Hong Kong Institute of Certified Public Accountants
香港會計師公會

MEMBERS' HANDBOOK

Update No. 102

(Issued 21 December 2010)

This Update relates to the issuance of:

- Amendments to HKAS 12 *Income Taxes* – Deferred Tax: Recovery of Underlying Assets

Document Reference and Title	***Instructions***	***Explanations***
VOLUME II		
Contents of Volume II	Discard existing pages i & iii replace with revised pages i & iii.	Revised contents pages
HONG KONG ACCOUNTING STANDARDS (HKAS)		
HKAS 12 *Income Taxes*	Replace cover page and page 4 with revised cover page and page 4. Insert pages 64 – 73 after page 63	- Note
HONG KONG (SIC) INTERPRETATIONS (HK(SIC)-Int)		
HK(SIC)-Int 21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets*	Replace cover page with revised cover page.	- Note

Note:

1. HKAS 12 *Income Taxes* requires an entity to measure the deferred tax relating to an asset depending on whether the entity expects to recover the carrying amount of the asset through use or sale. It can be difficult and subjective to assess whether recovery will be through use or through sale when the asset is measured using the fair value model in HKAS 40 *Investment Property*. The amendment provides a practical solution to the problem by introducing a presumption that recovery of the carrying amount will, normally be , be through sale.

2. As a result of the amendments, HK(SIC)-21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets* would no longer apply to investment properties carried at fair value. The amendments also incorporate into HKAS 12 the remaining guidance previously contained in HK(SIC)-21, which is accordingly withdrawn.

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

MEMBERS' HANDBOOK
CONTENTS OF VOLUME II

(Updated to December 2010)

		Issue/(Review date)
	PREFACE AND FRAMEWORK	
PREFACE	Preface to Hong Kong Financial Reporting Standards	10/06(9/10)
CONCEPTUAL FRAMEWORK	Conceptual Framework for Financial Reporting	10/10
	HONG KONG ACCOUNTING STANDARDS (HKAS)	
HKAS 1 Revised	Presentation of Financial Statements	12/07 (5/10)
HKAS 2	Inventories	3/04(1/10)
HKAS 7	Statement of Cash Flows	12/04(1/10)
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors	9/04(1/10)
HKAS 10	Events after the Reporting Period	3/04(1/10)
HKAS 11	Construction Contracts	12/04(3/10)
HKAS 12	Income Taxes	11/04(12/10)
HKAS 16	Property, Plant and Equipment	11/05(3/10)
HKAS 17	Leases	12/04(6/10)
HKAS 18	Revenue	11/04(3/10)
HKAS 19	Employee Benefits	12/04(6/10)
HKAS 20	Accounting for Government Grants and Disclosure of Government Assistance	12/04(3/10)
HKAS 21	The Effects of Changes in Foreign Exchange Rates	3/04(6/10)
HKAS 23 Revised	Borrowing Costs	6/07(3/10)
HKAS 24	Related Party Disclosures	12/04(11/09)
HKAS 24 Revised	Related Party Disclosures	11/09
HKAS 26	Accounting and Reporting by Retirement Benefit Plans	8/04
HKAS 27 Revised	Consolidated and Separate Financial Statements	3/08(7/10)
HKAS 28	Investments in Associates	3/04(7/10)

Issue/(Review date)

HONG KONG (IFRIC) INTERPRETATIONS (HK(IFRIC)-Int)

		Issue/(Review date)
HK(IFRIC)-Int 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities..	8/04(7/10)
HK(IFRIC)-Int 2	Members' Shares in Co-operative Entities and Similar Instruments............	2/05(7/10)
HK(IFRIC)-Int 4	Determining whether an Arrangement contains a Lease	2/05(7/10)
HK(IFRIC)-Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	2/05(7/10)
HK(IFRIC)-Int 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment..	9/05
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 *Financial Reporting in Hyperinflationary Economies*	1/06(7/10)
HK(IFRIC)-Int 8	Scope of HKFRS 2...	5/06(7/10)
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives	5/06(7/10)
HK(IFRIC)-Int 10	Interim Financial Reporting and Impairment	9/06(7/10)
HK(IFRIC)-Int 11	HKFRS 2–Group and Treasury Share Transactions	1/07(7/10)
HK(IFRIC)-Int 12	Service Concession Arrangements...	3/07(8/10)
HK(IFRIC)-Int 13	Customer Loyalty Programmes	9/07(5/10)
HK(IFRIC)-Int 14	HKAS 19 —The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction..	9/07(12/09)
HK(IFRIC)-Int 15	Agreements for the Construction of Real Estate	8/08(8/10)
HK(IFRIC)-Int 16	Hedges of a Net Investment in a Foreign Operation..................................	8/08(8/10)
HK(IFRIC)-Int 17	Distributions of Non-cash Assets to Owners	12/08(8/10)
HK(IFRIC)-Int 18	Transfers of Assets from Customers...	2/09(8/10)
HK(IFRIC)-Int 19	Extinguishing Financial Liabilities with Equity Instruments..........................	12/09

HONG KONG INTERPRETATIONS (HK-Int)*

HK-Int 4	Leases – Determination of the Length of Lease Term in respect of Hong Kong Land Leases	6/06 (12/09)
HK-Int 5	Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause...............	11/10

Note: * *With effect from 24 May 2005, all Interpretations that are developed locally by the Institute are named Hong Kong Interpretations.*

HONG KONG (SIC) INTERPRETATIONS (HK(SIC)-Int)

HK(SIC)-Int 10	Government Assistance – No Specific Relation to Operating Activities	12/04(8/10)
HK(SIC)-Int 12	Consolidation – Special Purpose Entities...	2/05(1/08)
HK(SIC)-Int 13	Jointly Controlled Entities – Non-Monetary Contributions by Venturers	12/04(8/10)
HK(SIC)-Int 15	Operating Leases – Incentives	12/04(9/10)
HK(SIC)-Int 21	Income Taxes – Recovery of Revalued Non-Depreciable Assets...............	3/05(12/10)
HK(SIC)-Int 25	Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders	12/04(8/10)
HK(SIC)-Int 27	Evaluating the Substance of Transactions Involving the Legal Form of a Lease..	12/04(9/10)

HKAS 12
Revised ~~June~~ December 2010

Hong Kong Accounting Standard 12

Income Taxes

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

D Amendments resulting from other HKFRSs

E Amendments to HKAS 12 *Deferred Tax: Recovery of Underlying Assets*

BASIS FOR CONCLUSIONS

Hong Kong Accounting Standard 12 *Income Taxes* (HKAS 12) is set out in paragraphs 1-95. All the paragraphs have equal authority. HKAS 12 shall be read in the context of its objective, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Appendix E
Amendments of HKAS 12 *Deferred Tax: Recovery of Underlying Assets* (issued in December 2010) - effective for annual periods beginning on or after 1 January 2012

The following sets out amendments required for this Standard resulting from amendments to HKAS 12 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

Paragraph 52 is renumbered as paragraph 51A. Paragraph 10 and the examples following paragraph 51A are amended (new text is underlined and deleted text is struck through). Paragraphs 51B and 51C and the following example, and paragraphs 51D, 51E, 98 and 99 are added.

Definitions

Tax base

10 Where the tax base of an asset or liability is not immediately apparent, it is helpful to consider the fundamental principle upon which this Standard is based: that an entity shall, with certain limited exceptions, recognise a deferred tax liability (asset) whenever recovery or settlement of the carrying amount of an asset or liability would make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences. Example C following paragraph ~~52~~ 51A illustrates circumstances when it may be helpful to consider this fundamental principle, for example, when the tax base of an asset or liability depends on the expected manner of recovery or settlement.

Measurement

51A ~~52~~ In some jurisdictions, the manner in which an entity recovers (settles) the carrying amount of an asset (liability) may affect either or both of:

(a) the tax rate applicable when the entity recovers (settles) the carrying amount of the asset (liability); and

(b) the tax base of the asset (liability).

In such cases, an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.

Example A

An ~~asset~~ item of property, plant and equipment has a carrying amount of 100 and a tax base of 60. A tax rate of 20% would apply if the ~~asset~~ item were sold and a tax rate of 30% would apply to other income.

The entity recognises a deferred tax liability of 8 (40 at 20%) if it expects to sell the ~~asset~~ item without further use and a deferred tax liability of 12 (40 at 30%) if it expects to retain the ~~asset~~ item and recover its carrying amount through use.

© Copyright

Example B

An ~~asset~~ item of property, plant and equipment with a cost of 100 and a carrying amount of 80 is revalued to 150. No equivalent adjustment is made for tax purposes. Cumulative depreciation for tax purposes is 30 and the tax rate is 30%. If the ~~asset~~ item is sold for more than cost, the cumulative tax depreciation of 30 will be included in taxable income but sale proceeds in excess of cost will not be taxable.

The tax base of the ~~asset~~ item is 70 and there is a taxable temporary difference of 80. If the entity expects to recover the carrying amount by using the ~~asset~~ item, it must generate taxable income of 150, but will only be able to deduct depreciation of 70. On this basis, there is a deferred tax liability of 24 (80 at 30%). If the entity expects to recover the carrying amount by selling the ~~asset~~ item immediately for proceeds of 150, the deferred tax liability is computed as follows:

	Taxable Temporary Difference	*Tax Rate*	*Deferred Tax Liability*
Cumulative tax depreciation	*30*	*30%*	*9*
Proceeds in excess of cost	*50*	*nil*	*–*
Total	*80*		*9*

(note: in accordance with paragraph 61A, the additional deferred tax that arises on the revaluation is recognised in other comprehensive income)

Example C

The facts are as in example B, except that if the ~~asset~~ item is sold for more than cost, the cumulative tax depreciation will be included in taxable income (taxed at 30%) and the sale proceeds will be taxed at 40%, after deducting an inflation-adjusted cost of 110.

If the entity expects to recover the carrying amount by using the ~~asset~~ item, it must generate taxable income of 150, but will only be able to deduct depreciation of 70. On this basis, the tax base is 70, there is a taxable temporary difference of 80 and there is a deferred tax liability of 24 (80 at 30%), as in example B.

If the entity expects to recover the carrying amount by selling the ~~asset~~ item immediately for proceeds of 150, the entity will be able to deduct the indexed cost of 110. The net proceeds of 40 will be taxed at 40%. In addition, the cumulative tax depreciation of 30 will be included in taxable income and taxed at 30%.

On this basis, the tax base is 80 (110 less 30), there is a taxable temporary difference of 70 and there is a deferred tax liability of 25 (40 at 40% plus 30 at 30%). If the tax base is not immediately apparent in this example, it may be helpful to consider the fundamental principle set out in paragraph 10.

(note: in accordance with paragraph 61A, the additional deferred tax that arises on the revaluation is recognised in other comprehensive income)

© Copyright

51B If a deferred tax liability or deferred tax asset arises from a non-depreciable asset measured using the revaluation model in HKAS 16, the measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the non-depreciable asset through sale, regardless of the basis of measuring the carrying amount of that asset. Accordingly, if the tax law specifies a tax rate applicable to the taxable amount derived from the sale of an asset that differs from the tax rate applicable to the taxable amount derived from using an asset, the former rate is applied in measuring the deferred tax liability or asset related to a non-depreciable asset.

51C If a deferred tax liability or asset arises from investment property that is measured using the fair value model in HKAS 40, there is a rebuttable presumption that the carrying amount of the investment property will be recovered through sale. Accordingly, unless the presumption is rebutted, the measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the investment property entirely through sale. This presumption is rebutted if the investment property is depreciable and is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale. If the presumption is rebutted, the requirements of paragraphs 51 and 51A shall be followed.

Example illustrating paragraph 51C

An investment property has a cost of 100 and fair value of 150. It is measured using the fair value model in HKAS 40. It comprises land with a cost of 40 and fair value of 60 and a building with a cost of 60 and fair value of 90. The land has an unlimited useful life.

Cumulative depreciation of the building for tax purposes is 30. Unrealised changes in the fair value of the investment property do not affect taxable profit. If the investment property is sold for more than cost, the reversal of the cumulative tax depreciation of 30 will be included in taxable profit and taxed at an ordinary tax rate of 30%. For sales proceeds in excess of cost, tax law specifies tax rates of 25% for assets held for less than two years and 20% for assets held for two years or more.

Because the investment property is measured using the fair value model in HKAS 40, there is a rebuttable presumption that the entity will recover the carrying amount of the investment property entirely through sale. If that presumption is not rebutted, the deferred tax reflects the tax consequences of recovering the carrying amount entirely through sale, even if the entity expects to earn rental income from the property before sale.

The tax base of the land if it is sold is 40 and there is a taxable temporary difference of 20 (60 – 40). The tax base of the building if it is sold is 30 (60 – 30) and there is a taxable temporary difference of 60 (90 – 30). As a result, the total taxable temporary difference relating to the investment property is 80 (20 + 60).

In accordance with paragraph 47, the tax rate is the rate expected to apply to the period when the investment property is realised. Thus, the resulting deferred tax liability is computed as follows, if the entity expects to sell the property after holding it for more than two years:

	Taxable Temporary Difference	*Tax Rate*	*Deferred Tax Liability*
Cumulative tax depreciation	*30*	*30%*	*9*
Proceeds in excess of cost	*50*	*20%*	*10*
Total	*80*		*19*

continued…

… continued

If the entity expects to sell the property after holding it for less than two years, the above computation would be amended to apply a tax rate of 25%, rather than 20%, to the proceeds in excess of cost. If, instead, the entity holds the building within a business model whose objective is to consume substantially all of the economic benefits embodied in the building over time, rather than through sale, this presumption would be rebutted for the building. However, the land is not depreciable. Therefore the presumption of recovery through sale would not be rebutted for the land. It follows that the deferred tax liability would reflect the tax consequences of recovering the carrying amount of the building through use and the carrying amount of the land through sale.

The tax base of the building if it is used is 30 (60 – 30) and there is a taxable temporary difference of 60 (90 – 30), resulting in a deferred tax liability of 18 (60 at 30%).

The tax base of the land if it is sold is 40 and there is a taxable temporary difference of 20 (60 – 40), resulting in a deferred tax liability of 4 (20 at 20%).

As a result, if the presumption of recovery through sale is rebutted for the building, the deferred tax liability relating to the investment property is 22 (18 + 4).

51D The rebuttable presumption in paragraph 51C also applies when a deferred tax liability or a deferred tax asset arises from measuring investment property in a business combination if the entity will use the fair value model when subsequently measuring that investment property.

51E Paragraphs 51B–51D do not change the requirements to apply the principles in paragraphs 24–33 (deductible temporary differences) and paragraphs 34–36 (unused tax losses and unused tax credits) of this Standard when recognising and measuring deferred tax assets.

Effective date

98 Paragraph 52 was renumbered as 51A, paragraph 10 and the examples following paragraph 51A were amended, and paragraphs 51B and 51C and the following example and paragraphs 51D, 51E and 99 were added by *Deferred Tax: Recovery of Underlying Assets*, issued in December 2010. An entity shall apply those amendments for annual periods beginning on or after 1 January 2012. Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact.

Withdrawal of HK(SIC)- Int 21

99 The amendments made by *Deferred Tax: Recovery of Underlying Assets*, issued in December 2010, supersede Hong Kong (SIC) Interpretation 21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets.*

Addition of Basis for Conclusions on HKAS 12 *Income Taxes*

A Basis for Conclusions on HKAS 12 containing paragraphs BC1–BC36 is added.

Basis for Conclusions on IAS 12 *Income Taxes*

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

HKAS 12 is based on IAS 12 *Income Taxes*. In approving HKAS 12, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 12. Accordingly, there are no significant differences between HKAS 12 and IAS 12. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 12 referred to below generally correspond with those in HKAS 12.

Introduction

BC1 When IAS 12 *Income Taxes* was issued by the International Accounting Standards Committee in 1996 to replace the previous IAS 12 *Accounting for Taxes on Income* (issued in July 1979), the Standard was not accompanied by a Basis for Conclusions. This Basis for Conclusions is not comprehensive. It summarises only the International Accounting Standards Board's considerations in making the amendments to IAS 12 contained in *Deferred Tax: Recovery of Underlying Assets* issued in December 2010. Individual Board members gave greater weight to some factors than to others.

BC2 The Board amended IAS 12 to address an issue that arises when entities apply the measurement principle in IAS 12 to temporary differences relating to investment properties that are measured using the fair value model in IAS 40 *Investment Property*.

BC3 In March 2009 the Board published an exposure draft, *Income Tax* (the 2009 exposure draft), proposing a new IFRS to replace IAS 12. In the 2009 exposure draft, the Board addressed this issue as part of a broad proposal relating to the determination of tax basis. In October 2009 the Board decided not to proceed with the proposals in the 2009 exposure draft and announced that, together with the US Financial Accounting Standards Board, it aimed to conduct a fundamental review of the accounting for income tax in the future. In the meantime, the Board would address specific significant current practice issues.

BC4 In September 2010 the Board published proposals for addressing one of those practice issues in an exposure draft *Deferred Tax: Recovery of Underlying Assets* with a 60-day comment period. Although that is shorter than the Board's normal 120-day comment period, the Board concluded that this was justified because the amendments were straightforward and the exposure draft was short. In addition, the amendments were addressing a problem that existed in practice and needed to be solved as soon as possible. The Board considered the comments it received on the exposure draft and in December 2010 issued the amendments to IAS 12. The Board intends to address other practice issues arising from IAS 12 in due course, when other priorities on its agenda permit this.

Recovery of revalued non-depreciable assets

BC5 In December 2010, the Board incorporated in paragraph 51B of IAS 12 the consensus previously contained in SIC Interpretation 21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets*. However, because paragraph 51C addresses investment property carried at fair value, the Board excluded such assets from the scope of paragraph 51B. Paragraphs BC6 and BC7 set out the basis that the Standing Interpretations Committee (SIC) gave for the conclusions it reached in developing the consensus expressed in SIC-21.

© Copyright

BC6 The SIC noted that the *Framework for the Preparation and Presentation of Financial Statements* stated that an entity recognises an asset if it is probable that the future economic benefits associated with the asset will flow to the entity. Generally, those future economic benefits will be derived (and therefore the carrying amount of an asset will be recovered) through sale, through use, or through use and subsequent sale. Recognition of depreciation implies that the carrying amount of a depreciable asset is expected to be recovered through use to the extent of its depreciable amount, and through sale at its residual value. Consistently with this, the carrying amount of a non-depreciable asset, such as land having an unlimited life, will be recovered only through sale. In other words, because the asset is not depreciated, no part of its carrying amount is expected to be recovered (ie consumed) through use. Deferred taxes associated with the non-depreciable asset reflect the tax consequences of selling the asset.

BC7 The SIC noted that the expected manner of recovery is not predicated on the basis of measuring the carrying amount of the asset. For example, if the carrying amount of a non-depreciable asset is measured at its value in use, the basis of measurement does not imply that the carrying amount of the asset is expected to be recovered through use, but through its residual value upon ultimate disposal.

Recovery of investment properties

Reason for the exception

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

BC9 It is particularly difficult and subjective to determine the entity's expected manner of recovery for investment property that is measured using the fair value model in IAS 40. In contrast, for investment property that is measured using the cost model in IAS 40, the Board believes that the estimates required for depreciation establish the expected manner of recovery because there is a general presumption that an asset's carrying amount is recovered through use to the extent of the amount subject to depreciation and through sale to the extent of the residual value.

BC10 To address this issue, the Board introduced an exception to the principle in IAS 12 that applies when an entity adopts an accounting policy of remeasuring investment property at fair value. The purpose of the exception is to reflect the entity's expectation of recovery of the investment property in a practical manner that involves little subjectivity.

BC11 Many respondents to the exposure draft of September 2010 commented that the Board should develop application guidance rather than creating an exception. The Board could have achieved a similar result in some cases by providing application guidance on how to apply the underlying principle to investment property. However, the Board chose an exception because it is simple, straightforward and can avoid unintended consequences by a strict definition of its scope. In fact, this exception is very similar to application guidance. However, it is technically an exception because, in some cases, the asset's carrying amount is assumed to be recovered entirely through sale even though an entity expects it to be recovered partly through sale and partly through use.

BC12 The Board also noted that application guidance would not resolve a practice issue that arises when the future income generated from an asset is expected to exceed the carrying amount of that asset and that future income will be subject to two or more different tax regimes. In those situations, IAS 12 provides no basis for determining which tax rate and tax base apply to the recovery of the carrying amount. The Board concluded that the practical way to resolve this issue was to create an exception that determines the manner of recovery of an asset within the scope of that exception.

© Copyright

Scope of the exception

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

BC14 Many respondents disagreed with the proposal to include property, plant and equipment or intangible assets measured using the revaluation model in IAS 16 or IAS 38 in the scope of the exception. They stated that many items of property, plant and equipment are recovered through use rather than through sale, and that this is consistent with the definition of property, plant and equipment in IAS 16. In addition, many respondents disagreed with the presumption of recovery through sale when the underlying assets are intangible assets for similar reasons. They also warned of unintended consequences that could arise because of the varying nature of intangible assets. Many respondents suggested limiting the scope of the exception to investment properties measured using the fair value model in IAS 40. Having considered those comments, the Board adopted that suggestion.

BC15 Some respondents supported inclusion of property, plant and equipment in the scope of the exception, including property, plant and equipment measured on a cost basis, because of their concerns about the lack of discounting deferred tax assets and deferred tax liabilities and about a possible double-counting of tax effects (see paragraph BC19). However, the Board concluded that considering concerns about the lack of discounting and about the possible double-counting was outside the limited scope of the amendments.

BC16 The Board made it clear that the exception also applies on initial measurement of investment property acquired in a business combination if the investment property will subsequently be measured using the fair value model in IAS 40. If the exception did not apply in these circumstances, deferred taxes might reflect the tax consequences of use at the acquisition date, but at a later date reflect the tax consequences of sale. The Board believes that measurement of deferred taxes at the acquisition date should be consistent with the subsequent measurement of the same deferred taxes. For the same reason, the Board concluded that the exception should not apply to investment property initially measured at fair value in a business combination if the entity subsequently uses the cost model.

BC17 Having considered the responses to the exposure draft, the Board decided not to extend the exception to other underlying assets and liabilities that are measured at fair value, including financial instruments or biological assets. This is because the Board understands that the most significant current practice issues relate to investment property. In addition, the Board wished to avoid unintended consequences of expanding the scope to other assets and liabilities that are measured on a fair value basis.

BC18 The Board concluded that the amendments should apply to all temporary differences that arise relating to underlying assets within the scope of the exception, not just those separate temporary differences created by the remeasurement of the underlying asset. This is because the unit of account applied in determining the manner of recovery in the Standard is the underlying asset as a whole, not the individual temporary differences.

Measurement basis

BC19 The Board decided that when the exception applies, there should be a presumption that deferred taxes should be measured to reflect the tax consequences of recovering the carrying amount of the investment property entirely through sale. In making that decision, the Board considered various views expressed by interested parties, which included, but were not limited to the following:

(a) the tax effect would be double-counted in some situations if deferred taxes are measured on the basis of the tax consequences of use, because the investment property is measured at fair value, which reflects some of these tax consequences; and

(b) presuming sale is consistent with a fair value measurement basis that reflects the price that would be received if the investment property is sold.

BC20 Many respondents to the exposure draft said that choosing a measurement basis of fair value is an accounting policy choice that does not imply or predict recovery of the investment property through sale. Many also said that the proposed exception would solve the double-counting problem partially but not completely. The Board noted that the aim of the exception was neither to link the accounting policy with measurement of deferred taxes (see paragraph BC7), nor to remove completely the double-counting of tax effects (see paragraph BC15). The aim of this exception is to provide a practical approach when determination of the expected manner of recovery is difficult and subjective.

BC21 In many cases when an entity chooses the fair value model for investment property, investment properties are recovered through sale. Even if an investment property earns income through rental use in a given period, the value of the future earnings capacity of the investment property will often not decrease and that value will ultimately be realised through sale. Therefore, the Board retained its proposal to introduce a presumption of recovery through sale.

BC22 The Board made that presumption rebuttable because the Board believes that it is not always appropriate to assume the recovery of investment property through sale. The Board initially proposed in the exposure draft that the presumption of recovery through sale is not appropriate when the entity has clear evidence that it will consume the asset's economic benefits throughout its economic life. The Board set a criterion that refers to consumption of the asset's economic benefits, rather than to the recovery of the carrying amount, because the Board understands that there is diverse practice regarding the meaning of the recovery of the carrying amount through use or through sale.

BC23 After considering the responses to the exposure draft, the Board reworded the rebuttable presumption so that clear evidence would not be required to rebut it. Instead, the presumption is rebutted if an asset is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale. Many respondents were concerned that, because clear evidence is an ambiguous term, the requirement to gather clear evidence would have been onerous for entities that have no problem applying the existing principle in IAS 12, and could have led to abuse by entities that choose whether to gather clear evidence to achieve a favourable result. The Board chose to use the term 'business model' because it is already used in IFRS 9 *Financial Instruments* and would not depend on management's intentions for an individual asset. Many respondents were concerned that the presumption would lead to inappropriate results in some cases because it would not be rebutted if a minor scrap value would be recovered through sale. The Board also reworded the rebuttable presumption in order to respond to those concerns. The Board also made it clear that the presumption of recovery through sale cannot be rebutted if the asset is non-depreciable because that fact implies that no part of the carrying amount of the asset would be consumed through use (see paragraph BC6).

BC24 The Board also considered other approaches to the measurement of deferred tax liabilities and deferred tax assets when the exception applies, specifically whether deferred taxes should be measured on the basis of the lower of the tax consequences of recovery through use and through sale. However, the Board rejected such an approach, noting that it would have created:

(a) conceptual and practical concerns about whether deferred tax assets should be measured to reflect the lower of, or higher of, the tax consequences of use and of sale;

(b) a measurement basis that some believe would be arbitrary; and

(c) concerns that entities might be required to measure deferred taxes on a basis that is inconsistent with their expectations of recovery of the carrying amount of the underlying asset.

BC25 Some respondents to the exposure draft drew the mistaken conclusion that the exposure draft required presumption of *immediate* sale at the end of the reporting period when assessing the presumption of recovery through sale. The Board observed that paragraph 47 of IAS 12 requires deferred tax assets and liabilities to be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled on the basis of tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. This requirement applies even when the presumption of recovery through sale is used. For clarification, the Board adjusted the illustrative example following paragraph 51C to reflect the requirement in paragraph 47.

BC26 In the exposure draft, the Board proposed to withdraw SIC-21. However, many respondents commented that SIC-21 should be retained in order to avoid unintended consequences. Having considered the responses to the exposure draft, the Board decided to incorporate SIC-21 into IAS 12 in its entirety after excluding from the scope of SIC-21 the investment property subject to the requirement in paragraph 51C.

Assessment of deferred tax assets

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

Disclosure requirement

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

The costs and benefits of the amendments to IAS 12

BC29 Computation of the tax consequences of selling assets is complex in some tax jurisdictions and there are concerns that the amendments to IAS 12 will increase the administrative burden for some entities in those tax jurisdictions.

BC30 However, the Board believes that the benefit of providing the exception outweighs this potential increase in administrative burden for some entities. This is because the purpose of the exception is to enable preparers to measure deferred taxes in these circumstances in the least subjective manner and in so doing enhance the comparability of financial information about deferred taxes for the benefit of users of financial statements. It is also expected to result in an overall reduction of the administrative burden for entities that have previously had to consider the tax consequence of both use and sale of an investment property when measuring deferred taxes.

BC31 Many respondents to the exposure draft said that entities would not benefit from the amendments in jurisdictions in which this practice issue did not exist but would suffer from an increased administrative burden as a result of the amendments. Their criticism mainly focused on the rebuttable presumption, as discussed in paragraphs BC22 and BC23. They also said that the disclosure requirement proposed in the exposure draft would be onerous.

BC32 After considering the responses to the exposure draft, the Board narrowed the scope of the exception to apply only to investment property carried at fair value. It reworded the rebuttable presumption so that clear evidence would no longer be required to rebut the presumption. The Board also did not pursue the proposed disclosure requirement regarding the fact of, and reason for, the rebuttal. After those changes, the Board believes that the amendments will not be onerous for entities that have previously been able to establish without difficulty how they expect to recover investment property carried at fair value.

© Copyright

Transition and effective date

BC33 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to apply retrospectively a change in accounting policy resulting from the initial application of an IFRS that does not have a transition provision. The Board did not include any transition provision in the amendments because, in the Board's view, it would not be unduly burdensome for entities to apply the changes to IAS 12 retrospectively.

BC34 The Board acknowledges that the amendments may add some administrative burden if they apply to investment property acquired in a business combination that occurred in a previous reporting period. For example, it could be difficult to restate goodwill and recalculate previous impairment reassessments if some information is not available and an entity is unable to separate the effects of hindsight. However, the Board reasoned that the amendments apply only to specific circumstances. Moreover, IAS 8 provides sufficient guidance to deal with cases when it might be impracticable to reassess impairment of goodwill or recoverability of deferred tax assets.

BC35 Consequently, the Board concluded that the cost of requiring retrospective application is outweighed by the benefit of consistent application of the amendments by entities to all periods presented in the financial statements. Accordingly, the Board decided that entities should apply the amendments to IAS 12 retrospectively in accordance with IAS 8.

First-time adoption of IFRSs

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

HK(SIC)-Int 21
Issued December ~~2004~~2010

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong (SIC) Interpretation 21

Income Taxes – Recovery of Revalued Non-Depreciable Assets*

*This HK(SIC) Interpretation is applicable for annual periods beginning on or after 1 January 2005 but before 1 January 2012. Amendments to HKAS 12 *Deferred Tax: Recovery of Underlying Assets* issued in December 2010 is applicable for annual periods beginning on or after 1 January 2012 and supersedes this HK(SIC) Interpretation.

Hong Kong Institute of
Certified Public Accountants
香港會計師公會