DRAFT INTERPRETATION

HKAS-INT – 21
Income Taxes – Recovery of Revalued Non-Depreciable Assets

Paragraph 14 of HKAS 1, Presentation of Financial Statements, requires that financial statements should not be described as complying with Hong Kong Accounting Standards unless they comply with all the requirements of each applicable Standard and each applicable Interpretation. HKAS Interpretations are not intended to apply to immaterial items.

Reference: HKAS 12 *Income Taxes*

ISSUE

1. Under HKAS 12.51, the measurement of deferred tax liabilities and assets should reflect the tax consequences that would follow from the manner in which the enterprise expects, at the balance sheet date, to recover or settle the carrying amount of those assets and liabilities that give rise to temporary differences.

2. HKAS 12.20 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 under paragraph 31 of HKAS 16.

4. This Interpretation also applies to investment properties which are carried at revalued amounts under HKAS 40.33 but would be considered non-depreciable if HKAS 16 were to be applied.

CONSENSUS

5. The deferred tax liability or asset that arises from the revaluation of a non-depreciable asset under HKAS 16.31 should 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.

BASIS FOR CONCLUSIONS

6. The Framework indicates that an enterprise recognises an asset if it is probable that the future economic benefits associated with the asset will flow to the enterprise. 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 Issue: [   ] 2004

Effective Date: This consensus becomes effective on 1 January 2005. Changes in accounting policies should be accounted for in accordance with HKAS 8.

Withdrawal of Interpretation 20: This Interpretation supersedes Interpretation 20 *Income taxes – Recovery of Revalued Non-Depreciable Assets*.