

Urgent Issues Group

Interpretation 121

July 2004

Income Taxes – Recovery of Revalued Non-Depreciable Assets



Australian Government

**Australian Accounting
Standards Board**

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PREFACE

Reasons for Issuing UIG Interpretation 121

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's policy of adopting the Standards of the International Accounting Standards Board (IASB) for application to reporting periods beginning on or after 1 January 2005. The AASB has decided it will continue to issue sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. Except for Standards that are specific to the not-for-profit or public sectors or that are of a purely domestic nature, the AASB is using the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, to broaden the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues.

The same approach applies to UIG pronouncements. This Interpretation is part of the set of Australian equivalents to each International Accounting Standard (IAS), International Financial Reporting Standard (IFRS) and Interpretation of the IASB (collectively defined by the IASB as IFRSs). This set includes UIG Interpretations that correspond to the IASB Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

Main Features of this Interpretation

This Interpretation is applicable to annual reporting periods beginning on or after 1 January 2005. To promote comparability among the financial reports of Australian entities, early adoption of this Interpretation is not permitted.

Application of this Interpretation will begin in the first annual reporting period beginning on or after 1 January 2005 in the context of adopting all Australian equivalents to IFRSs. The requirements of Accounting Standard AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, the Australian equivalent of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, must be observed. AASB 1 requires prior period information, presented as comparative information, to be restated as if the requirements of this Interpretation had always applied. This differs from previous Australian requirements where changes in accounting policies did not require the restatement of the income statement and balance sheet of the preceding period.

The Interpretation clarifies the basis for measuring deferred taxes arising in relation to a revalued non-depreciable asset, when applying AASB 112

Income Taxes. The tax rate applicable to the taxable amount derived from the sale of the asset is to be applied, rather than the tax rate applicable to the taxable amount derived from using an asset.

Comparison with Superseded Requirements

There is no substantive difference with the requirements in Australia in Accounting Standards AASB 1020 and AAS 3 *Income Taxes* (1999). Now superseded by AASB 112, those Standards adopted the view that the carrying amount of a non-depreciable asset would only be recovered through sale (which is consistent with this Interpretation). The measurement of the deferred tax liabilities and assets was required to reflect the manner in which the carrying amount of the asset was expected to be recovered.

COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS

UIG Interpretation 121 is equivalent to Standing Interpretations Committee Interpretation SIC-21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets*, issued by the IASB. Paragraphs that have been added to this Interpretation (and do not appear in the text of the equivalent SIC Interpretation) are identified with the prefix “Aus”, followed by the number of the relevant SIC paragraph and decimal numbering.

Entities that comply with Interpretation 121 will simultaneously be in compliance with SIC-21.

International Public Sector Accounting Standards (IPSASs) are issued by the Public Sector Committee of the International Federation of Accountants. There is no specific IPSAS dealing with accounting for income taxes at present.

URGENT ISSUES GROUP

INTERPRETATION 121

INCOME TAXES – RECOVERY OF REVALUED NON-DEPRECIABLE ASSETS

ISSUE

1. Under Accounting Standard AASB 112 *Income Taxes*, paragraph 51, the measurement of deferred tax liabilities and assets should reflect the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover or settle the carrying amount of those assets and liabilities that give rise to temporary differences.
2. AASB 112.20 notes that the revaluation of an asset does not always affect taxable profit (tax loss) in the period of the revaluation and that the tax base of the asset may not be adjusted as a result of the revaluation. If the future recovery of the carrying amount will be taxable, any difference between the carrying amount of the revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset.
3. The issue is how to interpret the term “recovery” in relation to an asset that is not depreciated (non-depreciable asset) and is revalued in accordance with paragraph 31 of AASB 116 *Property, Plant and Equipment*.
4. This Interpretation also applies to investment properties that are carried at revalued amounts under AASB 140 *Investment Property*, paragraph 33, but would be considered non-depreciable if AASB 116 were to be applied.

CONSENSUS

5. **The deferred tax liability or asset that arises from the revaluation of a non-depreciable asset in accordance with AASB 116.31 shall be measured on the basis of the tax consequences that would follow from recovery of the carrying amount of that 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.

Application

- Aus5.1 This Interpretation applies when AASB 112 applies.**
- Aus5.2 This Interpretation applies to annual reporting periods beginning on or after 1 January 2005.**
- Aus5.3 This Interpretation shall not be applied to annual reporting periods beginning before 1 January 2005.**
- Aus5.4 The requirements specified in this Interpretation apply to the financial report where information resulting from their application is material in accordance with AASB 1031 *Materiality*.**

DISCUSSION

6. *The Framework for the Preparation and Presentation of Financial Statements* indicates that an entity recognises an asset if it is probable that the future economic benefits associated with the asset will flow to the entity. Generally, those future economic benefits will be derived (and therefore the carrying amount of an asset will be recovered) through sale, through use, or through use and subsequent sale. Recognition of depreciation implies that the carrying amount of a depreciable asset is expected to be recovered through use to the extent of its depreciable amount, and through sale at its residual value. Consistent with this, the carrying amount of a non-depreciable asset, such as land having an unlimited life, will be recovered only through sale. That is, because the asset is not depreciated, no part of its carrying amount is expected to be recovered (that is, consumed) through use. Deferred taxes associated with the non-depreciable asset reflect the tax consequences of selling the asset.
7. The expected manner of recovery is not predicated on the basis of measuring the carrying amount of the asset. For example, if the carrying amount of a non-depreciable asset is measured at its value in use, the basis of measurement does not imply that the carrying amount of the asset is expected to be recovered through use, but through its residual value upon ultimate disposal.

Date of SIC's Consensus: [Deleted by the UIG]

Effective Date of SIC-21: [Deleted by the UIG]

REFERENCES

Australia

The Urgent Issues Group discussed Issues Paper UIG/SIC 04/1 “Adoption of Various SIC Interpretations in Australia” in relation to this Interpretation at its meeting on 4 May 2004.

Accounting Standard AASB 112 *Income Taxes*

Accounting Standard AASB 116 *Property, Plant and Equipment*

Accounting Standard AASB 140 *Investment Property*

Framework for the Preparation and Presentation of Financial Statements

International Accounting Standards Board

International Accounting Standard IAS 12 *Income Taxes*

Standing Interpretations Committee Interpretation SIC-21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets*