

Recognising deferred tax on leases – Transition

May 2021

Illustrative example

On 1 January 2018, Company M and Company N each entered into a 10-year lease of a building with the following identical terms.

- The annual lease payments of 15 are payable at the end of each year.
- The interest rate implicit in the lease cannot be readily determined. The lessee's incremental borrowing rate is 8.15%.

The right-of-use asset and the lease liability at the relevant dates are as follows.

	Right-of-use asset	Lease liability
1 January 2018	100	(100)
1 January 2022	60	(69)
1 January 2023	50	(60)
31 December 2023	40	(50)

M and N adopt the IAS 12 amendments¹ in their annual financial statements for the period ending 31 December 2023 and present comparatives for one year – i.e. the beginning of the earliest comparative period presented is 1 January 2022.

Previously, M accounted for deferred tax on a lease under the net approach – i.e. it assessed the temporary differences on a net basis. N applied the initial recognition exemption and therefore recognised no deferred tax for leases. M and N determine the temporary differences relating to the right-of-use asset and the lease liability at 1 January 2022 as follows.

The corporate tax rate is 30%.

	Carrying amount	Tax base	Deductible (taxable) temporary difference	Deferred tax asset (liability) at 30%
Right-of-use asset	60	-	(60)	(18)
Lease liability	(69)	-	69	21
Net approach	(9)	-	9	3

¹ *Deferred Tax related to Assets and Liabilities arising from a Single Transaction (Amendments to IAS 12)*

M and N determine that the deferred tax asset meets the recognition criteria in IAS 12.

Because M previously accounted for deferred tax on a lease under the net approach, it records the following entry on transition (1 January 2022) in its statement of financial position to present separately the deferred tax asset and the deferred tax liability relating to the lease.

	Debit	Credit
Deferred tax asset	18*	
Deferred tax liability		18
<i>To present separately deferred tax asset and deferred tax liability</i>		

* M has already recognised deferred tax of 3 at 1 January 2022 so the deferred tax asset becomes 21.

There is no impact on M's retained earnings at 1 January 2022.

N previously applied the initial recognition exemption and recognised no deferred tax for leases. Therefore, N records the following entry on transition (1 January 2022) to recognise the deferred tax asset and the deferred tax liability relating to the lease.

	Debit	Credit
Deferred tax asset	21	
Deferred tax liability		18
Retained earnings		3
<i>To recognise deferred tax asset and deferred tax liability on transition</i>		

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