

Recognising deferred tax on leases

May 2021

Illustrative examples

1. Leases

Company C enters into a 10-year lease of a building and recognises a right-of-use asset and a lease liability of 450. In addition, C incurs initial direct costs of 20.

On commencement of the lease, C records the following entries under IFRS 16 *Leases*.

	Debit	Credit
Right-of-use asset	450	
Lease liability		450
<i>To recognise lease liability and right-of-use asset</i>		
Right-of-use asset	20	
Cash		20
<i>To recognise initial direct costs</i>		

Local tax legislation allows tax deductions for lease payments and initial direct costs when they are paid. Economic benefits that will flow to C when it recovers the carrying amount of the right-of-use asset will be taxable. After considering the applicable tax legislation, C concludes that the tax deductions that it will receive for lease payments relate to the repayment of the lease liability.

The corporate tax rate is 20%.

C determines the temporary differences that arise on initial recognition of the lease as follows.

	Carrying amount	Tax base	Deductible (taxable) temporary difference	Deferred tax asset (liability) at 20%
Right-of-use asset				
– Initial direct cost	20	- ^a	(20)	(4)
– Initial measurement of lease liability	450	- ^b	(450)	(90)
Lease liability	(450)	- ^c	450	90

Notes

IAS 12.15(b)(ii)

a. The tax base of the initial direct costs is zero because C has already used the deduction for tax purposes when it made the payment. Because this transaction affected the taxable profit on initial recognition, C recognises a deferred tax liability for the taxable temporary difference of 20.

IAS 12.7

b. The tax base of the right-of-use asset is zero because the tax deduction relates to the lease liability and no tax deduction will be available for the asset.

IAS 12.8

c. The tax base of the lease liability is zero because it is determined as the carrying amount of 450 less the future tax deduction of 450.

On commencement of the lease, C records the following entry for the temporary differences.

	Debit	Credit
Income tax expense	4	
Deferred tax liability		94
Deferred tax asset	90	
<i>To recognise deferred tax on initial recognition of the lease</i>		

2. Decommissioning liability

Company B recognises a provision of 100 for decommissioning its nuclear plant, which it capitalised as part of the cost of the plant. For tax purposes, the expenditure will be deducted only when it is incurred and the tax deduction is allocated to the decommissioning liability.

The corporate tax rate is 30%.

B records the following entry to recognise the decommissioning liability.

	Debit	Credit
Property, plant and equipment	100	
Decommissioning liability		100
<i>To recognise the decommissioning liability</i>		

B determines the temporary differences arising on initial recognition of the decommissioning liability as follows.

	Carrying amount	Tax base	Deductible (taxable) temporary difference	Deferred tax asset (liability) at 30%
Property, plant and equipment	100	- ^a	(100)	(30)
Decommissioning liability	100	- ^b	100	30

Notes

IAS 12.7

a. The tax base of the property, plant and equipment is zero because the tax deduction relates to the decommissioning liability and no tax deduction will be available for the asset.

IAS 12.8

b. The tax base of the decommissioning liability is zero because it is determined as the carrying amount of 100 less the future tax deduction of 100.

On initial recognition of the decommissioning liability, B records the following entry for the temporary differences.

	Debit	Credit
Deferred tax asset	30	
Deferred tax liability		30
<i>To recognise deferred tax on property, plant and equipment and the decommissioning liability</i>		

Publication name: *Recognising deferred tax on leases – Illustrative examples*

Publication date: May 2021

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