

Briefing Sheet

Amendments to IAS 12 – deferred tax on investment property

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This Briefing Sheet summarises *Deferred Tax: Recovery of Underlying Assets – Amendments to IAS 12* (the 2010 amendment), which was published by the IASB¹ on 20 December 2010.

In general the measurement of deferred tax assets and liabilities is based on the expected manner of recovery or settlement of the underlying asset or liability.

The 2010 amendment provides an exception to this measurement principle in respect of investment property measured using the fair value model in accordance with IAS 40 *Investment Property*. Under the exception, the measurement of deferred tax assets and liabilities is based on a rebuttable presumption that the carrying amount of the investment property will be recovered entirely through sale.

The presumption can be rebutted only if the investment property is depreciable and held within a business model whose objective is to consume substantially all of the asset's economic benefits over the life of the asset. Therefore, the presumption cannot be rebutted in respect of the land component of investment property as it is a non-depreciable asset.

The 2010 amendment also integrates the requirements of SIC-21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets* into IAS 12 *Income Taxes*; as a result SIC-21 is withdrawn.

Background

The 2010 amendment is part of a limited scope project focussing on resolving issues in practice under IAS 12, without changing the standard's fundamental approach and without increasing differences to US GAAP. Other practice issues that the IASB is expected to consider when their agenda allows include:

- uncertain tax positions;
- introduction of a step to consider whether the recovery of an asset or settlement of a liability will affect taxable profit;
- recognition of a deferred tax asset in full and an offsetting valuation allowance to the extent necessary;
- guidance on assessing the need for a valuation allowance;
- guidance on substantive enactment of tax laws; and
- allocation of current and deferred taxes within a group that files a consolidated tax return.

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Key changes from the exposure draft

Topic	Exposure draft	2010 amendment
Scope	Proposed to apply to: <ul style="list-style-type: none"> investment property measured at fair value in accordance with IAS 40; and assets measured using the revaluation model in accordance with IAS 16 <i>Property, Plant and Equipment</i> or IAS 38 <i>Intangible Assets</i>. 	Applies to: <ul style="list-style-type: none"> investment property measured at fair value in accordance with IAS 40.
Rebutting the presumption	Proposed that the presumption is rebutted only when there is <i>clear evidence</i> that all of the asset's economic benefits will be consumed over the life of the asset.	The presumption is rebutted only for investment property that is <i>depreciable</i> and is held within a <i>business model</i> whose objective is to consume substantially all of the asset's economic benefits over the life of the asset.
SIC-21	Proposed to withdraw SIC-21.	Integrates the requirements of SIC-21 into IAS 12; SIC-21 as a separate pronouncement is withdrawn.

The 2010 amendment

In general deferred tax assets and liabilities are measured based on:

- the expected manner of recovery (asset) or settlement (liability); and
- the tax rate expected to apply when the underlying asset (liability) is recovered (settled) based on rates that are enacted or substantively enacted at the reporting date.

The expected manner of recovery or settlement may affect either or both of the calculation of the tax base and the applicable tax rate. In such cases management's intentions are key in determining the amount of deferred tax to recognise.

The 2010 amendment provides an exception to the general measurement principles described above for investment property measured using the fair value model in accordance with IAS 40. The exception also applies to investment property acquired in a business combination accounted for in accordance with IFRS 3 *Business Combinations* provided that the investment property subsequently is measured using the fair value model.

The 2010 amendment introduces a rebuttable presumption that in these specified circumstances, deferred tax is calculated assuming that the manner of recovery of the carrying amount of the investment property is *entirely through sale*. Management's intention is not relevant. However, the 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 asset's economic benefits over the life of the asset.

A key point to note is that the presumption is rebutted only in respect of depreciable investment property. Therefore, the presumption of recovery through sale is not rebutted in respect of the land component of investment property, even if the entity's business model is based on holding the asset. This is because land is a non-depreciable asset.

Example

Company T has a portfolio of investment properties 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. In Country B, the tax rate applicable to the sale of investment property is 10 percent, while the tax rate applicable to other taxable profits is 20 percent. The fair values (i.e. carrying amounts), tax bases and resulting temporary differences of the land and building components are as follows:

	Fair value (carrying amount)	Tax base	Temporary difference
Land	300.00	180.00	120.00
Buildings	200.00	135.00	65.00
Total	500.00	315.00	185.00

Under the 2010 amendment, the measurement of deferred tax depends on T's business model, which is illustrated using the following scenarios:

- Scenario A: T's business model is to sell properties in the future in order to participate in the increase in real estate prices (i.e. it consumes substantially all of the investment properties' economic benefits through rental income and sales).
- Scenario B: T's business model is to hold properties for strategic purposes (i.e. it consumes substantially all of the investment properties' economic benefits through rental income). T rebuts the presumption.

The deferred tax liability under each scenario is calculated as follows:

	Temporary difference	Applicable tax rate	Deferred tax liability
Scenario A: Investment property	185.00	10%	18.50
Deferred tax liability			18.50
Scenario B: Land	120.00	10%	12.00
Buildings	65.00	20%	13.00
Deferred tax liability			25.00

Effective date and transition

The 2010 amendment is effective for annual periods beginning on or after 1 January 2012 and is applied retrospectively; early adoption is permitted with disclosure of that fact.

If you would like further information on any of the matters discussed in this issue of *Briefing Sheet*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.

Abbreviations

1 IASB: International Accounting Standards Board

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