IFRS

STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	New items for initial consideration
Paper topic	IAS 12 *Income Taxes*—Expected manner of recovery of indefinite life intangible assets when measuring deferred tax

CONTACT(S) Prahalad Halgeri phalgeri@ifrs.org +44 (0)20 7246 6905

This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS Standard do not purport to be acceptable or unacceptable application of that IFRS Standard—only the IFRS Interpretations Committee or the International Accounting Standards Board® (the "Board") can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

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 in 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 objective of this paper is to provide the Interpretations Committee with a summary of the issue and the staff's research, analysis and recommendation.

Structure of the paper

4. This paper is structured as follows:

   (a) background information;

   (b) summary of outreach conducted;

   (c) staff analysis;

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

   (e) staff recommendation;

   (f) questions for the Interpretations Committee;

   (g) Appendix A— Tentative agenda decision;

   (h) Appendix B—Submission; and

   (i) Appendix C—Extracts from IAS 12 *Income Taxes* and IAS 38.

Background information

What the requirements say

5. 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.

6. 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.

7. Paragraph 51of 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.

8. 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.

The submission

9. The submitter thinks that, currently, 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.

10. 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.* Applying View 1, an entity would apply the general principle and requirements in paragraph 51 of IAS 12 when measuring deferred tax arising from indefinite life intangible assets. In doing so, the entity would conclude that, in the absence of a plan to sell the intangible asset, the expected manner of recovery of the asset is through use as part of the entity's trading operations. View 1 distinguishes a non-depreciable asset with an unlimited useful life (for example, land) from an asset that is not depreciated because it has an indefinite life.

    (b) **View 2**—*Use the tax rate (and tax base) that would apply if the asset were sold*. Applying View 2, an entity would apply paragraph 51B of IAS 12 by analogy and, thus, the entity would conclude that the carrying amount of an indefinite life intangible asset would be

recovered through sale, rather than through use. Some proponents of View 2 might restrict the application of paragraph 51B of IAS 12 to intangible assets for which the manner of recovery is not expected to be through use.

(c) **View 3**—*Select the appropriate tax rate as an accounting policy choice*. Applying View 3, an entity might select either to apply paragraph 51B of IAS 12 to indefinite life intangible assets, or alternatively apply View 1.

11. A more detailed description of each view, and its basis, are set out in Appendix B to this paper.

Summary of outreach conducted

12. In order to gather information about the issue described in the submission, we sent requests to securities regulators, members of the International Forum of Accounting Standard-Setters (IFASS) and the global IFRS technical teams of the international networks of the large accounting firms. Specifically, we asked:

Q1. How common is the issue in the stakeholder's jurisdiction?

Q2. If the issue is common, what is the predominant approach used to determine the expected manner of recovery of the carrying amount of indefinite life intangible assets, and to what extent has diversity in the application of the requirements of paragraph 51 of IAS 12 been observed?

13. We asked for examples, if available.

Responses received

14. We received 17 responses from the following respondents:

(a) nine national standard-setters;

(b) two regulator groups; and

(c) the global IFRS technical teams of six of the large accounting firms.

15. The views received represent informal opinions and do not reflect the formal views of those organisations.

16. The majority of the standard-setters commented that the issue is not common in their respective jurisdictions, and only one member of each of the regulator groups indicated that the issue is common. Of the two standard-setters and members of the regulator groups that indicated that the issue is common in their jurisdictions, only one said that they had observed diversity in practice, and in that case all three views had been observed. The others indicated that they think that practice is consistent with View 1.

17. However, the majority of the large accounting firms noted that the issue is common in some jurisdictions and also that there is diversity in practice. Indeed, as noted in the submission, each of the views included in the submission (Views 1, 2 and 3 summarised in paragraph 10 above) is expressed in the published literature of at least one large accounting firm. Some of the accounting firms also noted that this can be a significant issue in business combinations, including business combinations under common control. One firm noted that the issue becomes more significant when the deferred tax liability on an indefinite lived intangible asset is a potential source of income to support the recognition of a deferred tax asset.

18. The accounting firms provided differing views about the predominant approach applied—one is of the view that an entity should apply the principles in paragraph 51 and 51A of IAS 12; another noted that the predominant approach observed in practice is View 1; another noted that, in their view, it is difficult to support View 1 because of the requirements in paragraph 51B of IAS 12; another would support View 3; and another noted that they have a published position that allows an entity to apply paragraph 51B by analogy.

Staff analysis

19. Paragraphs 51 and 51A of IAS 12 set out the general principle and requirements regarding the measurement of deferred tax—ie an entity 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.

20. Paragraphs 51B and 51C provide more specific requirements for two particular categories of assets—paragraph 51B applies to deferred tax arising from a non-depreciable asset measured using the revaluation model in IAS 16; paragraph 51C applies to deferred tax arising from investment property measured using the fair value model in IAS 40.

21. The requirements in paragraph 51B of IAS 12 relating to non-depreciable assets using the revaluation model in IAS 16 were previously contained in SIC Interpretation 21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets*. Paragraph BC6 of IAS 12 carries forward the basis that the Standing Interpretations Committee gave for the conclusions it reached in developing that Interpretation. It includes a statement to say that recognition of depreciation implies that the carrying amount of a depreciable asset is expected to be recovered through use to the extent of its depreciable amount, and through sale at its residual value. Paragraph BC6 further provides land as an example of a non-depreciable asset and says that consistently with this, the carrying amount of a non-depreciable asset such as land having an unlimited life will be recovered only through sale.

22. When amending IAS 12 in 2010 to include the requirements relating to investment property measured using the fair value model in IAS 40, the Board initially proposed that the requirements in paragraph 51C should be applied not only to investment property measured using the fair value model, but also to property, plant and equipment or intangible assets measured using the revaluation model in IAS 16 or IAS 38. However, many respondents disagreed with that proposal. As explained in paragraph BC14 of the Basis for Conclusions on IAS 12, many respondents disagreed with the presumption of recovery through sale for intangible assets because, in their view, many intangible assets are

recovered through use rather than through sale. Some respondents had also warned of unintended consequences that could arise because of the varying nature of intangible assets. Accordingly, on the basis of the feedback received, the Board decided against finalising that proposal.

23. Within the context of this issue, we therefore think that the question to ask is whether an indefinite life intangible asset is a non-depreciable asset.

Is an indefinite life intangible asset a non-depreciable asset?

What is a non-depreciable asset?

24. IAS 16 does not provide a definition of 'non-depreciable asset', but on the basis of the requirements in IAS 16, we think that a depreciable asset is an asset with a limited (or finite) useful life and a non-depreciable asset is an asset with an unlimited (or infinite) useful life.

25. In the context of land and buildings, paragraph 58 of IAS 16 explains:

> […] land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets.

Is an indefinite life intangible asset a non-depreciable asset?

26. Paragraph 88 of IAS 38 explains that an entity regards an intangible asset as having an indefinite useful life when there is no foreseeable limit to the period over which the assets is expected to generate net cash inflows for the entity. Paragraph 91 of IAS 38 explains that 'the term 'indefinite' does not mean 'infinite'.

27. In our view, an indefinite life intangible asset is not a non-depreciable asset, because having an indefinite useful life does not mean having an unlimited (or infinite) useful life, such as is typically the case for land. The useful life of an intangible asset is indefinite when the cash flows associated with the asset are expected to continue for many years or even indefinitely (but not infinitely). When an intangible asset has an indefinite useful life, the asset is not depreciated, because there is no foreseeable limit on the period during which an entity expects

to consume the future economic benefits embodied in an asset. However, this does not mean that the asset's useful life is unlimited. In other words, an entity will have to start amortising the asset's carrying amount when the limit to which the entity can consume the economic benefit embodied in that asset becomes foreseeable.

28. Consequently, we are of the view that the requirements in paragraph 51B of IAS 12 do not apply to indefinite life intangible assets. 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. Those paragraphs require an entity to use the tax rate (and tax base) that is consistent with the entity's expected manner of recovery of the carrying amount of the intangible asset. An entity's assessment of the expected manner of recovery will require judgement. Nonetheless, we think that the requirements in IAS 12 are sufficient in this respect.

Assessment against the Interpretations Committee's agenda criteria

29. Our assessment of the Interpretations Committee's agenda criteria is as follows:[1]

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.

[1] These criteria can be found in the *IFRS Foundation Due Process Handbook* .

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	**Met.** 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 IAS12 to indefinite life intangible assets.
that can be resolved efficiently within the confines of existing IFRS Standards and the *Conceptual Framework for Financial Reporting*.	**Not met.** 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

30. On the basis of our analysis in paragraphs 19-28 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.

31. In addition, we note that, when amending IAS 12 in 2010, the Board considered including specific requirements relating to deferred tax arising from intangible assets measured using the revaluation model in IAS 38 but, on the basis of the feedback received, decided not to do so. Given this earlier decision by the Board,

we see no reason to recommend amending IAS 12 to specifically address deferred tax arising from indefinite life intangible assets.

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

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

Questions for the Interpretations Committee

Questions to 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 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 *Intangible Assets* explains that indefinite does not mean infinite.

Consequently, an entity would not apply the requirements in paragraph 51B of IAS 12 to indefinite life intangible assets. Instead, the entity would apply the principle and requirements in paragraphs 51 and 51A of IAS 12. Accordingly, when measuring deferred tax, the entity would reflect the tax consequences that follow from its expected manner of recovery of the carrying amount of an indefinite life intangible asset.

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
Submission

B1. The submission has been reproduced below. We have deleted details that would identify the submitter of this request.

…

Suggested agenda item: Determining the expected manner of recovery for the purposes of calculating deferred tax on indefinite life intangible assets

It has come to our attention that there are diverse views on the determination of the expected manner of recovery of an indefinite life intangible asset for the purposes of measuring deferred tax assets or liabilities arising on those assets. We are seeking clarification by the Committee of the issue detailed below.

The issue

In accordance with paragraph 107 of IAS 38 *Intangible Assets*, intangible assets with indefinite lives are not amortised. Common examples of such assets include brands and perpetual licences to use intellectual property. As is stated in paragraph 88 of IAS 38, the life of an intangible asset is concluded to be indefinite when, based on an analysis of all of the relevant factors, there is not foreseeable limit to the period over which the asset is expected to generate cash inflows for the entity.

In many jurisdictions, the tax treatment of such an asset differs between its continued use in the business (for example, allowing deductions over a period determined by tax law that reduce the amount of income tax calculated at a rate applicable to trading profits) and its disposal (for example, deducting the tax base of the asset from a capital gain taxed at a different rate).

In such circumstances, should deferred tax on the asset be calculated using the tax rate (and tax base) applicable to trading profits or to capital gains?

View 1 – At the tax rate (and tax base) applicable to trading profits unless there is a current plan to sell the asset in question

In accordance with the general requirements of paragraph 51 of IAS 12 *Income Taxes*, the measurement of deferred tax should reflect the tax consequences that would follow from the manner in which the entity expects to recover the asset. In the absence of a plan to sell an intangible asset, that expectation is recovery as part of an entity's trading operations.

Proponents of this view draw a distinction between a *non-depreciable* asset with an *unlimited* life (land being the only asset assumed to have those qualities) and an asset that is *not depreciated* because it has an *indefinite* life (an assessment that is subject to an annual review). Proponents would further argue that the economic benefits of such an asset are (in the absence of its sale) consumed through its use in the business, but over an uncertain period that may be recognised in the financial statements by commencement of amortisation following the annual

review of useful life required by IAS 38:109 or on a non-systematic basis (through a future impairment assessment).

Conversely, once there is a plan to sell an intangible asset with an indefinite life in place at the end of the reporting period then the expected manner of recovery would be through sale and the tax base and tax rate used to calculate the related deferred taxes should both be based on this assumption.

View 2 – At the tax rate (and tax base) applicable to sale of the asset

Proponents of this view believe that many of the reasons given in the Basis for Conclusions on theDecember 2010 amendments to IAS 12 to require deferred tax on a non-depreciable asset to reflect the tax consequences of recovery through sale also apply to an indefinite life intangible asset and that, as such, the requirements of IAS 12:51B should be applied by analogy. Specifically, such assets may be considered to have a high residual value that is not reduced by use and that, as noted in IAS 12:BC13 in the context of intangible assets measured using the revaluation model, determining the expected manner of recovery will be difficult and subjective.

Some proponents of this view would restrict application of paragraph 51B to intangible assets whose carrying amounts are not expected to be consumed through use. In particular, some would see any impairment of an intangible asset as evidence that its value has been consumed through use and, therefore, that once an impairment has occurred (unless there is a current plan to sell) the tax rate (and base) applicable to trading profits should be applied.

View 3 – Accounting policy choice

Proponents of this view believe that application of paragraph 51B is available (possibly subject to facts and circumstances) as an accounting policy choice but that it is not required and, as such, View 1 remains acceptable.

Reasons for the Committee to address the issue

Currently, divergent views can be demonstrated to exist as each of the views above is expressed in the published literature of at least one large accounting firm.

Recognition of indefinite life intangible assets is common, particularly in the context of business combinations, and the tax effects of sale and use in the business are markedly different in many jurisdictions.

In addition, the issue is not related to a Board project that is expected to be completed in the near future.

For these reasons, we believe that this issue meets the criteria for acceptance onto the Committee's agenda.

…

Appendix C
Extracts from IAS 12 and IAS 38

C1. Paragraph 51 of IAS 12 *Incomes Taxes* notes that (emphasis added):

> The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from 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.

C2. Paragraph 88 of IAS 38 *Intangible Assets* notes that (emphasis added):

> ... 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, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.

C3. Paragraph 91 of IAS 38 *Intangible Assets* notes that (emphasis added):

> The term 'indefinite' does not mean 'infinite'. 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.