HKFRSs / IFRSs UPDATE

2010/22

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HKAS 12 AMENDMENTS
CHANGES TO DEFERRED TAX ACCOUNTING FOR INVESTMENT PROPERTY AT FAIR VALUE

The IASB has issued limited amendments to IAS 12 "Income Taxes". These amendments have been adopted by the HKICPA as amendments to HKAS 12 which are set out in **"Deferred Tax: Recovery of Underlying Assets"**.

Need for Change

HKAS 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.

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 HKAS 40. In contrast, for investment property that is measured using the cost model in HKAS 40, it is believed 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.

To address this issue, an exception has been introduced to the principle in HKAS 12 that applies when an entity adopts an accounting policy of re-measuring 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.

STATUS

Final amendments to HKAS 12 "Income Taxes"

EFFECTIVE DATE

Effective for annual periods beginning on or after 1 January 2012, with earlier application permitted

ACCOUNTING IMPACT

May be significant for those entities holding investment property at fair value

Deferred Tax: Recovery of Underlying Assets

Investment property at fair value (new paragraph 51C)

- If a deferred tax liability or deferred tax 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. This is an exception to the principles in HKAS 12 introduced by the amendments.
  - If that is the case, 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.** The IASB explained in the Basis for Conclusions that it 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.
  - If that is the case, the normal deferred tax accounting requirements of paragraphs 51 and 51A shall be followed.
- Working examples are provided to demonstrate the application of the new requirements.

Business combinations-investment property at fair value (new paragraph 51D)

- The rebuttable presumption in the new 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.

Non-depreciable assets measured using the revaluation model in HKAS 16 "PPE" (new paragraph 51B)

- As a result of the amendments, **HK(SIC) Interpretation 21 "Income Taxes—Recovery of Revalued Non-Depreciable Assets"** would no longer apply to investment property at fair value. The remaining guidance previously contained in this Interpretation has been incorporated into the new paragraph 51B. As a result, this Interpretation is withdrawn.
- Under the new paragraph 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 deferred tax asset related to a non-depreciable asset.

A Practical Solution for Hong Kong

- The rebuttable presumption exception to the principles in HKAS 12 introduced by the amendments provides a practical approach for measuring deferred tax liabilities and deferred tax assets when it would be difficult and subjective to determine the expected manner of recovery of an investment property at fair value.
- The amendments address an issue currently affecting many Hong Kong HKFRSs reporting entities because Hong Kong has no capital gains tax, as well as entities in certain IFRSs jurisdictions such as Singapore, New Zealand and South Africa where there is no capital gains tax or the capital gains tax rate is different from the income tax rate.

Action Plan

As a result of the amendments, deferred tax assets or deferred tax liabilities arising from investment property at fair value are likely to be affected. Management is therefore advised to start early to consider the implications of the amendments, in particular:

- whether the amendments should be early adopted for the 2010 year-end reporting
- the impact of the amendments on previous business combinations involving investment property.

Effective Date

An entity shall apply the 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.

The amendments should be applied retrospectively in accordance with HKAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors".

BDO's support and assistance on HKFRSs

For any support and assistance on HKFRSs, please talk to your usual BDO contact or Stephen Chan, Partner and Head of Technical & Training at +852 2853 5820 or email StephenChan@bdo.com.hk

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