# Snapshot

by Capital Markets & Accounting Advisory Services (CMAAS)

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# Amendments to IAS 12 on Deferred Tax related to Assets and Liabilities arising from a Single Transaction

## What is the issue?

IAS 12 exempts companies from recognising deferred tax when they recognise assets or liabilities for the first time. There has been some uncertainty about whether this exemption applies to situations where both asset and liability are recognised at the same time in a single transaction. For example, at the lease commencement date, it is not clear whether lessees could apply the exemption to right-of-use assets and lease liabilities. Similarly, it is not clear whether companies could apply the exemption to decommissioning obligations and the corresponding amounts recognised as part of the cost of the related asset.

Due to the uncertainty, there is diversity in practice where some companies have recognised deferred taxes in such situations whilst others have not recognised any deferred tax. To promote consistent application of accounting standards, the International Accounting Standards Board has issued the amendments to IAS 12 to clarify how this exemption should be applied in the above situations.

## What are the key amendments?

The amendments clarify that the exemption in IAS 12 from recognising the deferred taxes does **not** apply to transactions where an asset and a liability are recognised at the same time resulting in equal amounts of taxable and deductible temporary differences. In other words, a temporary difference that arises on initial recognition of an asset or liability is **not** subject to the exemption in IAS 12 if that transaction gave rise to equal amounts of taxable and deductible temporary differences.

This essentially means that lessees would not be able to apply the exemption in IAS 12 for the right-of-use assets and the lease liabilities. Similarly, companies recognising decommissioning liabilities would also not be able to apply the exemption in IAS 12.

## Illustrative example

**Fact pattern**

Entity A (lessee) enters into a 5-year lease of a building. The annual lease payments are RM100 million payable at the end of each year.

At the lease commencement date, applying IFRS 16, Entity A recognises a right-of-use asset (ROU asset) and lease liability at an equal amount of RM435 million (measured at the present value of the 5 lease payments of RM100 million, discounted at the interest rate of 5% per year).

The tax law allows tax deductions for lease payments when Entity A makes the payments. After considering the applicable tax law, Entity A concludes that the tax deductions on the lease payments relate to the repayment of the lease liability. The applicable tax rate is 24%.

**Analysis**

| At the lease commencement date | Guidance note | ROU asset (RM million) | Lease liability (RM million) |
|---|---|---|---|
| Carrying amount | | 435 | (435) |
| Tax base | GN1 | 0 | 0 |
| Deductible/(taxable) temporary differences | GN2, GN3 | (435) | 435 |
| Deferred tax asset / (liability) (@ 24%) | | (104) | 104 |

**GN1 -** In accordance with IAS 12.7, tax base of an asset is the future deductible amount when the asset's carrying amount is recovered and tax base of a liability is the liability's carrying amount less future deductible amounts.

Applying the principle to the above fact pattern:

- Tax base of ROU asset is nil as no tax deductions are available on the ROU asset.
- Tax base of lease liability is nil because Entity A will receive tax deductions equal to the carrying amount of the lease liability.

**GN2 -** In accordance with the amendments to IAS 12, the exemption in IAS 12 from recognising the deferred taxes does not apply because the transaction gives rise to equal amounts of taxable and deductible temporary differences.

**GN3 -** In this case, Entity A concludes that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised.

## When is the effective date?

The amendments are effective for annual reporting periods beginning on or after 1 January 2023, with early application permitted. At the date of publication, the Malaysian Accounting Standards Board has not issued the equivalent amendments to MFRS 112, however we expect these amendments will be adopted in due course.

## What are the transition provisions?

Companies shall apply the amendments to transactions that occur on or after the beginning of the earliest comparative period presented. Companies applying the amendments shall also, at the beginning of the earliest comparative period presented:

(a) recognise a deferred tax asset – to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised – and a deferred tax liability for all deductible and taxable temporary differences associated with:
- right-of-use assets and lease liabilities; and
- decommissioning liabilities, and the corresponding amounts recognised as part of the cost of the related asset; and

(b) recognise the cumulative effect of initial application in the opening balance of retained earnings at that date.

## What is the impact and for whom?

Companies that have substantial balances of right-of-use assets, lease liabilities, decommissioning obligations and have currently adopted the policy not to recognise deferred taxes for leases and decommissioning obligations would need to recognise the additional deferred taxes when the amendments become effective.

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| **Do you need further information on this topic?** | Contact: Ha Thanh Ngo \| Assurance Senior Manager from PwC Malaysia CMAAS<br>Email: ha.thanh.ngo@pwc.com Tel: +60 (3) 2173 0771 |
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