Deferred tax: Technical issues

17 March 2011
ICAZ CPD
Summary of general rules

- Current tax
- Deferred tax

Specific issues

Amendments to IAS12

Recap
Income taxes

Income tax = Current tax + Deferred tax
Measurement of current tax

Applicable tax rate for that type of income

Enacted or substantively enacted by balance sheet date

- General rate
- Specific rates (e.g. capital gains tax rate)
Recognition of current tax – Performance statements

Income statement → Unless relates to item in OCI

OCI → If relates to item in OCI
Five steps to calculate deferred tax

IFRS book value vs Tax base = Temporary differences

Deductible

Taxable

Tax rate applicable

Income statement or -OCI - Goodwill

Deferred tax asset recognition?
Measurement of deferred tax

Applicable tax rate

Enacted or substantively enacted by balance sheet date

Expected manner of recovery or settlement:
- usage rate
- disposal rate
Recognition of deferred tax

- Income statement: All cases, unless:
- OCI: If relates to item in OCI
- Goodwill: If arises on a business combination
Recognition of deferred tax asset / liability

**Liability**
Recognise in full

**Asset**
Recognise if recoverable
Summary of general rules

Specific issues
- Changes in tax status
- Business combinations
- Investments
- Foreign exchange differences
- Dual intention

Amendments to IAS 12

Recap
Changes in the Tax Status of an Entity or its Shareholders

Income statement (if not related to items recognised in OCI)
Business combinations – Initial accounting

General principles:
- Temporary differences arise on fair value and other adjustments made as part of the purchase accounting
- The deferred tax position of acquirer and acquiree is reassessed at the date of acquisition
  Resulting deferred tax affects goodwill

Exceptions:
- Deferred tax liability arising from initial recognition of goodwill not recognized
- Change in the deferred tax positions of the acquirer due to the acquisition is recognized in P&L
Business combinations – Subsequent adjustments

Adjustments to fair value of identifiable assets and liabilities at acquisition date

Recognition of additional deferred tax assets

GOODWILL

GOODWILL
Deferred tax assets subsequently realised or recognised

- Increase in deferred tax asset/tax benefit is credited to the tax line in the income statement
- Decrease in goodwill is debited to pre-tax expense in the income statement

<table>
<thead>
<tr>
<th>Dr Deferred tax asset</th>
<th>90</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cr Income tax expense</td>
<td>90</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Dr Other expenses</th>
<th>90</th>
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<tbody>
<tr>
<td>Cr Goodwill</td>
<td>90</td>
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</tbody>
</table>
Temporary differences:

- Consolidated subsidiaries, associates and joint ventures:
  - undistributed profits
  - changes in foreign exchange rate
  - reduction of carrying amount to recoverable amount
  - Etc.

- Non-consolidated investments:
  - Changes in fair value
Investments – Exception to the general rule

Subsidiary, Associate, Joint Venture

Control timing of reversal
Probable won’t reverse in foreseeable future

Unlikely for associates and JVs unless contractually agreed
Foreign exchange differences

Deferred tax related to foreign currency transactions

Deferred tax related to past translation of foreign entity

Income statement

OCI

In relation with IAS 12.39
In many cases, an entity may have a dual intention for an asset, e.g. to use an asset and then to sell it.

- Calculate deferred tax based on the expected manner of recovery or settlement using a “blended rate”
Agenda

Summary of general rules

Specific issues

Amendments to IAS 12

Recap
On 20 December 2010 the IASB issued the 2010 amendment to IAS 12 *Deferred tax: Recovery of underlying assets – amendments to IAS 12.*

The related ED was issued in September 2010.

The amendment is part of a narrow-scope project that the IASB initiated to fix practice issues within IAS 12. Other issues that may be addressed are:

− Uncertain tax positions
− Recognition of deferred tax assets in full with an offsetting valuation allowance necessary
− Other minor items
## Key changes to IAS 12

<table>
<thead>
<tr>
<th>Issue</th>
<th>2010 amendment</th>
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<tbody>
<tr>
<td>Scope</td>
<td>Applies to:</td>
</tr>
<tr>
<td></td>
<td>- investment property measured at fair value in accordance with IAS 40</td>
</tr>
<tr>
<td>Rebutting</td>
<td>The presumption is rebutted only for investment property that is <em>depreciable</em> and is held within a <em>business model</em> whose objective is to consume substantially all of the asset’s economic benefits over the life of the asset</td>
</tr>
<tr>
<td>SIC-21</td>
<td>Integrates the requirements of SIC-21 into IAS 12</td>
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</tbody>
</table>
Measurement of deferred taxes – general principle

General principle in IAS 12

Paragraph 51 of IAS 12 requires deferred tax assets and liabilities to be measured based on:

- Expected manner of recovery (asset) or settlement (liability); and
- Enacted tax rates or substantively enacted tax rates expected to apply at the reporting date.

Management’s intentions are key in determining the expected manner of recovery (asset) or settlement (liability).
Measurement of deferred taxes – amendment

Investment property measured using the fair value model

Investment property acquired in a business combination and subsequently measured using the fair value model.

Rebuttable presumption that the measurement of the deferred tax liability or asset reflects the tax consequences of recovering the carrying amount of the investment property entirely through sale.
Presumption can be rebutted if:

- Investment property is depreciable; and
- Held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time.

If the presumption is rebutted, the general requirements of IAS 12 apply.
Other implications

Withdrawal of SIC-21 *Income taxes – Recovery of revalued non-depreciable assets*

- Guidance from SIC-21 has been integrated into a new paragraph 51B of IAS 12

The measurement of a deferred tax liability or deferred tax asset arising from a non-depreciable asset measured under the revaluation model in IAS 16 reflects the tax consequences of recovering the carrying amount entirely through sale.
Company T has a portfolio of investment properties measured at fair value in Country B from which it currently earns rental income.

The properties consist of land and buildings and are measured at fair value in accordance with IAS 40.

Tax rate applicable for sale of investment property is 10 percent while the tax rate applicable to other taxable profits is 20%.

<table>
<thead>
<tr>
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<th>Fair value (carrying amount)</th>
<th>Tax base</th>
<th>Temporary difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>300</td>
<td>180</td>
<td>120</td>
</tr>
<tr>
<td>Buildings</td>
<td>200</td>
<td>135</td>
<td>65</td>
</tr>
<tr>
<td>Total</td>
<td>500</td>
<td>315</td>
<td>185</td>
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</table>
Scenario 1:
T’s business model is to sell the properties in the future (i.e. consumes substantially all of the economic benefits through rental income and sales)

T measures deferred taxes under the 2010 amendment
Rebuttable presumption for the measurement is that the recovery of the carrying amount will be entirely by sale.

Total deferred taxes = 185 x 10% = 18.5

Scenario 2:
T’s business model is to hold properties for strategic purposes (i.e. consumes substantially all of the economic benefits through rental income).

T rebuts the presumption
Buildings: Deferred taxes in accordance with paragraphs 51 and 51A

Deferred taxes on buildings = 65 x 20% = 13

For the land: Tax consequences from sale in accordance with paragraph 51B

Deferred taxes on land = 120 x 10% = 12

Total deferred taxes = 25
Effective date and transition

Effective date

- Amendment will become effective for annual periods beginning on or after 1 January 2012.
- Earlier application is permitted.

Transition

- Retrospective application required
Summary of general rules (1)

- Deferred tax generally is recognised when there is a taxable or deductible temporary difference between the carrying amount of an asset or a liability in the balance sheet and its tax base.

- Initial recognition exemption is applicable to:
  - the initial recognition of goodwill
  - the initial recognition of an asset or liability in a transaction which is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable profit (loss).

- Income taxes are measured using tax law and tax rates that have been enacted or substantively enacted by the balance sheet date.
Summary of general rules (2)

- Current tax and deferred tax are recognised in the same way as the underlying transactions or events (income statement, equity or goodwill)

- No discounting of deferred tax assets or liabilities is permitted

- Deferred tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised
Summary of specific issues (1)

**Changes in tax status**

- The changes in current and deferred taxes should be included in the net profit or loss for the period (if not related to items recognised in equity).

**Business combinations**

- Deferred tax on temporary differences arising on fair value and other adjustments made as part of the purchase accounting affect goodwill.
**Investments in subsidiaries, associates and joint ventures**

- Deferred tax should be recognised on temporary differences between the parent’s share in the investee’s net assets and the tax base of the investment, except when the parent 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.

**Dual intention**

- Calculate deferred tax based on the expected manner of recovery or settlement, using a “blended rate”
Summary of specific issues (3)

Foreign exchange differences

- Deferred tax relating to effects of changes in foreign exchange rates should be accounted for in the same way as the underlying transactions or events
Amendments to IAS 12

Deferred tax on investment properties
- Rebuttable presumption that the measurement of the deferred tax liability or asset reflects the tax consequences of recovering the carrying amount of the investment property entirely through sale.

SIC 21
- Guidance from SIC-21 has been integrated into a new paragraph 51B of IAS 12
Questions?
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