DEFERRED TAX - RECOVERY OF INVESTMENT PROPERTY

AASB 112 *INCOME TAXES* REQUIRES THAT DEFERRED TAX LIABILITIES AND DEFERRED TAX ASSETS SHOULD REFLECT THE TAX CONSEQUENCES THAT WOULD FOLLOW FROM THE MANNER IN WHICH AN ENTITY EXPECTS TO RECOVER OR SETTLE THE AMOUNT OF THE ASSETS OR LIABILITIES THAT THE DEFERRED TAX RELATES TO.

The measurement of deferred tax liabilities and deferred tax assets therefore depends on whether an entity expects to recover an asset by using it or selling it, as in each case, different tax rates may apply. This is particularly relevant in countries such as Singapore and Hong Kong where there is no capital gains tax, thus an entity incurs tax if it uses the property to collect rent, but pays no tax if it sells the property.

Determining the method of recovery of the buildings portion of an investment property measured using the fair value model in AASB 140 *Investment Property* can be particularly tricky. When an entity chooses the fair value model for investment property, the entity expects to:

- Rent it out and earn rental income
- Sell it in future to benefit from any capital appreciation.

Without specific plans for disposal of the investment property, it is difficult and subjective to estimate how much of the carrying amount of the investment property will be recovered through cash flows from rental income, and how much will be recovered through cash flows from selling the asset.

To provide a practical approach in such cases, AASB 2010-8 was recently released. It amends AASB 112 *Income Taxes* to introduce a presumption that an investment property is recovered entirely through sale. This presumption is rebutted if the investment property is held within a business model whose objective is to consume substantially all of the economic benefits in the investment property over time, rather than through sale.

The IASB has made it clear that the presumption of recovery through sale cannot be rebutted if the asset is non-depreciable, because this implies that no part of the carrying amount of the asset would be consumed through use. The land portion of investment property will always therefore have a tax base that assumes recovery through sale.

Implications for Australian entities

Property trusts

The most popular investment vehicle in Australia for investment properties is through property trusts which generally do not pay tax and therefore do not recognise deferred tax liabilities. These amendments should not affect most property trusts holding investment property at fair value.

Pre CGT and post September 1999 properties

- These amendments are not likely to have an impact on investment properties acquired in the following time periods:
- Properties bought before 20 September 1985 because they attract no capital gain on sale and therefore no deferred tax liability is recognised
- Properties acquired since 20 September 1999 because indexation for capital gains tax purposes was suspended and the tax base should be similar, irrespective of whether the entity intends to recover the property through use or sale.

Properties acquired 20 September 1985 to 19 September 1999

These amendments could impact these properties where deferred tax liabilities have been calculated assuming recovery through use rather than sale because the tax base assuming a sale would have been subject to indexation until 19 September 1999, whereas a tax base for use would not have been indexed. However, in practice the impact may not be material because many of these properties may be near the end of their lives, in which case the business model rebuts the assumption of recovery through sale.

Application to overseas investments

The amendments are of particular relevance if they relate to properties held in jurisdictions which have significant differences between the corporate tax rate and the capital gains tax rate, e.g. Singapore, Hong Kong and the UK.

Application

The amendments apply to annual periods beginning on or after 1 January 2012 and may be adopted early. Comparatives will need to be restated because the amendments apply retrospectively.