HKFRSs / IFRSs UPDATE

2010/16

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IASB PROPOSES TO CHANGE ONE ASPECT OF DEFERRED TAX ACCOUNTING

The IASB has published for public comment an exposure draft "Deferred Tax: Recovery of Underlying Assets" proposing a limited amendment to IAS 12. This amendment is expected to have significant impact on December 2010 year-end reporting.

Need for Change

The current principle in IAS 12 requires the measurement of deferred tax assets or liabilities to reflect the tax consequences that would follow from the way that management expects to recover or settle the carrying amount of the entity's assets or liabilities. For example, management may expect to recover an asset by using it, by selling it or by a combination of use and sale. Management's expectations can affect the measurement of deferred taxes when different tax rates or tax bases apply to the profits generated from using and selling the asset.

The IASB believes that entities holding investment properties that are measured at fair value sometimes find it difficult or subjective to estimate how much of the carrying amount will be recovered through rental income (that is, through use) and how much will be recovered through sale, particularly when there is no specific plan for disposal at a particular time.

The purpose of the amendment is to provide an exception to 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.

Proposal

The proposed amendment states that, in specified circumstances, the measurement of deferred tax liabilities and deferred tax assets should reflect a rebuttable presumption that the carrying amount of the underlying asset will be recovered entirely by sale. This rebuttable presumption is contained in a new paragraph 51B.

The specified circumstances are that the deferred tax liability or deferred tax asset arises from:

1. investment property, when an entity applies the fair value model in IAS 40 "Investment Property"; or
2. property, plant and equipment (PPE) or intangible assets, when an entity applies the revaluation model in IAS 16 "Property, Plant and Equipment" or IAS 38 "Intangible Assets".

STATUS

Exposure Draft

EFFECTIVE DATE

To be confirmed but expected to be effective for December 2010 year-end

ACCOUNTING IMPACT

Significant for entities holding investment properties, PPE or intangible assets carried at fair value

COMMENT DEADLINE

9 November 2010

The presumption is rebutted only when an entity has clear evidence that it will consume the asset's economic benefits throughout its economic life.

The proposed amendment is intended to provide 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.

SIC Interpretation 21 "Income Taxes—Recovery of Revalued Non-Depreciable Assets" will be withdrawn upon the issue of the final amendment.

Business Impact

The proposed amendment addresses 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.

Upon the finalisation of the proposed amendment, deferred tax assets or liabilities, arising from investment properties, PPE or intangible assets measured at fair value which are recognised by HKFRSs reporting entities, are likely to be reduced. Management is therefore advised to start early to prepare for the final amendment which is expected to be effective for the December 2010 year-end reporting.

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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