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IASB issues amendments to IAS 12 in respect of investment properties

In a nutshell

The amendments provide an exception to the general principles of IAS 12 for investment property measured using the fair value model in IAS 40 *Investment Property*.

For the purposes of measuring deferred tax, the amendments introduce a rebuttable presumption that the carrying amount of the investment property will be recovered entirely through sale. The presumption can be rebutted if the investment property is held within a business model whose objective is to consume economic benefits.

The amendments are likely to have no impact on the amount of tax provided by entities that previously concluded that their investment properties will be recovered through sale, but may make it easier to justify. Entities previously unable to support recovery by sale (e.g. using use tax base), however, are likely to be impacted by the amendments, as they will now be able to presume recovery through sale. This could result in a change in their deferred tax liabilities.

The amendments

On 20 December 2010, the International Accounting Standards Board (IASB) published *Deferred Tax: Recovery of Underlying Assets – Amendments to IAS 12* ('the amendments'). The amendments provide an exception to the general principle in IAS 12 that the measurement of deferred tax assets and deferred tax liabilities should reflect the tax consequences that would follow from the manner in which the entity expects to recover the carrying amount of an asset.

The amendments were issued in response to concerns that application of this principle can be difficult or subjective particularly for an investment property measured at fair value because it may be that the entity intends to hold the asset for an indefinite or indeterminate period of time, during which it anticipates both rental income and capital appreciation. Gains and losses from the recovery of an asset through sale may be taxed at a different rate from that applicable to income earned from using the same asset. Additionally, different tax bases may be ascribed to the same asset depending on the manner of recovery. For example, some jurisdictions may provide cost base plus an indexation allowance for inflation on disposal, but allow no deductions for depreciation, or allow depreciation only on the original cost. These factors have resulted in confusion and potential inconsistency in applying this principle in practice.

In response, the Board has provided an exception to the principle when deferred tax assets or deferred tax liabilities arise from investment property measured using the fair value model in IAS 40 and for investment property acquired in a business combination if it is subsequently measured using the fair value model in IAS 40.

The amendments introduce a rebuttable presumption that the carrying amount of the investment property will be recovered 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 over time, rather than through sale.

Observation
Because the new presumption can only be rebutted in relation to *depreciable* investment property, it may not apply to the land component of an investment property. Accordingly, entities that are able to rebut the presumption may need to separate their investment property into 'depreciable' and 'non-depreciable' components and perform a separate deferred tax calculation for each component.

In the exposure draft released by the Board in October, the Board proposed to apply the exception to property, plant and equipment and intangible assets measured using the revaluation model in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* respectively. Many respondents to the exposure draft disagreed with this proposal and consequently the Board limited the exception to investment property measured using the fair value model in IAS 40.

Observation
Entities holding investment property accounted for using the fair value model in accordance with IAS 40 in jurisdictions where tax is not imposed on sale of the investment property would no longer recognise deferred tax on any temporary differences arising from fair value gains or losses (unless the presumption is rebutted). This is because there would be no tax consequences expected to arise from recovering the carrying amount entirely through sale, regardless as to whether the entity intends to use the property to generate rental income for a period of time prior to sale.

Transition

The amendments to IAS 12 should be applied retrospectively requiring a retrospective restatement of all deferred tax assets or deferred tax liabilities within the scope of the amendment, including those that were initially recognised in a business combination.

The amendments also incorporate the requirements of SIC Interpretation 21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets* (adapted to allow for the introduced rebuttable presumption), i.e., deferred tax arising on a non-depreciable asset measured using the revaluation model in IAS 16 should be based on the sale rate. Accordingly, SIC-21 has been withdrawn.

Effective date

The effective date of the amendments is for annual periods beginning on or after 1 January 2012 subject to EU endorsement. Earlier application is permitted.

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