STAFF PAPER

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IFRS® Interpretations Committee Meeting

Project	**IAS 12 *Income Taxes***
Paper topic	Expected manner of recovery of indefinite life intangible assets when measuring deferred tax

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Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') received a request to clarify the determination of the expected manner of recovery of indefinite life intangible assets for the purposes of measuring deferred tax. The question arises when:

   (a) for financial reporting purposes, an intangible asset is considered to have an indefinite life and is therefore not amortised applying IAS 38 *Intangible Assets*;

   (b) the applicable tax law allows or requires the asset to be amortised and the amortisation is deductible in determining taxable income; and

   (c) as a result, the asset's tax base differs from its carrying amount.

2. In that scenario, the submitter asked whether an entity should calculate deferred tax relating to the temporary difference that arises using the tax rate (and tax base) applicable to ordinary taxable income or to capital gains (ie should an entity consider the expected manner of recovery of the carrying amount of the intangible asset to be through use or through sale?).

3. The Interpretations Committee discussed the issue in May 2016[1]. At that meeting the Interpretations Committee observed that when measuring deferred tax on indefinite life intangible assets, an entity applies paragraphs 51 and 51A of IAS 12 *Income Taxes* in reflecting the tax consequences that follow from the expected manner of recovery of the carrying amount of those assets.

4. However, during the discussion, an Interpretations Committee member suggested that the Interpretations Committee could go further in clarifying how to determine the expected manner of recovery in this situation. It could do so by exploring the interaction between how an asset is amortised and the requirements in paragraphs 51 and 51A of IAS 12.

5. The objective of this paper is to analyse the interaction between amortisation of an indefinite life intangible asset vis-à-vis the recovery of its carrying amount, and recommend a revised tentative agenda decision that reflects our analysis.

6. This paper is structured as follows:

   (a) background information;

   (b) staff analysis;

   (c) assessment against the Interpretations Committee's agenda criteria;

   (d) staff recommendation;

   (e) questions for the Interpretations Committee;

   (f) Appendix A— Tentative agenda decision; and

   (g) Appendix B—Extracts from IAS 12 and IAS 38.

[1] http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2016/May/AP10-IAS_12-Expected_manner_of_recovery_of_indefinite_life_intangible_assets.pdf

Background

The submission

7. Paragraph 88 of IAS 38 states that an entity regards the useful life of an intangible asset to be indefinite when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate cash inflows for the entity. Common examples of such assets include brands and perpetual licences to use intellectual property.

8. Paragraph 107 of IAS 38 states that an entity does not amortise intangible assets with an indefinite useful life. Instead, the entity:

    (a) tests such an intangible asset for impairment at least annually; and

    (b) reviews the useful life of the intangible asset each period to determine whether events and circumstances continue to support an indefinite useful life assessment.

9. Paragraph 51 of IAS 12 requires that the measurement of deferred tax assets and liabilities should reflect the tax consequences that follow from the manner in which an entity expects to recover or settle the carrying amount of its assets and liabilities. Paragraph 51A explains this principle further.

10. Paragraphs 51B and 51C provide requirements regarding the determination of the expected manner of recovery of the carrying amount of non-depreciable assets and investment property measured using the fair value model in IAS 40 *Investment Property*. More specifically, paragraph 51B requires an entity to measure deferred tax arising from a non-depreciable asset measured using the revaluation model in IAS *16 Property, Plant and Equipment* to reflect the tax consequences of recovering the carrying amount through sale.

11. The submitter thinks that divergent views exist in applying IAS 12 with respect to determining the expected manner of recovery of the carrying amount of an indefinite life intangible asset.

12. The submitter identified the following views:

    (a) View 1—Use the tax rate (and tax base) applicable to ordinary taxable income unless there is a current plan to sell the asset in question.

    (b) View 2—Use the tax rate (and tax base) that would apply if the asset were sold.

    (c) View 3—Select the appropriate tax rate as an accounting policy choice.

The Interpretations Committee's discussions in May 2016

13. The following is a summary of the Interpretations Committee's discussion at its meeting in May 2016[2]:

    (a) Interpretations Committee members broadly agreed with the analysis and conclusion in the paper that the requirements in paragraph 51B of IAS 12 do not apply to indefinite life intangible assets.

    (b) one Interpretations Committee member commented that the tentative agenda decision did not sufficiently reflect the staff analysis that the requirements in paragraph 51 and 51A are applicable in determining the expected manner of recovery of an indefinite life intangible asset.

    (c) another Interpretation Committee member raised a few concerns regarding the tentative agenda decision:

        (i) although agreeing with the staff's conclusion about the applicability of the requirements in paragraph 51B to indefinite life intangible assets, the member was of the view that this was not the question asked in the submission;

        (ii) that member thought that the submission asked for clarification about how the requirements in paragraph 51 and 51A are applied in determining the expected manner of recovery of an indefinite life intangible asset; and

[2] http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2016/May/AP10-IAS_12-Expected_manner_of_recovery_of_indefinite_life_intangible_assets.pdf

(iii) the member suggested that the tentative agenda decision should clarify the interaction between how an asset is amortised and the recovery of its carrying amount. The member thinks that, in practice, amortisation of an asset is often construed as recovery of its carrying amount. Accordingly, when an asset is not amortised, the conclusion is often that its carrying amount is expected to be recovered through sale, rather than use.

Staff analysis

14. In the May 2016 staff paper [3], our analysis focused on whether an indefinite life intangible asset is a non-depreciable asset. In that paper, we explained that:

(a) an indefinite life intangible asset is not a non-depreciable asset as envisaged in paragraph 51B of IAS 12. An intangible asset is regarded as an asset with an indefinite life when there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity. However, this does not mean that the asset's useful life is unlimited or infinite;

(b) the requirements in paragraph 51B do not apply to indefinite life intangible assets; and

(c) accordingly, an entity applies the general principle and requirements in paragraphs 51 and 51A of IAS 12 when measuring deferred tax arising from such intangible assets.

15. When amending IAS 38 in 2004[4], the International Accounting Standards Board (the Board) observed that an indefinite life intangible asset is not amortised because there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in the asset and, hence, amortisation over an arbitrarily determined maximum period would not be representationally faithful. Therefore, we think the reason for not amortising an

[3] Paragraphs 26-28, AP 13, IFRIC May 2016

[4] BC74-BC75 of IAS 38 (reproduced in Appendix B).

indefinite life intangible asset is not because there is no consumption of the future economic benefits embodied in the asset. Rather, it is because there is no foreseeable limit on the period during which an entity expects to consume such future economic benefits.

16. Furthermore, in the context of the recognition of deferred tax liabilities and deferred tax assets, paragraph 16 of IAS 12 explains that:

> It is inherent in the recognition of an asset that its carrying amount will be recovered in the form of economic benefits that flow to the entity in future periods […].

17. Consequently, we think that:

(a) the carrying amount of an indefinite life intangible asset is recovered in the form of economic benefits that flow to the entity in future periods;

(b) those economic benefits could flow to the entity through use or through sale of the asset; and

(c) not amortising an indefinite life intangible asset does not necessarily mean that the economic benefits flow to the entity, in future periods, only through sale and not through use.

Assessment against the Interpretations Committee's agenda criteria

18. Our assessment of the Interpretations Committee's agenda criteria is as follows:

Paragraph 5.16 of the Due Process Handbook states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
that have widespread effect and have, or are expected to have, a material effect on those affected;	**Met.** Although it is unclear from the outreach conducted exactly how widespread the issue is, a number of respondents noted that the issue is common within some jurisdictions and can be significant, particularly within the context of business combinations.

Paragraph 5.16 of the Due Process Handbook states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	**<u>Met.</u>** The feedback received from some respondents to the outreach, and the guidance within the published literature of a number of the large accounting firms, indicates that there are diverse interpretations of the application of paragraph 51 of IAS 12 to indefinite life intangible assets.
that can be resolved efficiently within the confines of existing IFRS Standards and the *Conceptual Framework for Financial Reporting*.	**<u>Not met.</u>** We think that the existing requirements in IFRS Standards are sufficient with respect to this issue.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	Not applicable
The solution developed should be effective for a reasonable time period (paragraph 5.21).	Not applicable

Staff recommendation

19. On the basis of our analysis in paragraphs 14-17 of this paper, we think that paragraphs 51 and 51A of IAS 12 provide sufficient requirements with respect to the measurement of deferred tax assets and liabilities arising on indefinite life intangible assets.

20. In addition, we think that the non-amortisation of indefinite life intangible assets has no bearing on the manner of recovering its carrying amount. Accordingly, even though an entity does not amortise an indefinite life intangible asset, the entity might nonetheless expect to recover its carrying amount through use.

21. On the basis of our analysis and the assessment of the Interpretations Committee's agenda criteria, we recommend that the Interpretations Committee should not add this issue to its agenda.

22. We have set out proposed wording for the tentative agenda decision in **Appendix A** to this paper.

Questions for the Interpretations Committee

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff recommendation not to add this issue to its agenda? 2. Does the Interpretations Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

Appendix A—Tentative agenda decision

A1. We propose the following wording for the tentative agenda decision.

IAS 12 *Income Taxes— Expected manner of recovery of indefinite life intangible assets when measuring deferred tax*

The Interpretations Committee received a request to clarify the determination of the expected manner of recovery of an indefinite life intangible asset for the purposes of measuring deferred tax.

The Interpretations Committee noted that paragraph 51 of IAS 12 *Income Taxes* states that the measurement of deferred tax liabilities and deferred tax assets should reflect the tax consequences that follow from the manner in which an entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

The Interpretations Committee also noted the requirements in paragraph 88 of IAS 38 *Intangible Assets* regarding indefinite life intangible assets.

The Interpretations Committee observed that an indefinite life intangible asset is not a non-depreciable asset as envisaged by paragraph 51B of IAS 12. This is because a non-depreciable asset is an asset that has an unlimited (or infinite) life, and IAS 38 explains that indefinite does not mean infinite. Consequently, the requirements in paragraph 51B of IAS 12 do not apply to indefinite life intangible assets.

The Interpretations Committee noted the Board's observation about indefinite life intangible assets. When amending IAS 38 in 2004, the Board observed that an indefinite life intangible asset is not amortised because there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in the asset and, hence, amortisation over an arbitrarily determined maximum period would not be representationally faithful. Therefore, the reason for not amortising an indefinite life intangible asset is not because there is no consumption of the future economic benefits embodied in the asset.

The Interpretations Committee observed that an entity recovers the carrying amount of an asset in the form of economic benefits that flow to the entity in future periods, which could be through use or sale of the asset. Consequently, even though an entity does not amortise an indefinite life intangible asset, this does not necessarily mean that the entity will recover the carrying amount of that asset only through sale, and not through use.

The Interpretations Committee noted that an entity applies the principle and requirements in paragraphs 51 and 51A of IAS 12 when measuring deferred tax on an indefinite life intangible asset. In applying paragraphs 51 and 51A of IAS 12, an entity determines its expected manner of recovery of the carrying amount of the indefinite life intangible asset, and reflects the tax consequences that follow from that expected manner of recovery.

The Interpretations Committee concluded that the principle and requirements in paragraph 51 and 51A of IAS 12 provide sufficient requirements with respect to measuring deferred tax on indefinite life intangible assets.

In the light of existing requirements in IFRS Standards, the Interpretations Committee determined that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee [decided] not to add this issue to its agenda.

Appendix B
Extracts from IAS 12 and IAS 38

B1. Paragraph 51 of IAS 12 *Incomes Taxes* notes that (emphasis added):

> 51 The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from <u>the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities</u>.

B2. Paragraphs 88 and 91 of IAS 38 *Intangible Assets* note that (emphasis added):

> 88 ... An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, <u>there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.</u>
>
> …
>
> 91 <u>The term 'indefinite' does not mean 'infinite'.</u> The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset's useful life, and the entity's ability and intention to reach such a level. A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.

B3. Paragraphs BC74-BC75 of IAS 38 *Intangible Assets* note that:

> BC74 In developing the Exposure Draft and the revised Standard, the Board observed that many assets yield benefits to an entity over several periods. Amortisation is the systematic allocation of the cost (or revalued amount) of an asset, less any residual value, to reflect the consumption over time of the future economic benefits embodied in that asset. Thus, if there is no foreseeable

limit on the period during which an entity expects to consume the future economic benefits embodied in an asset, amortisation of that asset over, for example, an arbitrarily determined maximum period would not be representationally faithful. Respondents to the Exposure Draft generally supported this conclusion.

BC75 Consequently, the Board decided that intangible assets with indefinite useful lives should not be amortised, but should be subject to regular impairment testing. The Board's deliberations on the form of the impairment test, including the frequency of impairment testing, are included in the Basis for Conclusions on IAS 36. The Board further decided that regular re-examinations should be required of the useful life of an intangible asset that is not being amortised to determine whether circumstances continue to support the assessment that the useful life is indefinite.