Straight away
IFRS bulletin from PwC

Are you ready for changes to deferred tax accounting for indefinite-lived intangibles?

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What's the issue?

If you have indefinite-lived intangible assets (such as brands, trade names, licenses or some management rights), the deferred tax accounting for those assets may change in the June 2017 reporting season - in particular if you do not currently recognise deferred tax liabilities on those assets.

For tax purposes in Australia, these indefinite lived intangible assets typically have a capital gains tax base but no amortising tax base. Under the tax accounting standard (AASB 112 *Income Taxes*), to calculate deferred taxes, companies must determine whether they expect to recover the asset through sale (using the capital gains tax base), through use (with no amortising tax base) or a combination of the two. In practice, many companies have not recognised deferred tax liabilities on these indefinite lived intangibles on the basis that the carrying value is expected to be recovered through sale (given it is not amortising). Some have viewed this as analogous to the guidance in the tax standard on non-depreciable assets (i.e. land) where deferred tax is calculated based on the tax consequences arising on sale.

However, in November 2016, the IFRS Interpretations Committee (IFRIC) clarified that an intangible asset with an indefinite useful life is not a non-depreciable asset. Land is a non-depreciable asset and has an unlimited (or infinite) life. Under the intangible assets accounting standard, indefinite does not mean unlimited or infinite. The fact that an entity does not amortise an intangible asset with an indefinite useful life is only because the amortisation period would be arbitrary because the end of the life is not known. Non-amortisation does not necessarily mean that the entity will recover the carrying amount of that asset only through sale and not through use. Further, the IFRIC implies that the generation of economic benefits is recovery of the carrying value.

How to determine the appropriate tax base to use when calculating deferred tax?

The tax accounting standard requires deferred tax to be recognised based on management's expected manner of recovery. This is a matter of judgement. It is specific to the individual facts and circumstances of the company and particular asset and should reflect management's realistic expectations. In determining the expected manner of recovery of the carrying amount of indefinite-lived intangibles, there are three likely scenarios:

Scenario 1 - Recovery through sale

This scenario may be supported by a planned, expected or potential sale in the near future. This may occur prior to any asset being classified as "held for sale" under AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*, given assets are only classified as "held for sale" when a sale is "highly probable" to occur.

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Under this scenario, if the asset is acquired in a business combination, no deferred tax liability would be recognised if the capital gains tax base equals the carrying value.

Scenario 2 - Recovery through use

This scenario may be supported if management expects to hold and consume the intangible in its business until the end of its life (although this point in time is not known). In this case, the expectation is that the future economic benefits arising from the asset will eventually be consumed through ordinary use, despite the timing of that consumption being uncertain.

Under this scenario, if the asset is acquired in a business combination, a deferred tax liability would be recognised if there is no amortising tax base.

Scenario 3 - Dual manner of recovery

This scenario will be supported if management expects that they will hold and use the asset for a period of time prior to selling.

Under this scenario, if the asset is acquired in a business combination, a deferred tax liability would be recognised on that component of the asset expected to be recovered through use. In practice, it may be difficult to determine the component to be recovered through use, particularly if there is no specific timeframe over which management expects to sell the asset. However, in some cases, the residual value expected to be recovered through sale may be the entire carrying value if future impairments are not anticipated.

What do you need to do for June?

The IFRIC discussion emphasises the importance of companies reconsidering and documenting their judgement regarding how the carrying value of an asset will be recovered.

Following the IFRIC discussion, companies can no longer presume that an intangible asset will be recovered through sale, simply because the asset has an indefinite life. To support expectation that all or a portion of the carrying value will be recovered through sale, the factors a company may need to consider include:

- the reliance of the business on the asset (Is it realistic that the asset would, or could, be sold?)
- the nature of the asset and the possible markets for its sale (For example, are there potential market participants that could acquire the asset? Is it legally possible to sell? Are there contractual, legal or other restrictions from selling? Does the asset itself have a history of being acquired and sold? Does the company have any history itself of acquiring and selling such assets?)
- the tax attributes of the asset (What is the tax base of the asset considering recent tax law changes? Will a sale actually crystallise the benefits of the capital gains tax base?), and
- whether the business combination occurred prior to the adoption of IFRS and how transition would impact the assessment?

In times of impairment, the expected manner of recovery could change to recovery through use as impairment is likely to be evidence of recovery through use.

How do I account for any change as a result of this IFRIC discussion?

For the June reporting season, it's likely that any change arising from the IFRIC discussion would be accounted for as a change in accounting policy (i.e. retrospectively). Careful consideration will need to be given in assessing the impacts of any change, such as:

- confirming that potentially impacted assets were acquired in business combination and not subject to the exemption in the tax accounting standard from recognising deferred tax when an asset or liability is initially recognised outside of a business combination
- understanding the impacts on any previous impairment assessments (that is, assessing whether the opening balance sheet impact is recognised as an adjustment to opening retained earnings - due to previous impairments - or goodwill)
- understanding whether there are any unrecognised deferred tax assets that may now be recoverable given deferred tax liabilities may serve as a source of taxable profits for their recognition, and
- whether this key judgement should be disclosed as an area of significant judgement/estimate.

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