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Exposure Draft ED/2009/2

# Income Tax

Comments to be received by 31 July 2009



International  
Accounting Standards  
Board®

**Exposure Draft**  
**INCOME TAX**

*Comments to be received by 31 July 2009*

**ED/2009/2**

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## CONTENTS

*paragraphs*

## INTRODUCTION AND INVITATION TO COMMENT

**[DRAFT] INTERNATIONAL FINANCIAL REPORTING STANDARD X  
INCOME TAX**

CORE PRINCIPLE	1
SCOPE	2–4
STEPS IN ACCOUNTING FOR INCOME TAX	5
CURRENT TAX	6–8
DEFERRED TAX	9
ASSETS AND LIABILITIES FOR WHICH THE RECOVERY OR SETTLEMENT IS NOT EXPECTED TO AFFECT TAXABLE PROFIT	10–13
TAX BASIS	14–16
TEMPORARY DIFFERENCES	17–19
DEFERRED TAX LIABILITIES AND ASSETS	20–22
VALUATION ALLOWANCE	23
MEASUREMENT	24–28
PRESENTATION	29–39
Allocation of current and deferred tax to components of comprehensive income and equity	29–34
Tax assets and tax liabilities	35
Offset	36–37
Exchange differences on foreign tax liabilities or assets	38
Interest and penalties	39
DISCLOSURE	40–49
Analysis of tax expense recognised in profit or loss	41–44
Tax expense recognised in other comprehensive income or equity	45
Analysis of changes in deferred tax assets and liabilities	46–47
Other disclosures	48–49
TRANSITION AND EFFECTIVE DATE	50–52
WITHDRAWAL OF OTHER IFRSs	53–54
APPENDIX A	
Defined terms	

INCOME TAX

**APPENDIX B**

**Application guidance**

Investments in subsidiaries and joint ventures	B1–B9
Temporary differences arising on initial recognition	B10–B13
Temporary differences arising on remeasurement to fair value	B14–B15
Valuation allowance	B16–B25
Measurement	B26–B33
Allocation of current and deferred tax	B34–B43
Recognition of tax benefits	B34–B36
Groups with a consolidated tax return	B37
Deferred tax arising from a business combination	B38–B40
Current and deferred tax arising from share-based payment transactions	B41–B43
Presentation	B44–B46

**APPENDIX C**

**Amendments to other IFRSs**

**Amendments to guidance on other IFRSs**

**APPROVAL BY THE BOARD OF *INCOME TAX* PUBLISHED  
IN MARCH 2009**

**BASIS FOR CONCLUSIONS** (*see separate booklet*)

**TABLE OF CONCORDANCE** (*see separate booklet*)

## Introduction

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- IN1 This exposure draft contains proposals by the International Accounting Standards Board for an International Financial Reporting Standard (IFRS) on income tax to replace IAS 12 *Income Taxes*. The draft IFRS includes proposals on the treatment of uncertain tax amounts.
- IN2 The Board undertook this project for two reasons. First, it has received many requests to clarify various aspects of IAS 12. Second, the Board and the US Financial Accounting Standards Board (FASB) agreed to consider the accounting for income tax as part of their work to reduce differences between IFRSs and US generally accepted accounting principles (GAAP).
- IN3 IAS 12 and SFAS 109 *Accounting for Income Taxes* share a common approach—the temporary difference approach—the objective of which is to recognise the tax that would be payable or receivable if the entity’s assets and liabilities were recovered or settled at their present carrying amount. However, the standards include different exceptions to the temporary difference approach. There are also differences between the standards relating to the recognition and measurement of deferred tax assets and liabilities and the allocation of tax to the components of comprehensive income and equity.
- IN4 The boards decided that it would be appropriate to remove almost all of the exceptions to the temporary difference approach in IAS 12 and SFAS 109, resulting in simpler requirements based more on principle. They also decided on largely common requirements for the recognition and measurement of tax assets and liabilities. The decisions in the project would, if implemented in a standard, resolve the issues raised with the IASB by users of IAS 12.
- IN5 The FASB had originally intended to publish proposals to amend SFAS 109 for the decisions made in the project. However, in September 2008 it announced that it would review its strategy for short-term convergence projects in the light of the possibility that some or all US public companies might be permitted or required to adopt IFRSs at some future date. As part of that review, it will solicit input from US constituents by issuing an Invitation to Comment containing the IASB’s proposed replacement of IAS 12. At the conclusion of that review, the FASB will decide whether to undertake projects that would eliminate differences in the accounting for tax by adopting the IFRS.
- IN6 The Basis for Conclusions accompanying the exposure draft includes a summary of the differences between the proposals in the exposure draft and US GAAP.

## Significant changes to IAS 12

- IN7 The proposals in the exposure draft retain the fundamental requirements in IAS 12 to use the temporary difference approach to determine deferred tax assets and liabilities.
- IN8 The proposed main changes from IAS 12 are:
- (a) changes to the definition of tax basis. Tax basis would be defined as:
    - the measurement under applicable substantively enacted tax law of an asset, liability or other item.
  - (b) an additional specification that the tax basis of an asset is determined by the tax deductions that would be available if the entity recovered the carrying amount of the asset by sale. This replaces the requirement in IAS 12 that the tax basis depends on how the entity expects to recover the carrying amount of an asset. But it is proposed that those expectations would determine whether any deferred tax asset or liability arises (see (c)) and, as required by IAS 12, may affect the measurement of any temporary difference.
  - (c) the introduction of an initial step in determining deferred tax assets and liabilities so that no deferred tax arises in respect of an asset or liability if there will be no effect on taxable profit when the entity recovers or settles its carrying amount.
  - (d) introduction of definitions of tax credit and investment tax credit as follows:
    - Tax credit* is a tax benefit that takes the form of an amount that reduces income tax payable.
    - Investment tax credit* is a tax credit that relates directly to the acquisition of depreciable assets.
  - (e) removal of the initial recognition exception in IAS 12. That exception prohibits an entity from recognising deferred tax assets and liabilities that arise when an asset or liability has a tax basis different from its initial carrying amount, except in a business combination or in a transaction affecting accounting or taxable profit. Instead, the exposure draft introduces a proposal for the initial measurement of assets and liabilities that have tax bases different from their initial carrying amounts. Such assets and liabilities are disaggregated into (i) an asset or liability excluding entity-specific tax effects and (ii) any entity-specific tax advantage

or disadvantage. An entity would recognise and measure the former in accordance with IFRSs and recognise a deferred tax asset or liability for any resulting temporary difference between the carrying amount and the tax basis. If the consideration paid or received differs from the total recognised amounts of the acquired assets and liabilities (including deferred tax), an entity recognises the difference as an allowance against, or premium on, the deferred tax asset or liability.

- (f) changes to the exception in IAS 12 from the temporary difference approach relating to a deferred tax asset or liability arising from investments in subsidiaries, branches, associates and joint ventures. The proposed exception is restricted to investments in foreign subsidiaries, joint ventures or branches that are essentially permanent in duration. No exception is proposed for associates.
- (g) a proposal to recognise deferred tax assets in full, less, if applicable, a valuation allowance to reduce the net carrying amount to the highest amount that is more likely than not to be realisable against taxable profit. This approach replaces the existing single-step recognition of the portion of a deferred tax asset for which realisation is probable.
- (h) additional guidance on assessing the realisability of deferred tax assets, including the treatment of significant expenses for any relevant tax planning strategies.
- (i) a proposal that current and deferred tax assets and liabilities should be measured using the probability-weighted average amounts of possible outcomes assuming that the tax authorities will examine the amounts reported to them by the entity and have full knowledge of all relevant information. IAS 12 is silent on the treatment of uncertainty over tax amounts.
- (j) clarification that 'substantively enacted' means that future events required by the enactment process historically have not affected the outcome and are unlikely to do so.
- (k) a change to the requirements relating to the tax effects of distributions to shareholders. An entity would measure current and deferred tax assets and liabilities using the rate expected to apply when the tax asset or liability is realised or settled, including the effect of the entity's expectations of future distributions. This would replace the requirement in IAS 12 to use the undistributed rate.

## INCOME TAX

- (l) adoption of the SFAS 109 requirements for the allocation of income tax expense to the components of comprehensive income and equity. In particular, some changes in tax effects that were initially recognised outside continuing operations would be recognised in continuing operations.
- (m) classification of deferred tax assets and liabilities as either current or non-current on the basis of the financial reporting classification of the related non-tax asset or liability. IAS 1 *Presentation of Financial Statements* requires all deferred tax to be classified as non-current.
- (n) clarification that the classification of interest and penalties is an accounting policy choice and hence must be applied consistently, and introduction of a requirement to disclose the chosen policy.

IN9 A table of concordance showing how IAS 12 and the exposure draft correspond is set out after the Basis for Conclusions. Examples developed by the IASB staff that illustrate some aspects of the proposals in the exposure draft are available on the IASB website ([www.iasb.org](http://www.iasb.org)).

### **Invitation to comment**

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The International Accounting Standards Board invites comments on all matters in this exposure draft, particularly on the questions set out below. Comments are most helpful if they:

- (a) comment on the questions as stated
- (b) indicate the specific paragraph or paragraphs to which the comments relate
- (c) contain a clear rationale
- (d) include any alternative the Board should consider, if applicable.

Respondents should submit comments in writing so as to be received no later than 31 July 2009.

#### *Question 1 - Definitions of tax basis and temporary difference*

The exposure draft proposes changes to the definition of tax basis so that the tax basis does not depend on management's intentions relating to the recovery or settlement of an asset or liability. It also proposes changes to the definition of a temporary difference to exclude differences that are not expected to affect taxable profit. (See paragraphs BC17–BC23 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

*Question 2 – Definitions of tax credit and investment tax credit*

The exposure draft would introduce definitions of tax credit and investment tax credit. (See paragraph BC24 of the Basis for Conclusions.)

Do you agree with the proposed definitions? Why or why not?

*Question 3 – Initial recognition exception*

The exposure draft proposes eliminating the initial recognition exception in IAS 12. Instead, it introduces proposals for the initial measurement of assets and liabilities that have tax bases different from their initial carrying amounts. Such assets and liabilities are disaggregated into (a) an asset or liability excluding entity-specific tax effects and (b) any entity-specific tax advantage or disadvantage. The former is recognised in accordance with applicable standards and a deferred tax asset or liability is recognised for any temporary difference between the resulting carrying amount and the tax basis. Outside a business combination or a transaction that affects accounting or taxable profit, any difference between the consideration paid or received and the total amount of the acquired assets and liabilities (including deferred tax) would be classified as an allowance or premium and recognised in comprehensive income in proportion to changes in the related deferred tax asset or liability. In a business combination, any such difference would affect goodwill. (See paragraphs BC25–BC35 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

*Question 4 – Investments in subsidiaries, branches, associates and joint ventures*

IAS 12 includes an exception to the temporary difference approach for some investments in subsidiaries, branches, associates and joint ventures based on whether an entity controls the timing of the reversal of the temporary difference and the probability of it reversing in the foreseeable future. The exposure draft would replace these requirements with the requirements in SFAS 109 and APB Opinion 23 *Accounting for Income Taxes—Special Areas* pertaining to the difference between the tax basis and the financial reporting carrying amount for an investment in a foreign subsidiary or joint venture that is essentially permanent in duration. Deferred tax assets and liabilities for temporary differences related to such investments are not recognised. Temporary differences associated with branches would be treated in the same way as temporary differences associated with investments in subsidiaries. The exception in IAS 12 relating to investments in associates would be removed.

## INCOME TAX

The Board proposes this exception from the temporary difference approach because the Board understands that it would often not be possible to measure reliably the deferred tax asset or liability arising from such temporary differences. (See paragraphs BC39–BC44 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not? Do you agree that it is often not possible to measure reliably the deferred tax asset or liability arising from temporary differences relating to an investment in a foreign subsidiary or joint venture that is essentially permanent in duration? Should the Board select a different way to define the type of investments for which this is the case? If so, how should it define them?

### *Question 5 – Valuation allowances*

The exposure draft proposes a change to the approach to the recognition of deferred tax assets. IAS 12 requires a one-step recognition approach of recognising a deferred tax asset to the extent that its realisation is probable. The exposure draft proposes instead that deferred tax assets should be recognised in full and an offsetting valuation allowance recognised so that the net carrying amount equals the highest amount that is more likely than not to be realisable against taxable profit. (See paragraphs BC52–BC55 of the Basis for Conclusions.)

#### *Question 5A*

Do you agree with the recognition of a deferred tax asset in full and an offsetting valuation allowance? Why or why not?

#### *Question 5B*

Do you agree that the net amount to be recognised should be the highest amount that is more likely than not to be realisable against future taxable profit? Why or why not?

### *Question 6 – Assessing the need for a valuation allowance*

#### *Question 6A*

The exposure draft incorporates guidance from SFAS 109 on assessing the need for a valuation allowance. (See paragraph BC56 of the Basis for Conclusions.)

Do you agree with the proposed guidance? Why or why not?

*Question 6B*

The exposure draft adds a requirement on the cost of implementing a tax strategy to realise a deferred tax asset. (See paragraph BC56 of the Basis for Conclusions.)

Do you agree with the proposed requirement? Why or why not?

*Question 7 – Uncertain tax positions*

IAS 12 is silent on how to account for uncertainty over whether the tax authority will accept the amounts reported to it. The exposure draft proposes that current and deferred tax assets and liabilities should be measured at the probability-weighted average of all possible outcomes, assuming that the tax authority examines the amounts reported to it by the entity and has full knowledge of all relevant information. (See paragraphs BC57–BC63 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

*Question 8 – Enacted or substantively enacted rate*

IAS 12 requires an entity to measure deferred tax assets and liabilities using the tax rates enacted or substantively enacted by the reporting date. The exposure draft proposes to clarify that substantive enactment is achieved when future events required by the enactment process historically have not affected the outcome and are unlikely to do so.

(See paragraphs BC64–BC66 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

*Question 9 – Sale rate or use rate*

When different rates apply to different ways in which an entity may recover the carrying amount of an asset, IAS 12 requires deferred tax assets and liabilities to be measured using the rate that is consistent with the expected manner of recovery. The exposure draft proposes that the rate should be consistent with the deductions that determine the tax basis, ie the deductions that are available on sale of the asset. If those deductions are available only on sale of the asset, then the entity should use the sale rate. If the same deductions are also available on using the asset, the entity should use the rate consistent with the expected manner of recovery of the asset. (See paragraphs BC67–BC73 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

*Question 10 – Distributed or undistributed rate*

IAS 12 prohibits the recognition of tax effects of distributions before the distribution is recognised. The exposure draft proposes that the measurement of tax assets and liabilities should include the effect of expected future distributions, based on the entity's past practices and expectations of future distributions. (See paragraphs BC74–BC81 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

*Question 11 – Deductions that do not form part of a tax basis*

An entity may expect to receive tax deductions in the future that do not form part of a tax basis. SFAS 109 gives examples of 'special deductions' available in the US and requires that 'the tax benefit of special deductions ordinarily is recognized no earlier than the year in which those special deductions are deductible on the tax return'. SFAS 109 is silent on the treatment of other deductions that do not form part of a tax basis.

IAS 12 is silent on the treatment of tax deductions that do not form part of a tax basis and the exposure draft proposes no change. (See paragraphs BC82–BC88 of the Basis for Conclusions.)

Do you agree that the exposure draft should be silent on the treatment of tax deductions that do not form part of a tax basis? If not, what requirements do you propose, and why?

*Question 12 – Tax based on two or more systems*

In some jurisdictions, an entity may be required to pay tax based on one of two or more tax systems, for example, when an entity is required to pay the greater of the normal corporate income tax and a minimum amount. The exposure draft proposes that an entity should consider any interaction between tax systems when measuring deferred tax assets and liabilities. (See paragraph BC89 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

*Question 13 – Allocation of tax to components of comprehensive income and equity*

IAS 12 and SFAS 109 require the tax effects of items recognised outside continuing operations during the current year to be allocated outside continuing operations. IAS 12 and SFAS 109 differ, however, with respect to the allocation of tax related to an item that was recognised outside continuing operations in a prior year. Such items may arise from changes in the effect of

uncertainty over the amounts reported to the tax authorities, changes in assessments of recovery of deferred tax assets or changes in tax rates, laws, or the taxable status of the entity. IAS 12 requires the allocation of such tax outside continuing operations, whereas SFAS 109 requires allocation to continuing operations, with specified exceptions. The IAS 12 approach is sometimes described as requiring backwards tracing and the SFAS 109 approach as prohibiting backwards tracing.

The exposure draft proposes adopting the requirements in SFAS 109 on the allocation of tax to components of comprehensive income and equity. (See paragraphs BC90–BC96 of the Basis for Conclusions.)

*Question 13A*

Do you agree with the proposed approach? Why or why not?

The exposure draft deals with allocation of tax to components of comprehensive income and equity in paragraphs 29–34. The Board intends those paragraphs to be consistent with the requirements expressed in SFAS 109.

*Question 13B*

Would those paragraphs produce results that are materially different from those produced under the SFAS 109 requirements? If so, would the results provide more or less useful information than that produced under SFAS 109? Why?

The exposure draft also sets out an approach based on the IAS 12 requirements with some amendments. (See paragraph BC97 of the Basis for Conclusions.)

*Question 13C*

Do you think such an approach would give more useful information than the approach proposed in paragraphs 29–34? Can it be applied consistently in the tax jurisdictions with which you are familiar? Why or why not?

*Question 13D*

Would the proposed additions to the approach based on the IAS 12 requirements help achieve a more consistent application of that approach? Why or why not?

*Question 14 – Allocation of current and deferred taxes within a group that files a consolidated tax return*

IAS 12 is silent on the allocation of income tax to entities within a group that files a consolidated tax return. The exposure draft proposes that a systematic and rational methodology should be used to allocate the portion of the current and deferred income tax expense for the consolidated entity to the separate or individual financial statements of the group members. (See paragraph BC100 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

*Question 15 – Classification of deferred tax assets and liabilities*

The exposure draft proposes the classification of deferred tax assets and liabilities as current or non-current, based on the financial statement classification of the related non-tax asset or liability. (See paragraphs BC101 and BC102 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

*Question 16 – Classification of interest and penalties*

IAS 12 is silent on the classification of interest and penalties. The exposure draft proposes that the classification of interest and penalties should be a matter of accounting policy choice to be applied consistently and that the policy chosen should be disclosed. (See paragraph BC103 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

*Question 17 – Disclosures*

The exposure draft proposes additional disclosures to make financial statements more informative. (See paragraphs BC104–BC109 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

The Board also considered possible additional disclosures relating to unremitted foreign earnings. It decided not to propose any additional disclosure requirements. (See paragraph BC110 of the Basis of Conclusions.)

Do you have any specific suggestions for useful incremental disclosures on this matter? If so, please provide them.

*Question 18 – Effective date and transition*

Paragraphs 50–52 of the exposure draft set out the proposed transition for entities that use IFRSs, and paragraph C2 sets out the proposed transition for first-time adopters. (See paragraphs BC111–BC120 of the Basis for Conclusions.)

Do you agree with these proposals? Why or why not?

## INCOME TAX

[Draft] International Financial Reporting Standard X *Income Tax* ([draft] IFRS X) is set out in paragraphs 1–54 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the [draft] IFRS. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. [Draft] IFRS X should be read in the context of its core principle and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## **[Draft] International Financial Reporting Standard X Income Tax**

### **Core principle**

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- 1 An entity shall recognise tax liabilities, tax assets and tax expense for current tax, which is tax payable or refundable on taxable profit for the current and past periods. An entity shall also recognise tax liabilities, tax assets and tax expense for deferred tax, which is tax payable or recoverable on taxable profit for future periods as a result of past transactions or events. Such tax arises because of the difference between the amounts recognised for the entity's assets and liabilities in the statement of financial position and the recognition of those assets and liabilities by the tax authorities, and the carryforward of currently unused tax losses and tax credits.

### **Scope**

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- 2 This [draft] IFRS establishes the accounting for income tax. Income tax includes all domestic and foreign tax that is based on taxable profit. Income tax for a parent or investor in an associate or joint venture also includes tax payable on distributions (for example, withholding tax) by the subsidiary on behalf of the parent, or by an associate or joint venture on behalf of the investor.
- 3 Taxable profit is often not the same as profit or loss. Nonetheless, taxable profit implies a net amount of income and expense rather than a gross amount or individual item.
- 4 This [draft] IFRS does not apply to government grants (see IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*) or investment tax credits. However, it applies to the accounting for temporary differences that may arise from such grants or investment tax credits.

### **Steps in accounting for income tax**

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- 5 An entity shall account for income tax by following the steps (a)–(i) below:
- (a) recognise current tax, measured at an amount that includes the effect of the possible outcomes of a review by the tax authorities (paragraphs 6–8).

## INCOME TAX

- (b) identify which assets and liabilities would be expected to affect taxable profit if they were recovered or settled for their present carrying amounts (paragraphs 10–13).
- (c) determine the *tax basis* at the end of the reporting period of the assets and liabilities in (b), and of other items that have a tax basis. The tax basis is determined by the consequences of the sale of the assets or settlement of liabilities for their present carrying amounts (paragraphs 14–16).
- (d) compute any temporary differences, unused tax losses and unused tax credits (paragraphs 17–19).
- (e) recognise *deferred tax assets* and *liabilities* arising from the temporary differences, unused tax losses and unused tax credits (paragraphs 20–22).
- (f) measure deferred tax assets and liabilities at an amount that includes the effect of the possible outcomes of a review by the tax authorities using tax rates that, on the basis of substantively enacted tax law at the end of the reporting period, are expected to apply when the deferred tax asset is realised or the deferred tax liability is settled (paragraphs 24–28).
- (g) recognise a *valuation allowance* against deferred tax assets so that the net amount equals the highest amount that is more likely than not to be realisable against taxable profit (paragraph 23).
- (h) allocate current and deferred tax to the related components of comprehensive income and equity, and classify tax assets as current or non-current (paragraphs 29–37).
- (i) disclose the required information (paragraphs 40–49).

### **Current tax**

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- 6 An entity shall recognise a current tax liability for tax payable on taxable profit for the current and past periods. If the amount paid for the current and past periods exceeds the amount payable for those periods, the entity shall recognise the excess as a current tax asset.**
- 7 An entity shall recognise a current tax asset for the benefit of a tax loss that can be carried back to recover tax paid in a previous period.**

- 8 An entity shall include in the amounts recognised in accordance with paragraphs 6 and 7 the effect of the possible outcomes of a review by the tax authorities, measured in accordance with paragraph 26.

### **Deferred tax**

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- 9 An entity shall recognise a deferred tax asset or liability for tax recoverable or payable in future periods as a result of past transactions or events. Such tax arises from the difference between the amounts recognised for the entity's assets and liabilities in the statement of financial position and the recognition of those assets and liabilities by the tax authorities, and the carryforward of currently unused tax losses and tax credits.

### **Assets and liabilities for which the recovery or settlement is not expected to affect taxable profit**

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- 10 If there will be no effect on taxable profit when the entity recovers the carrying amount of an asset or settles the carrying amount of a liability, no deferred tax arises in respect of the asset or liability. This will happen when:
- (a) no taxable income or amounts deductible from taxable income arise on the recovery or settlement of the carrying amount, or
  - (b) equal taxable income and amounts deductible from taxable income arise, having a nil net effect, or
  - (c) a nil tax rate applies to any taxable or deductible amounts. In this case, although the recovery or settlement of the carrying amount may affect taxable profit, in practice the effect is the same as the situation described in (a).
- 11 In some tax jurisdictions, whether any of paragraph 10(a)–(c) applies depends on the manner in which the asset is recovered or liability is settled. If an entity expects to recover the carrying amount of an asset or settle the carrying amount of a liability in a manner that means that any of paragraph 10(a)–(c) applies, no deferred tax arises in respect of the asset or liability.

## INCOME TAX

- 12 In accordance with paragraphs 10 and 11, paragraphs 14–22 apply only to:
- (a) assets and liabilities for which the entity expects the recovery or settlement of the carrying amount to affect taxable profit, and
  - (b) other items that have a tax basis (see paragraph 16).
- 13 An entity might expect to recover the carrying amount of an asset or settle the carrying amount of a liability in a period in which it expects to pay no current tax, for example because of tax losses. Nonetheless, if the entity expects the recovery or settlement of the carrying amount of an asset or liability to affect the amount of taxable profit in that period, a deferred tax asset or liability relating to the asset or liability may exist in accordance with paragraphs 14–22.

### **Tax basis**

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- 14 An entity shall determine the tax basis of an asset, liability or other item in accordance with substantively enacted law. If the entity files a consolidated tax return, the tax basis is determined by the tax law governing the consolidated tax return. If the entity files separate tax returns for different operations, the tax basis is determined by the tax laws governing each tax return.
- 15 The tax basis determines the amounts that will be included in taxable profit on recovery or settlement of the carrying amount of an asset or liability. Specifically:
- (a) the tax basis of an asset equals the amount that would have been deductible against taxable income in arriving at taxable profit if the carrying amount of the asset had been recovered through sale at the end of the reporting period. If the recovery of the asset through sale does not give rise to taxable income, the tax basis shall be deemed to be equal to the carrying amount.
  - (b) the tax basis of a liability equals its carrying amount less any amounts deductible against taxable income (or plus any amounts included in taxable income) that would have arisen if the liability had been settled for its carrying amount at the end of the reporting period. In the case of deferred revenue, the tax basis of the resulting liability is its carrying amount, less any amount of revenue that will not be taxable in future periods.

- 16 Some items have a tax basis but are not recognised as assets and liabilities. For example, research costs are recognised as an expense when they are incurred but may not be permitted as a deduction in determining taxable profit until a future period. Thus, the carrying amount of the research costs is nil and the amount that will be deducted in future periods is the tax basis. An equity instrument issued by the entity may also give rise to deductions in a future period. There is no asset or liability in the statement of financial position, but the tax basis is the amount of the future deductions.

### **Temporary differences**

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- 17 Temporary differences arise:
- (a) when there is a difference between the carrying amounts and tax bases on the initial recognition of assets and liabilities, or at the time a tax basis is created for those items that have a tax basis but are not recognised as assets and liabilities.
  - (b) when a difference between the carrying amount and tax basis arises after initial recognition because income or expense is recognised in comprehensive income or equity in one reporting period but is recognised in taxable profit in a different period.
  - (c) when the tax basis of an asset or liability changes and the change will not be recognised in the asset or liability's carrying amount in any period.
- 18 There are two types of temporary difference:
- (a) differences between the carrying amounts of individual assets and liabilities and their tax bases in the tax jurisdiction in which the assets, liabilities and tax basis reside. These include differences between the carrying amount of nil and the tax basis of items that have a tax basis but are not recognised as assets and liabilities.
  - (b) differences between the carrying amount of investments in a subsidiary or joint venture and the tax basis of those investments in the tax jurisdiction of the parent or investor (see paragraphs B1–B9).
- 19 Paragraphs 10–13 discuss the recovery or settlement of assets or liabilities that do not affect taxable profit. Those paragraphs apply to the recovery or settlement of individual assets and liabilities. Whether an entity expects to recover its investment in a subsidiary or joint venture without

affecting taxable profit does not affect the recognition of deferred tax assets and liabilities relating to the individual assets and liabilities of the subsidiary or joint venture in the entity's consolidated financial statements.

### **Deferred tax liabilities and assets**

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- 20 Except as required by paragraph 21, an entity shall recognise:
- (a) a deferred tax liability for all temporary differences that are expected to increase taxable profit in the future.
  - (b) a deferred tax asset for all temporary differences that are expected to reduce taxable profit in the future.
  - (c) a deferred tax asset for the carryforward of unused tax losses and unused tax credits.
- 21 An entity shall not recognise a deferred tax liability that arises on the initial recognition of goodwill, or any subsequent changes in that deferred tax liability. An entity shall recognise deferred tax liabilities and deferred tax assets for investments in subsidiaries and joint ventures in accordance with paragraphs B1–B9.
- 22 In recognising a deferred tax asset or liability, an entity shall apply the following paragraphs:
- (a) for temporary differences arising on the initial recognition of an asset or liability, paragraphs B10–B13
  - (b) for temporary differences arising on the remeasurement of an asset or liability at fair value, paragraphs B14 and B15.

### **Valuation allowance**

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- 23 An entity shall recognise a valuation allowance against deferred tax assets so that the net amount equals the highest amount that is more likely than not to be realisable against taxable profit. In determining when to recognise a valuation allowance, an entity shall apply paragraphs B16–B25.

## Measurement

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- 24 **An entity shall measure current tax assets and liabilities using the tax rates and tax laws that have been substantively enacted at the end of the reporting period.**
- 25 **An entity shall measure deferred tax assets and liabilities recognised in accordance with paragraph 20 at the tax rates that, on the basis of tax rates and tax laws that have been substantively enacted at the end of the reporting period, are expected to apply when the deferred tax asset is realised or the deferred tax liability is settled.**
- 26 Uncertainty about whether the tax authorities will accept the amounts reported to them by the entity affects the amount of current tax and deferred tax. An entity shall measure current and deferred tax assets and liabilities using the probability-weighted average amount of all the possible outcomes, assuming that the tax authorities will examine the amounts reported to them and have full knowledge of all relevant information. Changes in the probability-weighted average amount of all possible outcomes shall be based on new information, not a new interpretation by the entity of previously available information.
- 27 In measuring tax assets and liabilities, an entity shall apply the following paragraphs:
- (a) on substantive enactment of tax rates, paragraph B26
  - (b) on a change in tax status, paragraph B27
  - (c) when different tax rates apply to different levels of income or different ways of recovering the asset, paragraphs B28–B30
  - (d) for the tax effects of distributions of profit or retained earnings to shareholders, paragraphs B31 and B32
  - (e) when tax is based on two or more tax systems, paragraph B33.
- 28 An entity shall not discount deferred tax assets and liabilities. However, this does not affect the determination of temporary differences, which are calculated by reference to a carrying amount even when the carrying amount is determined on a discounted basis.

## Presentation

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### **Allocation of current and deferred tax to components of comprehensive income and equity**

- 29 **An entity shall recognise tax expense arising at the time of transactions and other events in the same component of comprehensive income (ie continuing operations, discontinued operations, or item in other comprehensive income) or equity in which it recognises the transaction or other event.**
- 30 An entity shall determine the tax expense arising from transactions and other events it recognises in continuing operations without including any effect of items recognised outside continuing operations, except when determining the tax benefit arising from a loss in continuing operations. In that case, an entity shall include in the determination of the tax benefit arising from the loss in continuing operations the effect on that tax benefit of items recognised in all components of comprehensive income and equity.
- 31 An entity shall determine the tax expense arising from items it recognises outside continuing operations as the difference between the total tax expense including the tax effect of the item and the total tax expense excluding the tax effect of the item.
- 32 In determining the tax expense for each component of comprehensive income and equity, an entity shall apply the following paragraphs:
- (a) for tax benefits, paragraphs B34 and B35
  - (b) for tax for groups filing a consolidated tax return, paragraph B37
  - (c) for deferred tax arising in a business combination, paragraphs B38–B40
  - (d) for tax arising from share-based payment transactions, paragraphs B41–B43.
- 33 **An entity shall recognise subsequent changes in the amounts previously recognised as tax expense as follows:**
- (a) **changes in a valuation allowance, in accordance with paragraph B36**
  - (b) **all other changes, in continuing operations.**

- 34 If the sum of the separately calculated tax expenses allocated to each component in accordance with paragraphs 29–33 does not equal the total tax expense, an entity shall:
- (a) allocate to continuing operations the tax expense for continuing operations calculated in accordance with paragraphs 29–33.
  - (b) if there is only one component other than continuing operations, allocate the remaining tax expense to that component.
  - (c) if there is more than one component other than continuing operations, allocate the tax expense remaining after the amount allocated to continuing operations to the other components as follows:
    - (i) Determine the effect on tax expense of the total loss for all loss items recognised outside continuing operations.
    - (ii) Allocate the amount determined in (i) to each loss item pro rata to its individual tax effect.
    - (iii) Determine the amount that remains, ie the difference between the amount to be allocated to all components other than continuing operations and the amount allocated to loss items recognised outside continuing operations.
    - (iv) Allocate the amount determined in (iii) to each remaining item pro rata to its individual tax effect.

*As discussed in paragraph BC97 of the Basis for Conclusions on this exposure draft, paragraphs 29A–34A set out an alternative approach to the allocation of tax to comprehensive income and equity that the Board does not propose to adopt.*

**29A An entity shall recognise tax expense arising at the time of transactions and other events in the same component of comprehensive income (ie continuing operations, discontinued operations, or items of other comprehensive income) or equity as it recognises the transaction or other event. An entity shall recognise subsequent changes in the amounts previously recognised as tax expense in the same component as the tax expense was originally recognised, if practicable. If it is not practicable to determine in which component the tax expense was originally recognised, an entity shall recognise subsequent changes based on a reasonable pro rata allocation of the tax expense of the entity in the tax jurisdiction concerned, or other method that achieves a more appropriate allocation in the circumstances.**

30A An entity shall determine the tax expense arising from transactions and other events recognised in continuing operations without considering any effect of items recognised outside continuing operations, except when determining the tax benefit arising from a loss in continuing operations. In that case, an entity shall consider in the determination of the tax benefit arising from the loss in continuing operations the effect on that tax benefit of items recognised in all components of comprehensive income and equity.

31A An entity shall determine the tax expense arising from items recognised outside continuing operations as the difference between the total tax expense including the tax effect of the item and the total tax expense excluding the tax effect of the item.

32A In recognising tax expense for each component of comprehensive income and equity, an entity shall apply the following paragraphs:

- (a) for tax benefits, paragraphs B34A and B35A
- (b) for changes in tax effects that were not originally recognised in comprehensive income or equity, paragraph B36A
- (c) for tax for groups filing a consolidated tax return, paragraph B37

- (d) for deferred tax arising from a business combination, paragraphs B38-B40
- (e) for tax arising from share-based payment transactions, paragraphs B41-B43.

33A [There is no equivalent to paragraph 33 in this approach.]

34A If the sum of the separately calculated tax expenses recognised in each component in accordance with paragraphs 29A-32A does not equal the total tax expense, an entity shall:

- (a) allocate to continuing operations the tax expense for continuing operations calculated in accordance with paragraphs 29A-32A.
- (b) if there is only one other component, allocate the remaining tax expense to that component.
- (c) if there is more than one component other than continuing operations, allocate the tax expense remaining after the amount recognised in continuing operations to the other components as follows:
  - (i) Determine the effect on tax expense of the total loss for all loss items recognised outside continuing operations.
  - (ii) Allocate the amount determined in (i) to each loss item pro rata with the item's individual tax effect.
  - (iii) Determine the amount that remains, ie the difference between the amount to be allocated to all components other than continuing operations and the amount allocated to loss items recognised outside continuing operations.
  - (iv) Allocate the amount determined in (iii) to each remaining item pro rata to the item's individual tax effect.

### **Tax assets and tax liabilities**

- 35 In a classified statement of financial position, an entity shall disaggregate deferred tax liabilities and assets into a current amount and a non-current amount on the basis of the classification of the related asset or liability. An entity shall classify a deferred tax liability or asset that is not related to a recognised asset or liability on the basis of the date when the entity expects the temporary difference to reverse. An entity shall allocate any valuation allowance for a particular tax jurisdiction pro rata between current and non-current deferred tax assets for that tax jurisdiction.

### **Offset**

- 36 An entity shall offset current tax assets against current tax liabilities when the entity:
- (a) has a legally enforceable right to set off the amounts, and
  - (b) intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

An entity shall apply paragraphs B44 and B45 in determining whether it meets these requirements.

- 37 An entity shall offset deferred tax assets (net of any valuation allowances) against deferred tax liabilities as follows:
- (a) the current amount of deferred tax assets against the current amount of deferred tax liabilities and
  - (b) the non-current amount of deferred tax assets against the non-current amount of deferred tax liabilities

when:

- (c) the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and
- (d) the deferred tax assets and the deferred tax liabilities relate to taxes levied by the same tax authority on either:
  - (i) the same taxable entity; or

- (ii) different taxable entities that intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

When an entity has a legally enforceable right of set-off and an intention to settle net for some periods but not for others, it shall apply paragraph B46.

#### **Exchange differences on foreign tax liabilities or assets**

- 38 IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires the effects of specified exchange differences to be recognised in profit or loss but does not specify how the effects of such differences should be classified. An entity shall make an accounting policy decision on whether to classify as tax expense the effects of such exchange differences on foreign tax liabilities and assets.

#### **Interest and penalties**

- 39 An entity shall make an accounting policy decision whether to classify interest and penalties payable to tax authorities as tax expense.

### **Disclosure**

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- 40 **An entity shall disclose information that informs users of its financial statements about current and deferred tax consequences of recognised transactions and other events.**

#### **Analysis of tax expense recognised in profit or loss**

- 41 An entity shall disclose separately the components of tax expense recognised in profit or loss. Components of tax expense include, for example:
- (a) current tax expense in respect of taxable profit for the current period.
  - (b) any adjustments recognised for current tax of prior periods, including separately the effect of the possible outcomes of a review by the tax authorities, determined in accordance with paragraph 26.

## INCOME TAX

- (c) the amount of deferred tax expense relating to the origination and reversal of temporary differences.
  - (d) the amount of deferred tax expense relating to changes in tax rates or the imposition of new taxes.
  - (e) the effect on deferred tax expense of any change in the effect of the possible outcomes of a review by the tax authorities, determined in accordance with paragraph 26.
  - (f) adjustments to deferred tax expense arising from a change in the tax status of the entity or its shareholders.
  - (g) any change in a valuation allowance, showing separately any change that arises from a tax benefit that reduces current tax expense.
  - (h) the amount of tax expense relating to changes in accounting policies and errors if they are included in profit or loss in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* or specific transitional requirements in another IFRS.
- 42 An entity shall disclose an explanation of the relationship between tax expense recognised in profit or loss and pre-tax profit or loss in either or both of the following forms:
- (a) a numerical reconciliation of tax expense and the product of accounting profit multiplied by the applicable tax rate or rates, disclosing also how the applicable tax rates are computed.
  - (b) a numerical reconciliation of the average effective tax rate and the applicable tax rate, disclosing also how the applicable tax rate is computed.
- 43 The applicable tax rate is the rate of tax in the country in which the entity is domiciled, aggregating the tax rate for national taxes with the rates for any local taxes that are computed on a substantially similar level of taxable profit. The average effective tax rate is the tax expense recognised in profit or loss divided by pre-tax profit or loss.
- 44 An entity shall disclose an explanation of changes in the applicable tax rates from the previous reporting period.

### **Tax expense recognised in other comprehensive income or equity**

- 45 An entity shall disclose the aggregate current and deferred tax recognised in other comprehensive income and the aggregate current and deferred tax recognised directly in equity.

### **Analysis of changes in deferred tax assets and liabilities**

- 46 An entity shall disclose for each type of temporary difference and for each type of unused tax losses and tax credits:
- (a) the amount of deferred tax liabilities and deferred tax assets for each period presented.
  - (b) a numerical analysis of the change in deferred tax liabilities, and deferred tax assets, including separate disclosure of the items in paragraphs 41(c)–(f) and 45;
  - (c) the expiry date, if any, of temporary differences, unused tax losses and tax credits.
- 47 An entity shall disclose the amount of any valuation allowance, any change in the valuation allowance, and a description of any event or change in circumstances that causes that change.

### **Other disclosures**

- 48 The entity shall disclose:
- (a) for entities that pay tax at a higher or lower rate if part or all of profit or retained earnings is paid out as a distribution to shareholders, the entity's estimates relating to future distributions and their effect on the tax rate used to measure deferred tax assets and liabilities.
  - (b) for discontinued operations, tax expense relating to:
    - (i) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operations; and
    - (ii) pre-tax profit or loss of discontinued operations for the period.

## INCOME TAX

- (c) the aggregate amount of temporary differences associated with investments in subsidiaries and interests in joint ventures, for which deferred tax liabilities have not been recognised (see paragraph B5).
  - (d) for transfers of assets and liabilities within a consolidated group between taxing jurisdictions with different tax rates:
    - (i) deferred tax assets and deferred tax liabilities arising from such transfers.
    - (ii) the net effect of such transfers on tax expense, either for all transfers or for only those transfers whose timing or terms are not customary for the consolidated group.
    - (iii) the tax effects of any modifications since the end of the reporting period, including unwinding (reversal) of the terms of such transfers.
  - (e) for an entity that is a member of a group that files a consolidated tax return, in its individual or separate financial statements or consolidated financial statements of a subgroup:
    - (i) the amount of any tax-related liabilities or assets due to or from other entities within the group and
    - (ii) the principal features of the method for allocating current and deferred tax expense to members of the group and the nature and effect of any changes in that method during the periods presented.
  - (f) the entity's accounting policies for the classification of:
    - (i) exchange differences on foreign tax assets and liabilities and
    - (ii) interest and penalties payable to tax authorities.
  - (g) for an entity that is not subject to tax because its income is taxed directly to its owners, that fact and the aggregate difference between the tax bases and the carrying amounts of the entity's assets and liabilities.
- 49 An entity shall disclose information about the major sources of estimation uncertainties relating to tax to enable users of the financial statements to assess the possible financial effects of the estimation uncertainties and their timing (for example, the effects of unresolved disputes with the tax authorities), including:
- (a) a description of the uncertainty; and

- (b) an indication of its possible financial effects on amounts recognised for tax and the timing of those effects.

### **Transition and effective date**

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- 50 An entity shall apply this [draft] IFRS in accordance with paragraphs 51 and 52 to the assets and liabilities in the opening statement of financial position for the first annual period starting on or after [date to be inserted after exposure]. An entity shall recognise any resulting net change in the assets and liabilities as an adjustment to retained earnings. An entity shall apply the amendments to all events and transactions thereafter.
- 51 In applying the amendments in that first opening statement of financial position, an entity shall make no transfers between retained earnings and other components of equity to restate cumulative amounts previously recognised in profit or loss, other comprehensive income or directly in equity.
- 52 In applying the amendments in that first opening statement of financial position, an entity shall treat assets and liabilities acquired or assumed in a transaction covered by paragraph B13(c) as if they had been acquired outside a business combination for their carrying amounts.

### **Withdrawal of other IFRSs**

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- 53 This [draft] IFRS supersedes IAS 12 *Income Taxes*.
- 54 This [draft] IFRS supersedes SIC-21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets* and SIC-25 *Income Taxes—Changes in the Tax Status of an Entity or its Shareholders*.

## Appendix A Defined terms

*This appendix is an integral part of the [draft] IFRS.*

<b>Current tax</b>	Income tax payable (refundable) in respect of the <b>taxable profit (tax loss)</b> for the current period or past reporting periods.
<b>Deferred tax</b>	Income tax payable (recoverable) in respect of the <b>taxable profit (tax loss)</b> for future reporting periods as a result of past transactions or events.
<b>Deferred tax assets</b>	Income taxes recoverable in future reporting periods in respect of: <ul style="list-style-type: none"> <li>(a) <b>temporary differences;</b></li> <li>(b) the carryforward of unused tax losses; and</li> <li>(c) the carryforward of unused tax credits.</li> </ul>
<b>Deferred tax liabilities</b>	Income taxes payable in future reporting periods in respect of <b>temporary differences</b> .
<b>Investment tax credit</b>	A tax credit that is directly related to the acquisition of depreciable assets.
<b>Tax basis</b>	The measurement, under applicable substantively enacted tax law, of an asset, liability or other item.
<b>Tax credit</b>	A tax benefit that takes the form of an amount that reduces income taxes payable.
<b>Tax expense</b>	The aggregate amount included in comprehensive income or equity for the reporting period in respect of <b>current tax</b> and <b>deferred tax</b> .
<b>Taxable income</b>	Income that is included in <b>taxable profit</b> determined in accordance with the rules established by the tax authorities.

<b>Taxable profit (tax loss)</b>	The profit or loss for a reporting period upon which income taxes are payable or recoverable, determined in accordance with the rules established by the tax authorities. Taxable profit equals <b>taxable income</b> less amounts deductible from taxable income.
<b>Temporary differences</b>	Differences between the carrying amount of an asset, liability or other item in the financial statements and its tax basis that the entity expects will affect <b>taxable profit</b> when the carrying amount of the asset or liability is recovered or settled (or, in the case of items other than assets and liabilities, will affect taxable profit in the future).
<b>Valuation allowance</b>	The amount recognised against <b>deferred tax assets</b> so that the net amount equals the highest amount that is more likely than not to be realisable against <b>taxable profit</b> .

## Appendix B

### Application guidance

*This appendix is an integral part of the [draft] IFRS.*

#### Investments in subsidiaries and joint ventures

- B1 Temporary differences arise when the carrying amount of an investment in a subsidiary or a joint venture (namely the parent's or investor's share of the net assets of the subsidiary or investee, including the carrying amount of goodwill) differs from the tax basis of the investment, and the entity expects the recovery of the carrying amount of the investment to affect taxable profit. Such temporary differences may arise in various circumstances, for example:
- (a) the existence of undistributed profits of subsidiaries or joint ventures
  - (b) changes in foreign exchange rates when a parent and its subsidiary have different functional currencies
  - (c) changes in the tax basis of the investment, eg indexation allowances.
- B2 In consolidated financial statements, a temporary difference may arise from an investment in a subsidiary or joint venture in addition to temporary differences that arise within the subsidiary or joint venture from its individual assets and liabilities. That additional temporary difference may also differ from the temporary difference associated with the investment in the subsidiary or joint venture in the parent's separate financial statements because the carrying amount of the investment may differ in the two sets of financial statements.
- B3 Similar additional temporary differences also can arise whenever there are tax consequences of remitting income from one part of an entity to another, for example when there are tax branches that are not separate subsidiaries. An entity shall treat such temporary differences in the same way as temporary differences on investments in subsidiaries.
- B4 An entity shall recognise a deferred tax liability or asset for all temporary differences associated with investments in subsidiaries and interests in joint ventures unless the exceptions in paragraph B5 apply.

- B5 An entity shall not recognise a deferred tax asset or liability for a temporary difference between the carrying amount and the tax basis of an investment in a foreign subsidiary or a foreign joint venture to the extent that:
- (a) the investment is essentially permanent in duration and
  - (b) it is apparent that the temporary difference will not reverse in the foreseeable future.
- B6 An investment in a foreign subsidiary or foreign joint venture is essentially permanent in duration to the extent that the entity has evidence of specific plans for reinvestment of the foreign subsidiary's or joint venture's undistributed earnings demonstrating that remittance of the earnings to the parent or investor will be postponed indefinitely. Experience of the foreign subsidiary or joint venture and definite future programmes of operations and remittances are examples of the types of evidence required.
- B7 If circumstances change and it becomes apparent that all or part of an investment in a foreign subsidiary or joint venture is no longer essentially permanent in duration, the entity shall recognise the related deferred tax asset or liability. Conversely, if it becomes apparent that all or part of an investment in a foreign subsidiary or joint venture has become essentially permanent in duration, the entity shall derecognise any related deferred tax asset or liability.
- B8 When an entity loses control of a foreign subsidiary that was essentially permanent in duration, the entity shall recognise any deferred tax asset or liability related to any remaining investment in accordance with paragraphs B4 and B5 and shall recognise the resulting deferred tax expense in profit or loss.
- B9 When an investment in a foreign entity becomes a subsidiary, an entity shall derecognise any deferred tax asset or liability related to the previous investment in that entity and shall recognise a deferred tax asset or liability related to the foreign subsidiary in accordance with paragraphs B4 and B5. The entity shall recognise any resulting change in the deferred tax asset or liability as tax expense in profit or loss.

### **Temporary differences arising on initial recognition**

- B10 When a temporary difference arises on the initial recognition of an asset or a liability, an entity shall disaggregate the asset or liability into:
- (a) the asset or liability excluding any entity-specific tax effects, ie the asset or liability with a tax basis available to market participants in a transaction for the individual asset or liability (ie not in a business combination) in that tax jurisdiction, and
  - (b) any entity-specific tax effects, ie the tax advantage or disadvantage arising from any difference between the tax basis described in (a) and the tax basis available to the entity.
- B11 An entity shall recognise the asset or liability in paragraph B10(a) in accordance with other IFRSs.
- B12 An entity shall recognise a deferred tax asset or liability for any resulting temporary differences between the initial carrying amount and the tax basis available to the entity.
- B13 An entity shall account for the effect of recognising the asset or liability and the deferred tax asset or liability as follows:
- (a) if the recognition of the asset or liability affects comprehensive income, equity or taxable profit, an entity shall recognise deferred tax income or tax expense in comprehensive income or equity in accordance with paragraphs 29–34.
  - (b) in a business combination, the recognition of the asset or liability and the deferred tax asset or liability affects the measurement of goodwill or a bargain purchase gain.
  - (c) in all other cases, an entity shall recognise any difference between the consideration paid and the total recognised amounts of the acquired assets and liabilities (including deferred taxes) as an allowance against, or premium in addition to, the deferred tax asset or liability. The entity shall reduce the allowance or premium pro rata with changes in the related deferred tax asset or liability and recognise the resulting tax expense in accordance with paragraphs 29–34. The entity shall present the allowance or premium within deferred tax in the statement of financial position. However, the entity shall not consider the allowance or premium when determining the need for or the measurement of a valuation allowance in accordance with paragraphs B16–B25.

### **Temporary differences arising on remeasurement to fair value**

- B14 IFRSs permit or require some assets and liabilities to be remeasured to fair value after their initial recognition. Fair value is determined using the same assumption about the tax consequences of recovering or settling the asset or liability as would be used by other market participants.
- B15 In some jurisdictions, the remeasurement of an asset or liability to fair value affects taxable profit for the current period. As a result, the tax basis of the asset or liability is adjusted and no temporary difference arises. In other jurisdictions, the remeasurement of an asset or liability does not affect taxable profit in the period of the remeasurement and, consequently, the tax basis of the asset or liability is not adjusted. The difference between the carrying amount of the remeasured asset or liability and its tax basis is a temporary difference that gives rise to a deferred tax liability or asset unless the entity expects to recover or settle the carrying amount without affecting taxable profit.

### **Valuation allowance**

- B16 Future realisation of the tax benefit of a temporary difference or carryforward of unused tax losses or tax credits depends on the existence of sufficient taxable profit of the appropriate character (eg taxable income or capital gain) within the carryback or carryforward period available under the tax law. An entity shall recognise a valuation allowance if, on the basis of the available evidence, it is more likely than not that there will not be sufficient taxable profit to realise the tax benefit. The deferred tax asset less the valuation allowance equals the highest amount that is more likely than not to be realisable against taxable profit.
- B17 The following sources of taxable profit may be available to realise a tax benefit for temporary differences and unused tax losses and tax credits:
- (a) future reductions in existing temporary differences that will result in future taxable amounts relating to the same taxation authority and the same taxable entity:
    - (i) in the same period as the expected reduction in the temporary difference giving rise to the tax benefit; or
    - (ii) in periods into which a tax loss arising from the reduction in (i) can be carried back or forward.

## INCOME TAX

However, in determining the existence of taxable profit available to realise a tax benefit, an entity shall not consider reductions in temporary differences for which, in accordance with paragraph B5, no deferred tax liability has been recognised.

- (b) Future taxable profit (exclusive of future reductions in existing temporary differences) relating to the same taxation authority and the same taxable entity:
  - (i) in the same period as the expected reduction in a temporary difference giving rise to the tax benefit; or
  - (ii) in periods into which a tax loss arising from the reduction in (i) can be carried back or forward.

In evaluating whether it will have sufficient taxable profit in future periods to realise a tax benefit, an entity shall ignore taxable amounts expected to originate in future periods that will themselves give rise to temporary differences. This is because the deferred tax asset arising from such temporary differences will itself require future taxable profit in order to be utilised. An entity shall also ignore future distributions of earnings of a foreign subsidiary or foreign joint venture, except to the extent that a deferred tax liability has been recognised for existing undistributed earnings or earnings that have been remitted to the parent or investor in the past.

- (c) tax planning strategies that would create taxable profit in appropriate periods.

B18 Tax planning strategies are actions (including elections for tax purposes) that:

- (a) are feasible and rational,
- (b) an entity would take in order to create or increase taxable profit in a particular period before the expiry of a tax loss or tax credit carryforward, and
- (c) would result in the realisation of deferred tax assets.

For example, in some jurisdictions, taxable profit may be created or increased by:

- (i) accelerating taxable amounts to utilise expiring carryforwards (eg electing to have interest income taxed on either a received or receivable basis; selling, and perhaps leasing back, assets that have

appreciated but for which the tax basis has not been adjusted to reflect such appreciation).

- (ii) deferring the claim for some deductions from taxable profit.
- (iii) changing the character of taxable or deductible amounts (eg from being taxable as part of profit to being taxable as a capital gain or loss).
- (iv) switching from tax-exempt to taxable investments, eg selling an asset that generates non-taxable profit in order to purchase another investment that generates taxable profit.

When tax planning strategies affect the amount of the valuation allowance, the entity shall include in their effect significant expenses or losses to implement those strategies, net of any recognisable tax benefits associated with those expenses or losses.

- B19 At the end of each reporting period, an entity shall adjust the amount of the valuation allowance to the extent that it has become more likely than not that future taxable profit will allow more or less of the deferred tax asset to be realised. For example, a change in trading conditions may make it more likely or less likely that the entity can generate sufficient taxable profit in the future for the deferred tax asset to be realised. Another example is when an entity reassesses deferred tax assets at the date of a business combination or subsequently (see paragraphs B39 and B40).

*Evidence available for the sources of taxable profit*

- B20 Evidence available about each of the possible sources of taxable profit noted in paragraph B17 will vary for different tax jurisdictions and, possibly, from period to period. If evidence about one or more sources of taxable profit is sufficient to support a conclusion that it is more likely than not that taxable profit will be available to utilise temporary differences and unused tax losses and tax credits, an entity need not consider other sources. However, consideration of each source is required to determine the amount of the valuation allowance to be recognised.
- B21 An entity shall consider all available evidence, both positive and negative, to determine whether, on the basis of the weight of that evidence, it is more likely than not that taxable profits will be available. Ordinarily, information about an entity's present financial position and its results of operations for the current and preceding years is readily available. That historical information is supplemented by all currently available information about future years. Sometimes, however, historical

## INCOME TAX

information may not be available (eg start-up operations) or it may not be as relevant (eg if there has been a recent change in circumstances) in which case other evidence is required to support a conclusion that it is more likely than not that taxable profits will be available for the entity to utilise temporary differences and unused tax losses and credits.

- B22 The existence of unused tax losses or tax credits is strong evidence that future taxable profit may not be available. Other examples of negative evidence include, but are not limited to, the following:
- (a) losses expected in early future years by a currently profitable entity.
  - (b) uncertain circumstances that, if unfavourably resolved, would adversely affect future operations and profit on a continuing basis.
  - (c) a carryback or carryforward period that is so brief that it would limit realisation of tax benefits if a significant temporary difference is expected to reduce to zero in a single year or the entity operates in a traditionally cyclical business.
- B23 Therefore, when an entity has a history of recent losses or there is other negative evidence, it shall recognise a valuation allowance against the deferred tax asset arising from unused tax losses or tax credits so that the net amount equals the amount for which it has sufficient temporary differences to give rise to taxable profit in the future or for which there is convincing other evidence that sufficient taxable profit will be available.
- B24 Examples of other evidence that might support a conclusion that a valuation allowance is not needed despite negative evidence include, but are not limited to, the following:
- (a) existing contracts or firm sales backlog that will produce more than enough taxable income to realise the deferred tax asset on the basis of existing sales prices and cost structures.
  - (b) an excess of unrecognised asset value over the tax basis of the entity's net assets sufficient to realise the deferred tax asset.
  - (c) a strong earnings history exclusive of any loss that created the deferred tax asset coupled with evidence indicating that the loss results from identifiable causes that are unlikely to recur.

- B25 An entity shall use judgement in considering the relative effect of negative and positive evidence. The weight given to the potential effect of negative and positive evidence shall be commensurate with the extent to which it can be objectively verified. The more negative evidence that exists the more positive evidence is necessary and the more difficult it is to conclude that the valuation allowance should be less than the full amount of the deferred tax asset.

## Measurement

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### *Substantive enactment*

- B26 In some jurisdictions, substantive enactment is achieved only on enactment. In other jurisdictions actions by the government relating to tax rates and tax laws have the substantive effect of actual enactment, which may follow the actions by a period of several months. An entity shall regard tax rates as substantively enacted when future events required by the enactment process historically have not affected the outcome and are unlikely to do so. In the US tax jurisdiction, substantive enactment is achieved only on enactment.

### *Change in tax status*

- B27 An entity shall recognise the effect of an election for a voluntary change in tax status on the approval date or, if approval is not necessary, on the filing date of the final required document. An entity shall recognise the effect of a change in tax status that results from a change in tax law on the date that the tax law is substantively enacted.

### *Different tax rates apply to different levels of income or different ways of recovering the asset*

- B28 When different tax rates apply because of the level of taxable profit, an entity shall measure deferred tax assets and liabilities using average rates that are expected to apply to the expected taxable profit of the periods in which the temporary differences are expected to reduce, rather than marginal rates.
- B29 Paragraph 15 requires the tax basis to be determined by the deductions that are available on the sale of an asset. If those deductions are available only on sale, an entity shall measure deferred tax assets and liabilities at the tax rate that is applicable to the sale. If the same deductions are

## INCOME TAX

available for the sale or use of the asset, an entity shall measure the deferred tax asset or liability at the rate that is applicable to how the entity expects to recover or settle the carrying amount of its asset or liability.

- B30 If an asset is revalued in accordance with IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets* and is not depreciated, for example land or intangible assets with indefinite useful lives, that fact means that the entity expects to recover the carrying amount only by sale. Similarly, for an investment property that is measured at fair value in accordance with IAS 40 *Investment Property*:
- (a) if the investment property would not be depreciated if IAS 16 applied, the entity expects to recover the carrying amount only through sale.
  - (b) if it would be depreciated if IAS 16 applied, the entity assesses whether it expects to recover the carrying amount through use or sale.

### *Tax effects of distributions*

- B31 In some jurisdictions, tax is payable at a higher or lower rate if part or all of the profit or retained earnings is paid out as a distribution to shareholders. In these circumstances, an entity shall measure current and deferred tax assets and liabilities using the rate expected to apply when the tax asset or liability is realised or settled, including the effect of the entity's expectations of future distributions. In other jurisdictions, tax may be refundable or payable if part or all of the profit or retained earnings is paid out as a dividend to shareholders. In those circumstances, the measurement of current and deferred tax assets and liabilities shall include the effect of the entity's expectations of future distributions.
- B32 When determining its expectations of future distributions, an entity shall consider past experience and whether it expects to have the intention and ability to make distributions for the period in which the deferred tax asset or liability is expected to be realised or settled. If the entity does not expect to make distributions, it shall use the rate applicable to undistributed amounts and shall not anticipate the effect of future distributions.

*Tax based on two or more systems*

- B33 In some jurisdictions, an entity may be required to pay tax based on one of two or more tax systems, for example, when an entity is required to pay the greater of the normal corporate income tax and a minimum amount. In such cases, an entity shall determine the applicable tax rate in a manner consistent with the tax law while considering any interaction between the alternative systems.

**Allocation of current and deferred tax**

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**Recognition of tax benefits**

- B34 An entity shall recognise the tax benefit from a deferred tax asset in the same component of comprehensive income or equity as the event or transaction giving rise to the deferred tax asset. The entity shall also recognise in that same component the effect of a valuation allowance recognised at the same time as the deferred tax asset.
- B35 The event or transaction giving rise to the deferred tax asset is the event or transaction giving rise to the temporary difference, tax loss or tax credit, not the source of the taxable income against which any tax benefit is recovered or expected to be recovered. In particular, if an entity recognises a pre-tax loss in continuing operations and realises the resulting tax benefit against taxable profit in another component, the entity shall recognise a tax benefit in continuing operations and tax expense in the other component. This may result in an allocation of tax benefit to continuing operations and tax expense to that other component, even if total tax expense for that reporting period is nil.
- B36 An entity shall recognise a change in a valuation allowance as follows:
- (a) in accordance with paragraph B40, if the valuation allowance relates to deferred tax acquired in a business combination.
  - (b) in equity, if the valuation allowance relates to deferred tax assets arising from transactions with equity holders in their capacity as equity holders (other than distributions to equity holders).
  - (c) in all cases other than those described in (a) and (b):
    - (i) if income in the current year causes a reduction in the valuation allowance, in the component in which the income is recognised, and

## INCOME TAX

- (ii) if a change in circumstances causes a change in judgement about the recoverability of deferred tax assets in future years, in continuing operations.

*As discussed in paragraph BC97 of the Basis for Conclusions on this exposure draft, paragraphs B34A–B36A set out an alternative approach to the allocation of tax to comprehensive income and equity that the Board does not propose to adopt.*

### **Recognition of tax benefits**

B34A An entity shall recognise the tax benefit from a deferred tax asset in the same component of comprehensive income or equity as the event or transaction giving rise to the deferred tax asset. The entity shall also recognise in that same component the effect of a valuation allowance, both initially and subsequently.

B35A The event or transaction giving rise to the deferred tax asset is the event or transaction giving rise to the temporary difference, tax loss or tax credit, not the source of the taxable income against which any tax benefit is recovered or expected to be recovered. In particular, if an entity recognises a pre-tax loss in continuing operations and realises the resulting tax benefit against taxable profit in another component, the entity shall recognise (a) a tax benefit in continuing operations and (b) tax expense in the other component. This may result in an allocation of tax benefit to continuing operations and tax expense to that other component, even if total tax expense for that reporting period is nil.

### **Changes in tax effects that were not originally recognised in comprehensive income or equity**

B36A An entity shall recognise changes in tax effects that were not originally recognised in comprehensive income or equity in continuing operations or discontinued operations as appropriate.

### **Groups with a consolidated tax return**

- B37 If a group of entities files a consolidated tax return, the financial statements of each entity within the group shall include an allocation of the consolidated tax expense. If the group does not charge or pay the entity for the allocated tax expense, the entity shall recognise both the

tax expense and an equal amount of capital contribution or distribution. The allocation shall be systematic, rational and consistent with the broad principles established by this [draft] IFRS. An example of such a method is one that allocates current and deferred tax to members of the group by applying this [draft] IFRS to each member as if it were a separate taxpayer. Examples of methods that are not consistent with the broad principles established by this [draft] IFRS include:

- (a) a method that allocates only current tax payable to a member of the group that has taxable temporary differences.
- (b) a method that allocates deferred taxes to a member of the group using a method fundamentally different from the temporary difference approach described in this [draft] IFRS.
- (c) a method that allocates no current or deferred tax expense to a member of the group that has taxable income if the consolidated group has no current or deferred tax expense.

### **Deferred tax arising from a business combination**

- B38 Temporary differences may arise in a business combination. In accordance with IFRS 3 *Business Combinations* (as revised in 2008), an entity recognises any resulting deferred tax assets (and related valuation allowances) and deferred tax liabilities as identifiable assets and liabilities at the acquisition date. Consequently, those deferred tax assets and deferred tax liabilities affect the amount of goodwill or the bargain purchase gain that the entity recognises. However, in accordance with paragraph 21 of this [draft] IFRS, an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.
- B39 As a result of a business combination, the probability of there being sufficient taxable profit to realise a pre-acquisition deferred tax asset of the acquirer could change. An acquirer may consider it more likely than not that it will realise its own deferred tax asset that required a valuation allowance before the business combination. For example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree. Alternatively, as a result of the business combination it may no longer be more likely than not that

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\* In that situation, the sum of the amounts allocated to individual members of the group may not equal the consolidated amount. That may also be the result when there are transactions between members of the group. The criteria are satisfied, nevertheless, after giving effect to the type of adjustments (including eliminations) normally present in preparing consolidated financial statements.

future taxable profit will allow the deferred tax asset to be realised. In such cases, the acquirer recognises a change in the related valuation allowance in the period of the business combination but does not include it in the accounting for the business combination. Therefore, the acquirer does not take the change into account in measuring the goodwill or bargain purchase gain it recognises in the business combination.

- B40 If an entity acquires deferred tax assets in a business combination, it may need to recognise valuation allowances against those assets when it initially accounts for the business combination. If those valuation allowances subsequently change, the entity shall recognise those changes as follows:
- (a) If the changes arise within the measurement period as defined in IFRS 3 and result from new information about facts and circumstances that existed at the acquisition date, the entity shall apply the changes to reduce the carrying amount of any goodwill related to that acquisition. If the carrying amount of that goodwill reaches zero, the entity shall recognise any remaining changes in profit or loss.
  - (b) All other changes in a valuation allowance shall be recognised in accordance with paragraph B36(b) and (c).

### **Current and deferred tax arising from share-based payment transactions**

- B41 In some tax jurisdictions, an entity receives a tax deduction for remuneration paid in shares, share options or other equity instruments of the entity. The amount of that tax deduction may differ from the related cumulative remuneration expense, and may arise in a later accounting period. For example, in some jurisdictions, an entity recognises an expense for the consumption of employee services received as consideration for share options granted, in accordance with IFRS 2 *Share-based Payment*, and receives a tax deduction only when the share options are exercised, with the measurement of the tax deduction based on the entity's share price at the date of exercise.
- B42 As with the research costs discussed in paragraph 16 of this [draft] IFRS, there is a difference between the tax basis of the employee services received to date (being the amount the tax authorities will permit as a deduction in future periods in respect of services received to date) and the carrying amount of nil in the statement of financial position. That

difference is a temporary difference that results in a deferred tax asset. If the amount the tax authorities will permit as a deduction in future periods is not known at the end of the period, it shall be estimated on the basis of information available at the end of the period. For example, if the tax deduction in future periods depends upon the entity's share price at a future date, the measurement of the deductible temporary difference shall be based on the entity's share price at the end of the period.

- B43 As noted in paragraph B41, the tax deduction (or estimated future tax deduction, measured in accordance with paragraph B42) may differ from the related cumulative remuneration expense. If the tax deduction (or estimated future tax deduction) exceeds the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, the entity shall recognise the excess of the associated current or deferred tax directly in equity.

## Presentation

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- B44 An entity normally has a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income tax levied by the same tax authority and the tax authority permits the entity to make or receive a single net payment.
- B45 In consolidated financial statements, an entity shall offset a current tax asset of one entity within the group against a current tax liability of another entity within the group if the entities concerned have a legally enforceable right to make or receive a single net payment and the entities intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously.
- B46 In rare circumstances, an entity may have a legally enforceable right of set-off, and an intention to settle net, for some periods but not for others. In such rare circumstances, detailed scheduling may be required to establish reliably whether the deferred tax liability of one taxable entity will result in increased tax payments in the same period in which a deferred tax asset of another taxable entity will result in decreased payments by that second taxable entity.

## Appendix C

### Amendments to other IFRSs

*The amendments in this [draft] appendix shall be applied for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies this [draft] IFRS for an earlier period, these amendments shall be applied for that earlier period. Amended paragraphs are shown with the new text underlined and deleted text struck through.*

- C1 In International Financial Reporting Standards (including International Accounting Standards and Interpretations), references to IAS 12 *Income Taxes* are amended to IFRS X *Income Tax*, unless otherwise stated in this appendix.
- C2 In IFRS 1 *First-time Adoption of International Financial Reporting Standards*, (as revised in 2008), paragraphs B1 and D1 are amended and paragraph B8, a heading and paragraphs D24–D26 are added:
- B1 An entity shall apply the following exceptions:
- (a) ...
  - (b) hedge accounting (paragraphs B4–B6); ~~and~~
  - (c) non-controlling interests (paragraph B7); ~~and~~
  - (d) recognition of income tax in comprehensive income and equity (paragraph B8).
- B8 IFRS X *Income Tax* paragraphs 29–34 set out requirements for the recognition of income tax expense in comprehensive income and equity. Some amounts that are recognised outside profit or loss are presented in a separate component of equity and are subsequently recognised in profit or loss on the disposal of related assets and liabilities. An entity shall not apply these requirements retrospectively. An entity shall deem the amounts recognised outside profit or loss to be zero at the date of transition to IFRSs.
- D1 An entity may elect to use one or more of the following exemptions:
- (a) ...
  - (m) financial assets or intangible assets accounted for in accordance with IFRIC 12 *Service Concession Arrangements* (paragraph D22); ~~and~~
  - (n) borrowing costs (paragraph D23); ~~and~~

(o) deferred tax (paragraphs D24–D26).

### **Income tax**

- D24 An entity applies IFRS X *Income Tax* to temporary differences between the carrying amounts of the assets and liabilities in its opening IFRS statement of financial position and their tax bases. An entity with a transition date before [date IFRS X issued] may elect to apply IAS 12 *Income Taxes* for periods presented that begin before [date IFRS X issued].
- D25 When a temporary difference arises on the initial recognition of an asset or liability, IFRS X requires an entity to disaggregate the asset or liability into:
- (a) the asset or liability excluding any entity-specific tax effects and
  - (b) any entity-specific tax effects.
- D26 A first-time adopter need not comply retrospectively with this requirement. Instead the first-time adopter may:
- (a) recognise the asset or liability excluding any entity-specific tax effects at the date of the opening IFRS statement of financial position in accordance with the other requirements of this standard and
  - (b) recognise a deferred tax asset or liability for any resulting temporary difference.
- C3 In IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* paragraph 33(b)(ii) and (b)(iv) is amended as follows:
- 33(b)(ii) the related income tax expense as required by paragraph ~~81(h) of IAS 12 48(b)(i) of IFRS X.~~
- 33(b)(iv) the related income tax expense as required by paragraph ~~81(h) of IAS 12 48(b)(ii) of IFRS X.~~
- C4 In IAS 1 *Presentation of Financial Statements*, paragraph 56 is deleted and paragraph 56A added, as follows:
- 56 ~~**[Deleted] When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position, it shall not classify deferred tax assets (liabilities) as current assets (liabilities).**~~

INCOME TAX

**56A An entity shall classify deferred tax assets and liabilities in the statement of financial position in accordance with IFRS X *Income Tax*.**

C5 In IAS 32, paragraphs 35, 37 and 39 are amended as follows:

**35 Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be debited by the entity directly to equity, ~~net of any related income tax benefit~~. Transaction costs of an equity transaction shall be accounted for as a deduction from equity, ~~net of any related income tax benefit~~. Income tax benefits related to distributions and transaction costs shall be accounted for in accordance with IFRS X *Income Tax*.**

37 An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. The transaction costs of an equity transaction are accounted for as a deduction from equity (~~net of any related income tax benefit~~) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognised as an expense.

39 The amount of transaction costs accounted for as a deduction from equity in the period is disclosed separately under in accordance with IAS 1. The related amount of income taxes recognised directly in equity is included in the aggregate amount of current and deferred income tax credited or charged to equity that is disclosed under IAS 12 *Income Taxes*.

C6 In IAS 34 *Interim Financial Reporting*, paragraph B20 is amended as follows, paragraph B21 is deleted and paragraph B21A is added:

**B20 The benefits of a tax loss carryback are reflected in the interim period in which the related tax loss occurs. ~~IAS 12 provides that 'the benefit relating to a tax loss that can be carried back to recover current tax of a previous period shall be recognised as an asset'. A corresponding reduction of tax expense or increase of tax income is also recognised. An entity recognises a tax asset and reduction in tax expense for such losses in accordance with IFRS X.~~**

- B21 ~~IAS 12 provides that 'a deferred tax asset shall be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised'. IAS 12 provides criteria for assessing the probability of taxable profit against which the unused tax losses and credits can be utilised. Those criteria are applied at the end of each interim period and, if they are met, the effect of the tax loss carryforward is reflected in the computation of the estimated average annual effective income tax rate.~~
- B21A An entity recognises a deferred tax asset for unused tax losses and unused tax credits in accordance with IFRS X. An entity assesses the need for a valuation allowance against any deferred tax assets in accordance with IFRS X at the end of each interim period.

## Amendments to guidance on other IFRSs

*The following amendments to guidance on other IFRSs is necessary in order to ensure consistency with IFRS X. New text is underlined and deleted text is struck through.*

A1 In the guidance on implementing IFRS 1, paragraphs IG5 and IG6 are deleted and IG Example 2 is amended as follows:

- (g) recognises a net deferred tax liability of CU6 (CU20 at 30 per cent) arising from:
  - (i) the ~~taxable~~ temporary difference of CU50 (CU200 less CU150) associated with the identifiable assets acquired and non-pension liabilities assumed, less
  - (ii) the ~~deductible~~ temporary difference of CU30 (CU30 less nil) associated with the pension liability.

The entity recognises the resulting increase in the deferred tax liability as a deduction from retained earnings (paragraph C4(k) of the IFRS). If a ~~taxable~~ temporary difference arises from the initial recognition of goodwill, entity B does not recognise the resulting deferred tax liability (paragraph ~~15(a)~~ 21 of ~~IAS 12 *Income Taxes*~~ IFRS X *Income Tax*).

## **Approval by the Board of *Income Tax* published in March 2009**

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The exposure draft *Income Tax* was approved for publication by the thirteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
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