

Recognising deferred tax on leases

Narrowing the scope of IAS 12's initial recognition exemption to improve comparability



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Highlights

- What's the issue – Diversity in recognising deferred taxes on leases and decommissioning obligations
- Recognition exemption narrowed – Tax impact should be reflected in the financial statements
- Effective date and transition – Apply from 1 January 2023



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Targeted amendments¹ to IAS 12 *Income Taxes* clarify how companies should account for deferred tax on certain transactions – e.g. leases and decommissioning provisions.

The amendments narrow the scope of the initial recognition exemption (IRE) so that it does not apply to transactions that give rise to equal and offsetting temporary differences. As a result, companies will need to recognise a deferred tax asset and a deferred tax liability for temporary differences arising on initial recognition of a lease and a decommissioning provision.

By limiting the initial recognition exemption, the amendments will improve comparability and provide more relevant information to the users of financial statements about the tax consequences of leases and decommissioning obligations.

What's the issue?

Currently, there is diversity in practice when accounting for deferred tax on transactions that involve recognising both an asset and a liability with a single tax treatment related to both.

For example, a company may be entitled to a tax deduction on a cash basis for a lease transaction that involves recognising a right-of-use (ROU) asset and a corresponding lease liability under IFRS 16 *Leases*². A temporary difference may then arise on initial recognition of the ROU asset and the lease liability. When applying the IRE to this temporary difference, a company may currently apply one of the following approaches.

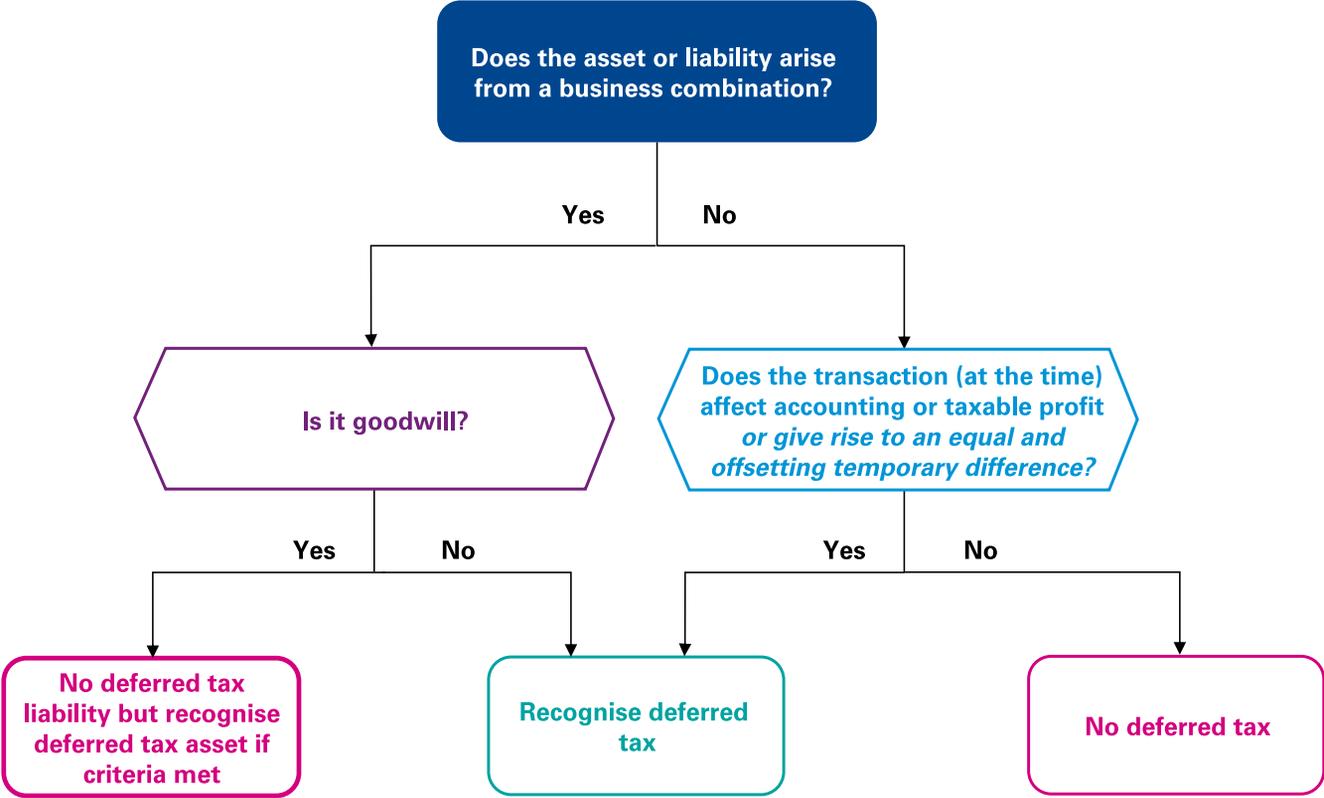
Approach	Outcome
Apply the IRE separately to the ROU asset and lease liability	Recognise the tax impacts in profit or loss when they are incurred and therefore recognise no deferred tax on the lease
Assess the ROU asset and lease liability together as a single or 'integrally linked' transaction on a net basis	Recognise deferred tax on a net temporary difference that arises after the initial recognition and is not subject to the IRE
Choose not to apply the IRE	Recognise deferred tax

In short, not all companies reflect the future tax impacts of leases in their financial statements.

Recognition exemption narrowed

The amendments clarify that the exemption does not apply to transactions such as leases and decommissioning obligations. These transactions give rise to equal and offsetting temporary differences and this [example](#) (PDF 88 KB) illustrates how a company applies the amendments.

All companies will now need to reflect the future tax impacts of these transactions and recognise deferred tax, as illustrated below.



Effective date and transition

The amendments apply for annual reporting periods beginning on or after 1 January 2023. Earlier application is permitted.

For leases and decommissioning liabilities, the associated deferred tax asset and liabilities will need to be recognised from the beginning of the earliest comparative period presented, with any cumulative effect recognised as an adjustment to retained earnings or other components of equity at that date. If a company previously accounted for deferred tax on leases and decommissioning liabilities under the net approach, then the impact on transition is likely to be limited to the separate presentation of the deferred tax asset and the deferred tax liability. This [example](#) (PDF 80 KB) illustrates the requirements on transition.

For all other transactions, the amendments apply to transactions that occur after the beginning of the earliest period presented.

¹ *Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12)*

² The amendments have been explained using leases as an example; they would also apply to the recognition of decommissioning liabilities and corresponding adjustment to the asset.

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