

**DRAFT ENDORSEMENT ADVICE AND EFFECTS STUDY REPORT ON  
DEFERRED TAX: RECOVERY OF UNDERLYING ASSETS  
(AMENDMENTS TO IAS 12)**

**INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS**

Comments should be sent to [commentletters@efrag.org](mailto:commentletters@efrag.org)

EFRAG has been asked by the European Commission to provide it with advice and supporting material on *Deferred Tax: Recovery of Underlying Assets (Amendments to IAS 12)* ('the Amendments'). In order to do that, EFRAG has been carrying out an assessment of the Amendments against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

A summary of the Amendments is set out in Appendix 1.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

**EFRAG initial assessments summarised in this questionnaire will be amended to reflect EFRAG's decisions on Appendix 2 and 3.**

1 Please provide the following details about yourself:

- (a) Your name or, if you are responding on behalf of an organisation or company, its name:

Belgian Accounting Standards Board

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- (b) Are you a:

Preparer  User  Other (please specify)

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*Amendments to IAS 12 – Invitation to Comment on EFRAG’s Initial Assessments*

(c) Please provide a short description of your activity:

Belgian Standard Setter

(d) Country where you are located:

Belgium

(e) Contact details including e-mail address:

Jan.verhoeve@cnc-cbn.be

2 EFRAG’s initial assessment of the Amendments is that they meet the technical criteria for endorsement. In other words, they are not contrary to the principle of true and fair and they meet the criteria of understandability, relevance, reliability and comparability. EFRAG’s reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

Yes                       No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG’s endorsement advice.

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(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of the Amendments? If there are, what are those issues and why do you believe they are relevant to the evaluation?

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3 EFRAG is also assessing the costs that are likely to arise for preparers and for users on implementation of the Amendments in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment are set out in paragraphs 2-10 of Appendix 3. To summarise, EFRAG’s initial assessment is that the Amendments will not significantly affect the costs for preparers and users.

Do you agree with this assessment?

X Yes  No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

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- 4 In addition, EFRAG is assessing the benefits that are likely to be derived from the Amendments. The results of this initial assessment are set in paragraphs 11-14 of Appendix 3. To summarise, EFRAG’s initial assessments is that users are likely to benefit from the Amendments because the information provided is likely to be less subjective and therefore enhance comparability of information. However, as noted in paragraph 14, there are no benefits to users in the rare cases where the Amendments are likely to result in information that is not relevant.

Do you agree with this assessment?

x Yes  No

If you do not agree with this assessment, please explain why and please explain what you think the implications should be for EFRAG’s endorsement advice?

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- 5 EFRAG’s initial assessment is that the benefits to be derived from implementing the Amendments in the EU as described in paragraph 4 above are likely to outweigh the costs involved as described in paragraph 3 above.

Do you agree with this assessment?

x Yes  No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG’s endorsement advice?

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- 6 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on the Amendments.

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Do you agree that there are no other factors?

x Yes                       No

If you do not agree, please explain why and please explain what you think the implications should be for EFRAG’s endorsement advice?

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## **APPENDIX 1**

### **A SUMMARY OF THE AMENDMENTS**

#### **Background**

- 1 IAS 12 requires an entity to recognise a deferred tax liability or asset (and a corresponding deferred tax expense or income) for the estimated future tax consequences of temporary differences.
- 2 Temporary differences arise when the accounting treatment and the tax treatment for a transaction differ in a given year, and create a difference between the carrying amount of an asset or a liability in the financial statements and its tax base.
- 3 IFRSs might require assets (or liabilities) to be measured at something other than depreciated cost – such as fair value or current value. However, for tax purposes the tax base of the underlying assets (liabilities) might not be adjusted, or the adjustment might be for a different amount than that reflected in the IFRS financial statements.
- 4 Under IAS 12, deferred tax liabilities are measured on a basis that reflects the manner in which the entity expects to recover the underlying asset that will generate the future tax expense in a future period.
- 5 In some jurisdictions, an entity will pay income tax if it recovers an asset by using it in its operations, but will not pay income tax if it recovers the asset through sale. Typically, this will occur in jurisdictions that 'tax' the profits generated by using an asset (for example, by earning rental income), but do not tax the gain realised if the asset is sold. In this case:
  - (a) if an entity expects to recover the asset only through use, it recognises a deferred tax liability.
  - (b) if an entity expects to recover the asset only through sale, it recognises no deferred tax liability.

#### **The issue**

- 6 An entity might 'recover' the carrying amount of an investment property by using the asset for a period of time (to earn rental income) and then sell it subsequently. In such cases, the carrying amount of the investment property will be recovered in two different ways and may be taxed based on different tax rates. Specifically, the Amendments apply to investment property measured at fair value under IAS 40 *Investment Property*.
- 7 Some entities may not have a current intention to sell the investment property, but this may change depending on market conditions or other events. Accordingly, management's expectation is that investment properties are held for an indeterminate period.
- 8 Under IAS 12, the calculation of deferred tax should reflect the underlying 'dual' purpose of recovery of the asset. However, the standard does not provide specific guidance on how this should be done, and how a 'dual' measurement approach should be applied.

## What has changed?

### *The rebuttable presumption*

- 9 The Amendments note that it is often difficult and subjective to determine the expected manner of recovery. To provide a practical approach in such cases, the Amendments introduce an exception to the measurement principle in IAS 12 in the form of a rebuttable presumption that assumes that the carrying amount of an investment property measured at fair value will be recovered through sale and an entity will be required to use the tax rate applicable to the sale of underlying asset.
- 10 The Amendments do not apply to other types of assets such as tangible assets and intangible assets measured under the revaluation model or financial assets measured at fair value.
- 11 In some cases, an entity might recover the fair value of a depreciable investment property measured at fair value by consuming its economic benefits over its useful life. The IASB acknowledged that in such cases it would not be appropriate to assume that the asset will be ‘recovered’ through sale, because the accounting outcome of using the exception in those cases would not reflect the real tax consequences of recovering the asset. An entity is required to rebut the presumption *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.

## When do the Amendments become effective?

- 12 The Amendments are effective for annual periods beginning on or after 1 January 2012. Earlier application is permitted. If an entity applies the Amendments from an earlier date, it shall disclose that fact.

## APPENDIX 2

### EFRAG’S TECHNICAL ASSESSMENT OF THE AMENDMENTS AGAINST THE ENDORSEMENT CRITERIA

*In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG’s capacity as a contributor to the IASB’s due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.*

*In the latter capacity, EFRAG’s role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG’s thinking may evolve.*

#### **Does the accounting that results from the application of the Amendments meet the technical criteria for EU endorsement?**

- 1 EFRAG has considered whether the Amendments meet the requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that the Amendments:
  - (a) are not contrary to the ‘true and fair’ set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
  - (b) meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.
- 2 EFRAG also considered whether it had any evidence that it would not be conducive to the European public good to adopt the Amendments.

#### *Relevance*

- 2 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.
- 3 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.
- 4 The Amendments introduce an exception in the form of a rebuttable presumption to the measurement principle in IAS 12. The Amendments require an entity to measure deferred tax on investment property carried at fair value, based on the tax consequences of selling that asset, unless an entity rebuts this presumption. 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 Amendments are intended to provide relief to entities that find it difficult to determine the manner of recovery of *depreciable* investment property measured at fair value, and thereby reduce subjectivity.

- 5 A fundamental principle in existing IAS 12 is to measure deferred taxes based on the manner in which an entity expects to recover the carrying amount of an asset. As explained below, the relevance of information produced under the Amendments is unaffected in most circumstances, because entities will rebut the presumption in paragraph 51C of the Amendments when it is appropriate to do so.
- 6 The information resulting from the application of the Amendments would be relevant in the following circumstances:
  - (a) When an entity has a clear expectation of recovering the carrying amount of the investment property through sale.
  - (b) If the investment property 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. In this case, the presumption would be rebutted and the measurement principle in IAS 12 would apply.
- 7 In EFRAG’s view, only in rare circumstances would an entity, produce information that does not reflect the real tax consequences that are expected to arise when the underlying asset is recovered. Such circumstances might arise when an entity does not have sufficient evidence to rebut the presumption, even though it might be more appropriate to do so.
- 8 The IFRS Interpretations Committee discussed a request to clarify whether the presumption can be rebutted in cases other than the case described in paragraph 51C of the Amendments. As noted in the November 2011 IFRIC Update, the IFRS Interpretations Committee commented that a presumption is a matter of policy in applying a principle (or an exception) in IFRSs, which can be rebutted when there is sufficient evidence to overcome it. The Committee also noted that the Amendments do not preclude the presumption to be rebutted in circumstances other than those in paragraph 51C. On this basis, the Committee decided not to take the issue to its agenda.
- 9 EFRAG agrees that the Amendments do not provide an exhaustive list of cases in which the presumption in paragraph 51C can be rebutted and do not preclude the presumption from being rebutted in other cases. Furthermore, if the presumption is rebutted, an entity must apply the measurement principles in IAS 12.
- 10 For the reasons stated above, EFRAG’s initial assessment is that the Amendments satisfy the relevance criterion.

#### *Reliability*

- 11 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 12 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.



- 13 Under the existing IAS 12, in the absence of specific plans to dispose of an investment property, an entity is required to estimate the portion of its carrying value that is expected to be recovered through future cash flows from use (for example rental income) and the portion that is expected to be recovered through cash flows from its sale. In some cases, it is difficult to undertake this exercise, given the degree of subjectivity involved in assessing future recovery of an asset.
- 14 The Amendments aim to reduce the subjectivity by shifting the focus away from the notion of ‘manner of recovery’ for investment property measured at fair value, and introducing a single measurement approach that provides relief to entities that find it difficult to determine the manner of recovery of investment property. This approach does not involve significant judgements or estimates, and would not raise any significant issues with regard to freedom from material error and bias, faithful representation or completeness.
- 15 For the reasons stated above, EFRAG’s initial assessment is that the Amendments satisfy the reliability criterion.

#### *Comparability*

- 16 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 17 EFRAG has considered whether the Amendments result in transactions that are:
  - (a) economically similar being accounted for differently; or
  - (b) transactions that are economically different being accounted for as if they are similar.
- 18 As explained above, the Amendments introduce a single measurement approach to calculate deferred tax on investment property measured at fair value. Therefore, the measurement of deferred tax balances of like investment properties held at fair value would be accounted for in a consistent way.
- 19 However, in the rare cases identified in paragraph 7 above, where information produced by the Amendments is not relevant, the information would represent transactions as similar when they are not.
- 20 For the reasons stated above, EFRAG’s initial assessment is that the Amendments satisfy the comparability criterion.

#### *Understandability*

- 21 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.
- 22 Although there are a number of aspects to the notion of ‘understandability’, EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

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- 23 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments is understandable, is whether that information will be unduly complex.
- 24 As previously explained the Amendments aim to provide relief to those entities that find it difficult to determine the manner of recovery of investment property measured at fair value, and do not introduce new accounting requirements.
- 25 EFRAG’s initial assessment is that the Amendments do not introduce any new complexities that may impair understandability and therefore satisfies the understandability criterion.

*True and Fair*

- 26 EFRAG has initially decided that the information resulting from the application of the Amendments would not be contrary to the principle of true and fair view.

*European public good*

- 27 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt the Amendments.

**Conclusion**

- 28 For the reasons set out above, EFRAG’s initial assessment is that the Amendments satisfy the technical criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

## **APPENDIX 3**

### **EFRAG’S EVALUATION OF THE COSTS AND BENEFITS OF THE AMENDMENT**

- 1 EFRAG has also considered whether, and if so to what extent, implementing the Amendments in the EU might result in incremental costs for preparers and/or users, and whether those costs are likely to be exceeded by the benefits to be derived from its adoption.

#### **Cost for preparers**

- 2 EFRAG has carried out an initial assessment of the cost implications for preparers resulting from the Amendments.
- 3 Entities holding investment property at fair value, with the intention to rent them out for a period of time and then sell them, previously had to consider the tax consequences of both use and sale when measuring deferred taxes. In some cases preparers find it difficult to determine the manner of recover of investment property in dual use scenarios.
- 4 The rebuttable presumption provides relief to those preparers and requires them to consider a single manner of recovery of the carrying amount of investment property held at fair value. For these preparers the Amendments are likely to result in an overall reduction of costs both upon the implementation phase and on an on-going basis.
- 5 Some preparers will be required to assess whether the carrying amount of the investments property held will be consumed through use over time, rather than through sale. Existing IAS 12 requires an entity to assess the manner in which it expects to recover investment property. This assessment also requires a degree of judgement and involves a similar level of administrative burden. Therefore, the Amendments are unlikely to increase the administrative burden significantly for entities that have previously been able to establish how they expect to recover investment property carried at fair value.
- 6 As such, EFRAG’s initial assessment is that the Amendments will not significantly affect the costs for preparers.

#### **Costs for users**

- 7 EFRAG has carried out an initial assessment of the cost implications for users resulting from the Amendments.
- 8 Users are expected to incur some incremental costs to incorporate the new requirements, resulting from the Amendments, into their analysis.
- 9 EFRAG believes that there are two factors to consider:
  - (a) The reduction in the degree of subjectivity when an entity applies the exception is likely to provide users with information that is more comparable and, as a result, generate cost savings to users.
  - (b) If the relevance and comparability of information is adversely affected by requiring entities to produce financial information on a basis that does not

reflect actual fact, users may need to perform additional work to understand the tax position of those entities.

- 10 Overall, EFRAG’s initial assessment is that the Amendments will not significantly affect the costs for users.

**Benefits for preparers and users**

- 11 EFRAG has carried out an initial assessment of the benefits for preparers and users resulting from the Amendments.
- 12 EFRAG’s initial assessment is that the Amendments will result in benefits for those preparers that will use the exemption, while other preparers remain unaffected.
- 13 Users are also likely to benefit from the Amendments to the extent that the information they obtain is less subjective, and as a result more reliable.
- 14 However, as explained above, there are no benefits to users in the rare cases where the Amendments result in information that is not relevant.

*Conclusion*

- 15 EFRAG’s overall initial assessment is that the benefits to be derived from implementing the Amendments are likely to outweigh the costs involved.

## APPENDIX 4

### DISSENTING OPINION

- 1 One EFRAG TEG member dissents from recommending endorsement of *Deferred Tax: Recovery of Underlying Assets (Amendments to IAS 12)* (‘the Amendments’). That EFRAG TEG member’s views are explained in this appendix.
- 2 The EFRAG TEG member believes that the Amendments should not be endorsed for use in the European Union and therefore dissents from EFRAG’s tentative decision to recommend its endorsement. This EFRAG TEG member has reached this conclusion because he believes aspects of the Amendments do not meet the criteria for endorsement. In particular:
  - (a) Paragraph 51C of the amended IAS 12 requires that, in measuring deferred tax on an investment property carried at fair value, there is a rebuttable presumption that the carrying amount of the investment property will be recovered through sale. In the view of this EFRAG TEG member, this presumption of recovery through sale is unnecessary, and may result in measurement of tax at an amount which is misleading.
  - (b) As IASB note in paragraph BC8 to the Amendments, IAS 12 includes a 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. Paragraph BC8 further notes that in many cases, 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. In the view of this EFRAG TEG member, the principle is adequate to deal with investment property which is used and then sold, and should result in deferred tax that reflects a period of use followed by sale. In practice, the resulting amount of deferred tax may be the same as that based on an assumption of sale. In such cases the Amendments are unnecessary, and promote a rule-based approach at the expense of principles.
  - (c) In cases where the resulting amount of deferred tax under the Amendments differs from the tax based on an assumption of use followed by sale, as occurs in the ‘Example illustrating paragraph 51C’, the deferred tax calculated under the Amendments will not represent a best estimate of future cash flows and may thus be misleading.