diversity in the way entities currently apply IAS 12, some entities may already apply an accounting policy that is similar to that ultimately required by the proposed amendments. Appendix B to this paper analyses whether the outcome of applying (or not applying) the transition relief would be the same in all situations. Based on our assessment in Appendix B, we think there are some situations in which an entity could arrive at a different outcome depending on whether it applies the transition relief.

20. Therefore, making the transition relief mandatory would mean that an entity that already applies an accounting policy that is aligned with the proposed amendments may be required to change its accounting solely as a result of applying the transition relief. We think this is undesirable because it could result in additional costs for some entities without providing significant additional benefits. Consequently, we recommend that the Board make the transition relief optional.

First-time adopters

21. We think the Board should also provide the transition relief discussed in paragraphs 11–20 to first-time adopters[2].

22. IFRS 1 does not include any exception to, or exemption from, retrospective application of the requirements in IAS 12. Accordingly, some might say that no further relief is necessary in respect of the proposed amendments. However, we think the requirements in the proposed amendments are different from the existing requirements in IAS 12.

23. IAS 12 requires entities to derecognise, or recognise previously unrecognised, deferred tax assets depending on whether the recoverability requirement is met after initial recognition. Therefore, in practice, a first-time adopter would generally only need to consider whether it meets the recoverability requirement at its date of transition to IFRSs (ie changes in the assessment of the recoverability requirement before the date of transition to IFRSs would not be relevant).

24. However, assessing the recoverability requirement in respect of the proposed amendments not only affects whether an entity recognises a deferred tax asset, but also whether it recognises a deferred tax liability (see paragraph 12 of this paper). Accordingly, in the absence of any transition relief, an entity would have to assess the recoverability requirement at the date of the transaction, which could be difficult for the reasons outlined in paragraph 13 of this paper.

Conclusion

25. Based on our analysis in paragraphs 7–24 of this paper, we recommend:

    (a) requiring entities to apply the proposed amendments retrospectively applying IAS 8. However, entities would be permitted to assess whether the requirements in IAS 12 to recognise deferred tax assets are met only at the date of transition (transition relief);

[2] Appendix A of IFRS 1 *First-time Adoption of International Financial Reporting Standards* defines a first-time adopter as 'an entity that presents its first IFRS financial statements.'

(b) also providing the transition relief for first-time adopters, ie first-time adopters would be permitted to assess whether the requirements in IAS 12 to recognise deferred tax assets are met only at the date of transition to IFRSs.

Early application

26. We think the Board should permit entities to apply the proposed amendments earlier than the effective date. The proposed amendments reduce diversity in the application of IFRS Standards and we see no reason not to permit entities to apply the amendments earlier.

Other matters

27. At the Board's October 2018 meeting, Board members raised questions about particular aspects of the proposed amendments. Specifically, they asked:

    (a) whether the expected cost of implementing the proposed amendments would outweigh the expected benefits;

    (b) whether the Board should address the interaction between the initial recognition exemption and the requirement in IAS 12 to assess unrecognised deferred tax assets for recognition; and

    (c) whether and how the effective date of the proposed amendments would interact with that of IFRS 16 *Leases.*

28. Appendix A to this paper presents our analysis and recommendations on these other matters. Based on our analysis, we recommend no changes to the proposed amendments.

Questions for the Board

1. Does the Board agree with our recommendations to:

    (a) require entities to apply the proposed amendments retrospectively applying IAS 8. However, entities would be permitted to assess whether the requirements in IAS 12 to recognise deferred tax assets are met only at the date of transition (transition relief); and

    (b) provide the transition relief for first-time adopters, ie first-time adopters would be permitted to assess whether the requirements in IAS 12 to recognise deferred tax assets are met only at the date of transition to IFRSs.

2. Does the Board agree with our recommendation to permit earlier application of the proposed amendments?

3. Does the Board agree with our recommendation not to change the proposed amendments with respect to the matters discussed in paragraph 27 of this paper?

Appendix A—Analysis of other matters

A1. This appendix provides our analysis and recommendations on other matters raised by Board members at the Board's October 2018 meeting (see paragraph 27 of this paper for more information).

Costs of applying the proposed amendments

A2. Some Board members asked about the expected costs to entities of applying the proposed amendments and whether the expected benefits would outweigh these costs.

A3. The IFRS Interpretations Committee (Committee) decided to recommend that the Board propose amending IAS 12 because, in its view, the expected benefits of the proposed amendments would outweigh the costs of standard-setting. In particular, as explained in paragraph 79 of the October Agenda Paper, the Committee concluded that the proposed amendments would (a) eliminate existing diversity in practice, and (b) improve the subsequent accounting for the tax effects of the transaction.

A4. Notwithstanding the above, we have further analysed the costs an entity would incur in applying the proposed amendments. We think any concern about implementation costs would relate primarily to leases because:

(a) some entities have a significant volume of leases, potentially across a number of different tax jurisdictions; and

(b) it might be costly to track the temporary differences arising from each of those transactions.

A5. The October Agenda Paper included our analysis of how a lessee applies the requirements in IAS 12 when it recognises an asset and liability at the lease commencement date and, for tax purposes, the lease payments are deductible when paid.

A6. Applying IAS 12, an entity first assesses whether temporary differences[3] arise on initial recognition of the lease. In doing so, an entity determines the tax bases[4] of the lease asset and liability by assessing whether, considering the applicable tax law, the tax deductions relate to:

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

(b) *the lease liability*—because the deductions relate to the repayment of the lease liability.

A7. Our analysis illustrated the different outcomes of such an assessment, which are summarised as follows:

(a) *tax deductions relate to the lease asset*—the tax bases of the lease asset and liability equal their carrying amounts. This is because the entity will (i) receive tax deductions for the full carrying amount of the lease asset; and (ii) receive no tax deductions for settling the lease liability. Consequently, no temporary differences arise on initial recognition; and

(b) *tax deductions relate to the lease liability*—the tax bases of the related asset and liability are zero. This is because the entity will (i) receive tax deductions for the full carrying amount of the lease liability; and (ii) receive no tax deductions for recovering the carrying amount of the lease asset. Consequently, temporary differences arise on initial recognition.

A8. Because no temporary differences arise on initial recognition of the lease asset and liability when tax deductions relate to the lease asset, the initial recognition exemption does not apply and, thus, the proposed amendments would not apply. It follows therefore that the proposed amendments would be applicable only in situations in which tax deductions relate to the lease liability.

[3] Paragraph 5 of IAS 12 defines a temporary difference as 'differences between the carrying amount of an asset or liability in the statement of financial position and its tax base'.

[4] Applying IAS 12, the tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. The tax base of a liability is its carrying amount, less any amounts that will be deductible for tax purposes in respect of that liability in future periods.

A9. We observe that in these situations, the tax bases of the lease asset and liability will be zero not only on initial recognition, but throughout the lease term. This is because the entity will never get any tax deductions from recovering the carrying amount of the lease asset; similarly, the carrying amount of the lease liability will always reflect future payments the entity is required to make (and for which it will receive tax deductions). Accordingly, the tax bases of the lease asset and liability will remain zero throughout the lease term.

A10. Because the tax bases of the lease asset and liability are zero throughout the lease term, the temporary differences related to them will always equal their carrying amounts. We think that information regarding the carrying amount of the related assets and liabilities would be readily available and, accordingly, tracking temporary differences associated with such assets and liabilities would not be unduly difficult[5].

Interaction with the requirement to reassess unrecognised deferred tax assets

A11. Paragraph 24 of IAS 12 requires an entity to recognise deferred tax assets only '…to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised…' (recoverability requirement).

A12. Paragraph 37 of IAS 12 requires an entity to reassess unrecognised deferred tax assets at the end of each reporting period. An entity recognises a previously unrecognised deferred tax asset to the extent that it has now become probable that future taxable profits will be available that allow the entity to recover the deferred tax asset (for example, because of an improvement in trading conditions).

A13. Appendix B to the October Agenda Paper provided our analysis of how these requirements in IAS 12 interact with the initial recognition exemption and proposed amendments. We considered more generally how an entity applies the requirements in paragraph 24 of IAS 12 (reproduced in paragraph A11 of this paper) to any transaction in which the entity, on initial recognition:

(a) does not satisfy the recoverability requirement; *and*

(b) meets the conditions to apply the initial recognition exemption.

[5] Although our analysis uses leases as an example, it applies equally to decommissioning obligations.

A14. In this situation, the entity would not recognise a deferred tax asset when it initially recognises the transaction. However, because IAS 12 does not specify whether an entity first considers the initial recognition exemption or the recoverability requirement when assessing whether to recognise a deferred tax asset, an entity might take different views as to whether it did not recognise a deferred tax asset because:

(a) *it applied the initial recognition exemption*—in this case, the entity would also not recognise deferred tax subsequently, regardless of whether it subsequently meets the recoverability requirement[6]; or

(b) *it did not satisfy the recoverability requirement*—in this case, the entity might consider that it should apply paragraph 37 of IAS 12 and subsequently reassess any unrecognised deferred tax assets. As a result of this assessment, the entity might conclude that it should subsequently recognise deferred tax if the recoverability requirement is met.

A15. In our analysis, we concluded that the Board should not specifically address this matter as part of the proposed amendments. This was because, in our view:

(a) addressing it would be broader than the scope of the proposed amendments and would affect transactions other than leases and decommissioning obligations; and

(b) the situation would generally arise only in the case of decommissioning obligations and only in particular situations. Addressing this broader-scope matter could add significant complexity to the project with limited incremental benefit.

A16. The Board agreed with our analysis and conclusions on this matter at its October 2018 meeting. Nonetheless, one Board member asked whether it would be possible to address the matter narrowly by limiting any proposed solution to the situations covered by the proposed amendments. The Board member suggested that one possible solution would be to require entities that do not initially recognise deferred tax assets

[6] When the initial recognition exemption applies, paragraph 22(c) of IAS 12 does not permit an entity to recognise a deferred tax asset or liability either on initial recognition or subsequently.

and liabilities to also not recognise deferred tax assets and liabilities subsequently. In the Board member's view, this would:

(a) provide clarity on the matter and ensure the subsequent accounting for the deferred tax asset and liability is symmetrical;

(b) retain the narrow scope of the project, because it would not seek to resolve the broader question outlined in paragraph A14; and

(c) avoids having to do further work at a later stage if feedback indicates the matter is more prevalent than expected.

A17. We acknowledge the reasons for addressing the matter in the context of the proposed amendments as suggested in paragraph A16. However, on balance, we continue to recommend that the Board not address it as part of the proposed amendments. This is because:

(a) it would be difficult to address the matter narrowly—in our view trying to do so is likely to raise questions for situations beyond those covered by the proposed amendments—for example, could or should entities apply the new requirements for situations not covered by the proposed amendments? and

(b) addressing this matter would add significant complexity to the proposed amendments without evidence that it is a matter that is prevalent.

A18. Because the Board has discussed this matter as part of its deliberations, the Basis for Conclusions to the Exposure Draft will include a discussion of it. This will allow respondents to provide feedback on the matter for the Board's consideration.

Effective date and interaction with IFRS 16

A19. The proposed amendments address situations in which an entity accounts for a transaction by recognising an asset and liability, such as for leases and decommissioning obligations. Applying IFRS 16, at lease commencement a lessee recognises a right-of-use asset and lease liability for all leases (except short-term leases and leases of low value assets that it accounts for applying paragraph 6 of IFRS 16). IFRS 16 became effective for annual reporting periods beginning on or after 1 January 2019.

A20. One Board member asked about whether and how the effective date of the proposed amendments would interact with that of IFRS 16.

A21. Because IFRS 16 is in effect as from 1 January 2019, entities will not apply the proposed amendments at the same time as they apply IFRS 16; we would expect the effective date of the proposed amendments to be no earlier than annual reporting periods beginning on or after 1 January 2021.

A22. We do not anticipate any difficulties in applying the proposed amendments at a later date than IFRS 16 for the following reasons:

(a) for some entities, the proposed amendments would not have any effect. This would be the case if, for example, temporary differences do not arise on initial recognition of lease assets and liabilities (if, having considered the tax law in the jurisdictions within which an entity operates, the entity attributes tax deductions to the lease asset, and not the lease liability).

(b) entities affected by the proposed amendments would not have recognised deferred tax on leases because of the initial recognition exemption in paragraphs 15 and 24 of IAS 12. Therefore, in applying IFRS 16 (and before applying the proposed amendments), such entities would not have incurred costs in accounting for deferred tax. Those entities would then incur such costs in applying the proposed amendments. However, we would not anticipate the costs of accounting for deferred tax as a consequence of applying the proposed amendments to be very different from the costs that would have been incurred had the proposed amendments been applied together with IFRS 16.

Appendix B—Outcomes of applying the proposed transition relief

B1. Paragraph 15 of this paper explains how an entity would apply the transition relief. This Appendix illustrates the outcomes of applying, or not applying, the transition relief.

B2. An entity that does not meet the recoverability requirement on initial recognition recognises neither deferred tax assets nor deferred tax liabilities.

B3. Applying, or not applying, the transition relief would lead to the same outcomes in situations in which an entity's assessment of the recoverability requirement does not change between the date of a transaction and the transition date. However, a change in the assessment of the recoverability requirement between the date of a transaction and the transition date could, in some situations, result in a different outcome.

B4. To illustrate, we considered the following example. Lessee entered into a lease five years before the transition date of the proposed amendments. Lessee applies the proposed amendments retrospectively and elects not to apply the transition relief. At lease commencement, Lessee met the recoverability requirement and would have been able to recognise deferred tax assets. However, Lessee no longer meets the recoverability requirement at the transition date.

B5. Applying the proposed amendments retrospectively, Lessee would have recognised a deferred tax asset and liability, because it met the recoverability requirement at the time it initially recognised the lease. At the transition date, Lessee would however:

(a) not recognise the deferred tax asset—because it no longer meets the recoverability requirement at that date; but

(b) recognise the deferred tax liability—because it would have recognised the deferred tax liability on initial recognition of the lease.

B6. However, if Lessee elects to apply the transition relief, it assesses whether the recoverability requirement is met only at the transition date. In this case, because Lessee does not meet the recoverability requirement at that date, it would not recognise any deferred tax asset. Lessee would also not recognise any deferred tax liability. This is because, on transition, it would recognise a deferred tax liability up to the amount that it recognises as a deferred tax asset (in this case, zero).

B7. The different outcomes of applying, or not applying, the transition relief are summarised in the following matrix:

Fact patterns		**Transition outcomes**			
Is the recoverability requirement satisfied?		**Is DTA and DTL recognised when amendments are applied?**[7]			
Assessment on initial recognition of a transaction	**Reassessment at transition date**	**Not applying the relief**		**Applying the relief**	
		DTA	**DTL**	**DTA**	**DTL**
Not probable that taxable profits will be available.	Not probable that taxable profits will be available.	No	No	No	No
It is probable that taxable profits will be available.	Probable that taxable profits will be available.	Yes	Yes	Yes	Yes
Not probable that taxable profits will be available.	Probable that taxable profits will be available.	No[8]	No	Yes	Yes
It is probable that taxable profits will be available.	Not probable that taxable profits will be available.	No	Yes	No	No

[7] DTA = Deferred tax asset / DTL = Deferred tax liability

[8] This assumes that the entity considered that the initial recognition exemption applied (see paragraph A14 of Appendix A to this paper).