IFRS

STAFF PAPER

November 2016

IFRS® Interpretations Committee Meeting

Project	**IAS 12 *Income Taxes***
Paper topic	Expected manner of recovery of intangible assets with indefinite useful lives

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Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify how an entity determines the expected manner of recovery when measuring deferred tax for an intangible asset with an indefinite useful life.

2. Paragraph 51 of IAS 12 *Income Taxes* states that the measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that follow from the manner in which an entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

3. The Interpretations Committee observed that an intangible asset with an indefinite useful life is not a non-depreciable asset as envisaged by paragraph 51B of IAS 12. This is because a non-depreciable asset has an unlimited (or infinite) life, and IAS 38 *Intangible Assets* explains that indefinite does not mean infinite.

4. When amending IAS 38 in 2004, the Board observed that an entity does not amortise an intangible asset with an indefinite useful life because there is no foreseeable limit on the period during which it expects to consume the future economic benefits embodied in the asset. Accordingly, amortisation over an arbitrarily determined maximum period would not be representationally faithful. The reason an entity does not amortise an intangible asset with an indefinite useful life is not because there is no consumption of the future economic benefits embodied in the asset.

5. The Interpretations Committee therefore noted that the requirements of paragraph 51B of IAS 12 do not apply because intangible assets with indefinite useful lives are not non depreciable assets. Entities are therefore required to apply paragraphs 51 and 51A of IAS 12 in determining the expected manner of recovery of the carrying amount of intangible assets with indefinite useful lives, and reflect the tax consequences that follow from that expected manner of recovery.

6. The purpose of this paper is to:

   (a) analyse the comments received on the tentative agenda decision; and

   (b) ask the Interpretations Committee if it agrees with the staff recommendation to finalise the agenda decision.

Comment letter summary and staff analysis

7. We received three comment letters, which are included in Appendix B to this paper. Mazars and Deloitte agree with the Interpretations Committee's decision not to add this issue to its agenda for the reasons set out in the tentative agenda decision. KPMG also agrees with the Interpretations Committee's decision not to add the issue to its agenda. However, KPMG disagrees with the rationale and the conclusion that an entity does not apply the requirements of paragraph 51B of IAS 12 by analogy to intangible assets with indefinite useful lives. This concern, together with our analysis, is presented below.

Applying paragraph 51B of IAS 12 by analogy

Concern raised by respondent

8. Paragraph 51B of IAS 12 states:

> If a deferred tax liability or deferred tax asset arises from a non-depreciable asset measured using the revaluation model in IAS 16, the measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the non-depreciable asset through sale, regardless of the basis of measuring the carrying

> amount of that asset. Accordingly, if the tax law specifies a tax rate applicable to the taxable amount derived from the sale of an asset that differs from the tax rate applicable to the taxable amount derived from using an asset, the former rate is applied in measuring the deferred tax liability or asset related to a non-depreciable asset.

9. KPMG suggests that consideration of this issue requires an analysis of the similarities and differences between intangible assets with indefinite useful lives (eg licence with an unlimited term) and non-depreciable property, plant & equipment (eg land) measured using the revaluation model in IAS 16 *Property, Plant and Equipment*.

10. KPMG says that in its view, entities may be able to apply the principles behind the requirements of paragraph 51B of IAS 12 by analogy. This is because, similar to a non-depreciable tangible asset, an intangible asset with an indefinite useful life is used to generate cash flows and arguably, in both cases there is no foreseeable limit to the period over which they can generate cash flows. Therefore, it may be argued that neither asset is consumed through use in generating future economic benefits.

11. Paragraph BC6 of IAS 12 states that 'because an asset is not depreciated, no part of its carrying amount is expected to be recovered (ie consumed) through use.' KPMG says that, in the absence of other facts and circumstances, this rationale also arguably applies to intangible assets with indefinite useful lives.

12. KPMG requests that the Interpretations Committee amend the agenda decision to:

    (a) not prohibit an entity from applying paragraph 51B of IAS 12 by analogy to intangible assets with indefinite useful lives; and

    (b) answer the question asked (ie how to determine the expected manner of recovery of an intangible asset with an indefinite useful life for the purposes of measuring deferred tax) or explain why the Interpretations Committee cannot answer this question (eg that this requires judgement in each particular set of circumstances).

Staff analysis

13. We continue to think that the Interpretations Committee's tentative conclusion that an intangible asset with an indefinite useful life is not a non-depreciable asset is

appropriate. Accordingly, we think that an entity does not apply paragraph 51B of IAS 12 by analogy.

14. At its meetings in May 2016 and July 2016, the Interpretations Committee discussed this issue. As outlined in Agenda Paper 10 of the Interpretations Committee's meeting in May 2016:

(a) IAS 16 does not define a non-depreciable asset. However, paragraph 58 of IAS 16 explains that:

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

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

(c) the reason an intangible asset is not depreciated is not because it has an unlimited useful life, but rather because there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in an asset.

15. The Interpretations Committee tentatively concluded that an intangible asset with an indefinite useful life is not a non-depreciable asset. Accordingly, the Interpretations Committee noted that an entity applies the requirements of paragraphs 51 and 51A of IAS 12, and it would not be appropriate to apply the requirements of paragraph 51B of IAS 12 by analogy.

16. The application of the requirements of paragraphs 51 and 51A and, in particular, the determination of the manner of recovery of an intangible asset with an indefinite useful life depends on the specific facts and circumstances. Based on those facts and circumstances, an entity may determine that the carrying amount of an intangible asset with an indefinite useful life will be recovered through sale. In this case, the measurement of the deferred tax asset (liability) will reflect the tax consequences of recovering the carrying amount of the asset through sale, which is similar to the

treatment required applying paragraph 51B of IAS 12 for non-depreciable assets measured using the revaluation model in IAS 16. However, an entity determines the manner of recovery based on the specific facts and circumstances (applying the requirements of paragraphs 51 and 51A of IAS 12)—it does not assume that the carrying amount of an intangible asset with an indefinite useful life will be recovered through sale.

17. We think that it would be appropriate to apply requirements by analogy only if there are no other requirements that apply to the particular transaction or issue in question. In this case, paragraphs 51 and 51A apply when measuring deferred tax.

18. We believe that the Agenda Decision should not be amended to include specific references to the requirement for an entity to consider facts and circumstances in determining the manner of recovery of an asset because this is implicit in the requirements of paragraphs 51 and 51A of IAS 12.

Staff recommendation

19. On the basis of our analysis, we recommend confirming the tentative agenda decision as published in the IFRIC Update in July 2016 with some proposed drafting amendments. Appendix A to this paper sets out the draft wording for the final agenda decision.

Question for the Interpretations Committee
Does the Interpretations Committee agree with the staff recommendation to finalise the agenda decision set out in Appendix A to this paper?

Appendix A—Proposed wording for final agenda decision

A1. We propose the following wording to finalise the agenda decision (new text is underlined and deleted text is struck through).

> **IAS 12 *Income Taxes*—Expected manner of recovery of ~~indefinite life~~ intangible assets <u>with indefinite useful lives</u> ~~when measuring deferred tax~~**
>
> The Interpretations Committee received a request to clarify how <u>an entity determines</u> ~~to determine~~ the expected manner of recovery of an ~~indefinite life~~ intangible asset <u>with an indefinite useful life</u> for the purposes of measuring deferred tax.
>
> The Interpretations Committee noted that paragraph 51 of IAS 12 *Income Taxes* states that the measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that follow from the manner in which an entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.
>
> The Interpretations Committee also noted the requirements in paragraph 88 of IAS 38 *Intangible Assets* regarding ~~indefinite life~~ intangible assets <u>with indefinite useful lives</u>.
>
> The Interpretations Committee observed that an ~~indefinite life~~ intangible asset <u>with an indefinite useful life</u> is not a non-depreciable asset as envisaged by paragraph 51B of IAS 12. This is because a non-depreciable asset has an unlimited (or infinite) life, and IAS 38 explains that indefinite does not mean infinite. Consequently, the requirements in paragraph 51B of IAS 12 do not apply to ~~indefinite life~~ intangible assets <u>with an indefinite useful life</u>.
>
> The Interpretations Committee noted the Board's observation about ~~indefinite life~~ intangible assets <u>with indefinite useful lives</u> when the Board amended IAS 38 in 2004. The Board observed that an ~~indefinite life~~ <u>entity does not amortise an</u> intangible asset <u>with an indefinite useful life</u> ~~is not amortised~~ because there is no foreseeable limit on the period during which ~~an entity~~ <u>it</u> expects to consume the future economic benefits embodied in the asset. ~~and, hence,~~ <u>Accordingly</u> amortisation over an arbitrarily determined maximum period would not be

representationally faithful. ~~Therefore, t~~The reason an entity does not ~~for not~~ amortise~~ing~~ an ~~indefinite life~~ intangible asset with an indefinite useful life is not because there is no consumption of the future economic benefits embodied in the asset.

The Interpretations Committee observed that an entity recovers the carrying amount of an asset in the form of economic benefits that flow to the entity in future periods, which could be through use or sale of the asset. Accordingly, the recovery of the carrying amount of an ~~indefinite life intangible~~ asset does not depend on whether the asset is amortised. Consequently, the fact that an entity does not amortise an ~~indefinite life~~ intangible asset with an indefinite useful life does not necessarily mean that the entity will recover the carrying amount of that asset only through sale and not through use.

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

The Interpretations Committee concluded that the principle and requirements in paragraphs 51 and 51A of IAS 12 provide sufficient requirements to enable an entity to measure ~~with respect to measuring~~ deferred tax on ~~indefinite life~~ intangible assets with indefinite useful lives.

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

Appendix B—Copies of comment letters

MAZARS

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

La Défense, September 19, 2016

Tentative Agenda Decisions –IAS 12 *Income Taxes* – Expected manner of recovery of indefinite life intangible assets when measuring deferred tax (Agenda Paper 2)

Dear Sir,

MAZARS is pleased to comment on the above IFRS Interpretations Committee tentative agenda decision published in the July IFRIC Update.

We agree with the IFRS Interpretations Committee's decision not to add this issue onto its agenda, and with the rationale expressed in the tentative agenda decision.

Should you have any questions regarding the above comments, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully

Michel Barbet-Massin

Head of Financial Reporting Technical Support

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21 September 2016

Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
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Dear Mr Upton

Tentative agenda decision – IAS 12 *Income Taxes*: Expected manner of recovery of indefinite life intangible assets when measuring deferred tax

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the July IFRIC Update of the tentative decision not to take onto the Committee's agenda the request for clarification on how to determine the expected manner of recovery of an indefinite life intangible asset for the purposes of measuring deferred tax.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
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Our ref MV/288

23 September 2016

Dear Ms Buchanan

Tentative agenda decision: IAS 12 – Expected manner of recovery of indefinite life intangible assets when measuring deferred tax

We appreciate the opportunity to comment on the IFRS Interpretations Committee's (Committee) tentative agenda decision, *IAS 12 Income Taxes – Expected manner of recovery of indefinite life intangible assets when measuring deferred tax* (IFRIC Update July 2016). We have consulted with, and this letter represents the views of, the KPMG network.

Although we agree with the Committee's decision not to add this issue to its agenda, we disagree with the rationale and the decision to prohibit the application of guidance in paragraph 51B of IAS 12 by analogy to non-amortisable intangible assets.

We believe that the principles behind the guidance in paragraph 51B of IAS 12 (as outlined in paragraph BC6 of IAS 12) may be applied to non-amortisable intangible assets for the following reasons.

- Similar to depreciation of tangible assets, amortisation of intangible assets is intended to reflect the pattern of consumption of the asset through use.
- Similar to land, an indefinite life intangible asset, such as a licence with unlimited term, is used in generating cash flows.
- Arguably, in both cases there is no foreseeable limit to the period over which they can generate net cash flows. Therefore, the assumption is that neither asset is consumed through use in generating the future economic benefits and neither asset is depreciated or amortised.
- Applying the rationale in paragraph BC6 of IAS 12 – i.e. because an asset is not depreciated, no part of its carrying amount is expected to be recovered (i.e. consumed) through use – we believe that in the absence of other facts and

circumstances, because no part of the licence is amortised, it may be argued that no part of its carrying amount is expected to be recovered (i.e. consumed) through use.

We note that the Committee's conclusion was based solely on the comparison of the terms 'infinite' vs 'indefinite' rather than on the analysis of the similarities and differences between non-amortisable intangible assets (e.g. licence with unlimited term) and non-depreciable property plant and equipment measured using the revaluation model (e.g. land) from the economic point of view. We believe that the consideration of this issue should have involved an analysis of the concept of 'non-depreciable' rather than be based on the comparison of words in *an example* in paragraph BC6 of IAS 12 (unlimited) and a statement in paragraph 91 of IAS 38 that the term 'indefinite' does not mean 'infinite'.

We urge the Committee to amend the agenda decision:

- not to prohibit the application of paragraph 51B of IAS 12 by analogy to non-amortisable intangible assets; and
- either answer the question posed – i.e. how to determine the expected manner of recovery of an indefinite life intangible asset for the purposes of measuring deferred tax – or explain why it cannot answer this question – e.g. that this requires judgement in each particular set of circumstances.

Please contact Mark Vaessen +44 (0)20 7694 8871 or Sanel Tomlinson + 85 221 43 8694 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

Copy: Reinhard Dotzlaw