

January 2016

International Financial Reporting Standard<sup>®</sup>

# Recognition of Deferred Tax Assets for Unrealised Losses

Amendments to IAS 12

IASB<sup>®</sup>

 IFRS<sup>®</sup>

# **Recognition of Deferred Tax Assets for Unrealised Losses**

(Amendments to IAS 12)

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ISBN: 978-1-911040-14-9

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## Amendments to IAS 12 *Income Taxes*

Paragraph 29 is amended and paragraphs 27A, 29A and 98G are added. An example following paragraph 26 is also added. New text is underlined. Paragraphs 24, 26(d), 27 and 28 have not been amended but are included for ease of reference.

### Deductible temporary differences

24 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

- (a) is not a business combination; and
- (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44.

...

26 The following are examples of deductible temporary differences that result in deferred tax assets:

- (a) ...
- (d) certain assets may be carried at fair value, or may be revalued, without an equivalent adjustment being made for tax purposes (see paragraph 20). A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.

#### **Example illustrating paragraph 26(d)**

Identification of a deductible temporary difference at the end of Year 2:

Entity A purchases for CU1,000, at the beginning of Year 1, a debt instrument with a nominal value of CU1,000 payable on maturity in 5 years with an interest rate of 2% payable at the end of each year. The effective interest rate is 2%. The debt instrument is measured at fair value.

At the end of Year 2, the fair value of the debt instrument has decreased to CU918 as a result of an increase in market interest rates to 5%. It is probable that Entity A will collect all the contractual cash flows if it continues to hold the debt instrument.

*continued...*

...continued

<b>Example illustrating paragraph 26(d)</b>
<p><u>Any gains (losses) on the debt instrument are taxable (deductible) only when realised. The gains (losses) arising on the sale or maturity of the debt instrument are calculated for tax purposes as the difference between the amount collected and the original cost of the debt instrument.</u></p> <p><u>Accordingly, the tax base of the debt instrument is its original cost.</u></p> <p><u>The difference between the carrying amount of the debt instrument in Entity A's statement of financial position of CU918 and its tax base of CU1,000 gives rise to a deductible temporary difference of CU82 at the end of Year 2 (see paragraphs 20 and 26(d)), irrespective of whether Entity A expects to recover the carrying amount of the debt instrument by sale or by use, ie by holding it and collecting contractual cash flows, or a combination of both.</u></p> <p><u>This is because deductible temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods, when the carrying amount of the asset or liability is recovered or settled (see paragraph 5). Entity A obtains a deduction equivalent to the tax base of the asset of CU1,000 in determining taxable profit (tax loss) either on sale or on maturity.</u></p>

- 27 The reversal of deductible temporary differences results in deductions in determining taxable profits of future periods. However, economic benefits in the form of reductions in tax payments will flow to the entity only if it earns sufficient taxable profits against which the deductions can be offset. Therefore, an entity recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised.
- 27A When an entity assesses whether taxable profits will be available against which it can utilise a deductible temporary difference, it considers whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. If tax law imposes no such restrictions, an entity assesses a deductible temporary difference in combination with all of its other deductible temporary differences. However, if tax law restricts the utilisation of losses to deduction against income of a specific type, a deductible temporary difference is assessed in combination only with other deductible temporary differences of the appropriate type.
- 28 It is probable that taxable profit will be available against which a deductible temporary difference can be utilised when there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity which are expected to reverse:
- (a) in the same period as the expected reversal of the deductible temporary difference; or
  - (b) in periods into which a tax loss arising from the deferred tax asset can be carried back or forward.

In such circumstances, the deferred tax asset is recognised in the period in which the deductible temporary differences arise.

29 When there are insufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, the deferred tax asset is recognised to the extent that:

(a) it is probable that the entity will have sufficient taxable profit relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference (or in the periods into which a tax loss arising from the deferred tax asset can be carried back or forward). In evaluating whether it will have sufficient taxable profit in future periods, an entity:

(i) compares the deductible temporary differences with future taxable profit that excludes tax deductions resulting from the reversal of those deductible temporary differences. This comparison shows the extent to which the future taxable profit is sufficient for the entity to deduct the amounts resulting from the reversal of those deductible temporary differences.

(ii) ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from these deductible temporary differences will itself require future taxable profit in order to be utilised.

(b) tax planning opportunities are available to the entity that will create taxable profit in appropriate periods.

29A The estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this. For example, when an asset is measured at fair value, the entity shall consider whether there is sufficient evidence to conclude that it is probable that the entity will recover the asset for more than its carrying amount. This may be the case, for example, when an entity expects to hold a fixed-rate debt instrument and collect the contractual cash flows.

...

## Effective date

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...

98G Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12), issued in January 2016, amended paragraph 29 and added paragraphs 27A, 29A and the example following paragraph 26. An entity shall apply those amendments for annual periods beginning on or after 1 January 2017. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact. An entity shall apply those amendments retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. However, on initial application of the amendment, the change in the opening

RECOGNITION OF DEFERRED TAX ASSETS FOR UNREALISED LOSSES

equity of the earliest comparative period may be recognised in opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. If an entity applies this relief, it shall disclose that fact.

**Approval by the Board of *Recognition of Deferred Tax Assets for Unrealised Losses* (Amendments to IAS 12) issued in January 2016**

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*Recognition of Deferred Tax Assets for Unrealised Losses* was approved for issue by the fourteen members of the International Accounting Standards Board.

Hans Hoogervorst	Chairman
Ian Mackintosh	Vice-Chairman
Stephen Cooper	
Philippe Danjou	
Martin Edelmann	
Patrick Finnegan	
Amaro Gomes	
Gary Kabureck	
Suzanne Lloyd	
Takatsugu Ochi	
Darrel Scott	
Chungwoo Suh	
Mary Tokar	
Wei-Guo Zhang	

## Amendments to the Basis for Conclusions on IAS 12 *Income Taxes*

Paragraphs BC1A and BC37–BC62 and their related headings are added. New text is underlined.

### Introduction

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...

BC1A In August 2014 the Board published an Exposure Draft of proposed amendments to IAS 12 to clarify the requirements on recognition of deferred tax assets for unrealised losses on debt instruments measured at fair value. The Board subsequently modified and confirmed the proposals and in January 2016 issued *Recognition of Deferred Tax Assets for Unrealised Losses* (Amendments to IAS 12). The Board's considerations and reasons for its conclusions are discussed in paragraphs BC37–BC62.

...

### **Recognition of Deferred Tax Assets for Unrealised Losses (2016 amendments)**

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BC37 The IFRS Interpretations Committee (the 'Interpretations Committee') was asked to provide guidance on how an entity determines, in accordance with IAS 12, whether to recognise a deferred tax asset when:

- (a) the entity has a debt instrument that is classified as an available-for-sale financial asset in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.<sup>1</sup> Changes in the market interest rate result in a decrease in the fair value of the debt instrument to below its cost (ie it has an 'unrealised loss');
- (b) it is probable that the issuer of the debt instrument will make all the contractual payments;
- (c) the tax base of the debt instrument is cost;
- (d) tax law does not allow a loss to be deducted on a debt instrument until the loss is realised for tax purposes;
- (e) the entity has the ability and intention to hold the debt instrument until the unrealised loss reverses (which may be at its maturity);
- (f) tax law distinguishes between capital gains and losses and ordinary income and losses. While capital losses can only be offset against capital gains, ordinary losses can be offset against both capital gains and ordinary income; and

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<sup>1</sup> IFRS 9 *Financial Instruments* replaced IAS 39. IFRS 9 applies to all items that were previously within the scope of IAS 39. Under IFRS 9, the same question arises for debt instruments measured at fair value.

- (g) the entity has insufficient taxable temporary differences and no other probable taxable profits against which the entity can utilise deductible temporary differences.

BC38 The Interpretations Committee reported to the Board that practice differed because of divergent views on the following questions:

- (a) Do decreases in the carrying amount of a fixed-rate debt instrument for which the principal is paid on maturity always give rise to a deductible temporary difference if this debt instrument is measured at fair value and if its tax base remains at cost? In particular, do they give rise to a deductible temporary difference if the debt instrument's holder expects to recover the carrying amount of the asset by use, ie continuing to hold it, and if it is probable that the issuer will pay all the contractual cash flows? (see paragraphs BC39–BC45)
- (b) Does an entity assume that it will recover an asset for more than its carrying amount when estimating probable future taxable profit against which deductible temporary differences are assessed for utilisation if such recovery is probable? This question is relevant when taxable profit from other sources is insufficient for the utilisation of the deductible temporary differences related to debt instruments measured at fair value. In this case, an entity may only be able to recognise deferred tax assets for its deductible temporary differences if it is probable that it will collect the entire cash flows from the debt instrument and therefore recover it for more than its carrying amount. (see paragraphs BC46–BC54)
- (c) When an entity assesses whether it can utilise deductible temporary differences against probable future taxable profit, does that probable future taxable profit include the effects of reversing deductible temporary differences? (see paragraphs BC55–BC56)
- (d) Does an entity assess whether a deferred tax asset is recognised for each deductible temporary difference separately or in combination with other deductible temporary differences? This question is relevant, for example, when tax law distinguishes capital gains and losses from other taxable gains and losses and capital losses can only be offset against capital gains. (see paragraphs BC57–BC59)

### **Existence of a deductible temporary difference**

BC39 In the case of many debt instruments, the collection of the principal on maturity does not increase or decrease taxable profit that is reported for tax purposes. This is the case in the example illustrating paragraph 26(d) of IAS 12. Interest is paid at the contractual rate each year, and on maturity of the debt instrument the issuer pays the principal of CU1,000. In this example, if the investor continues to hold the debt instrument, the investor only pays taxes on the interest income. The collection of the principal does not trigger any tax payments.

BC40 Because the collection of the principal does not increase or decrease the taxable profit that is reported for tax purposes, some thought that the collection of the

principal is a non-taxable event. Sometimes, tax law does not explicitly address whether the collection of the principal has tax consequences. Consequently, proponents of this view thought that a difference between the carrying amount of the debt instrument in the statement of financial position and its higher tax base does not give rise to a deductible temporary difference, if this difference results from a loss that they expect will not be realised for tax purposes.

BC41 Those who held this view thought that the loss would not be realised for tax purposes if the entity has the ability and intention to hold the debt instrument over the period until the loss reverses, which might be until maturity, and it is probable that the entity will receive all the contractual cash flows. In this case, differences between the carrying amount of the debt instrument in the statement of financial position and its tax base reverse over the period to maturity, as a result of continuing to hold the debt instrument.

BC42 The Board considered the guidance in IAS 12 on the identification of temporary differences and rejected the reasoning presented in paragraphs BC40 and BC41. Paragraphs 20 and 26(d) of IAS 12 specify that a difference between the carrying amount of an asset measured at fair value and its higher tax base gives rise to a deductible temporary difference. This is because the calculation of a temporary difference in IAS 12 is based on the premise that the entity will recover the carrying amount of an asset, and hence economic benefits will flow to the entity in future periods to the extent of the asset's carrying amount at the end of the reporting period. In contrast, the view presented in paragraphs BC40 and BC41 is based on the assessment of the economic benefits that are expected at maturity. The Board noted that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount.

BC43 Consequently, the Board concluded that decreases below cost in the carrying amount of a fixed-rate debt instrument measured at fair value for which the tax base remains at cost give rise to a deductible temporary difference. This applies irrespective of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use, ie continuing to hold it, or whether it is probable that the issuer will pay all the contractual cash flows. Normally, the collection of the entire principal does not increase or decrease taxable profit that is reported for tax purposes, because the tax base equals the inflow of taxable economic benefits when the principal is paid. Typically, the tax base of the debt instrument is deducted either on sale or on maturity.

BC44 The economic benefit embodied in the related deferred tax asset arises from the ability of the holder of the debt instrument to achieve future taxable gains in the amount of the deductible temporary difference without paying taxes on those gains. In contrast, an entity that acquires the debt instrument described in the example illustrating paragraph 26(d) of IAS 12 for its fair value at the end of Year 2 (in the example, CU918) and continues to hold it, has to pay taxes on a gain of CU82, whereas the entity in that example will not pay any taxes on the collection of the CU1,000 of principal. The Board concluded that it was

appropriate for the different tax consequences for these two holders of the same instrument to be reflected in the deferred tax accounting for the debt instrument.

BC45 The Board has added an example after paragraph 26 of IAS 12 to illustrate the identification of a deductible temporary difference in the case of a fixed-rate debt instrument measured at fair value for which the principal is paid on maturity.

### **Recovering an asset for more than its carrying amount**

BC46 The Board noted that paragraph 29 of IAS 12 identifies taxable profit in future periods as one source of taxable profits against which an entity can utilise deductible temporary differences. Future taxable profit has to be probable to justify the recognition of deferred tax assets.

BC47 The guidance in paragraph 29 of IAS 12 does not refer to the carrying amount of assets within the context of estimating probable future taxable profit. Some thought, however, that the carrying amount of an asset to which a temporary difference is related limits the estimate of future taxable profit. They argued that accounting for deferred taxes should be based on consistent assumptions, which implies that an entity cannot assume that, for one and the same asset, the entity will recover it:

- (a) for its carrying amount when determining deductible temporary differences and taxable temporary differences; as well as
- (b) for more than its carrying amount when estimating probable future taxable profit against which deductible temporary differences are assessed for utilisation.

BC48 Consequently, proponents of this view thought that an entity cannot assume that it will collect the entire principal of CU1,000 in the example illustrating paragraph 26(d) of IAS 12 when determining probable future taxable profit. Instead, they thought that an entity must assume that it will collect only the carrying amount of the asset.

BC49 The Board noted however that determining temporary differences and estimating probable future taxable profit against which deductible temporary differences are assessed for utilisation are two separate steps and the carrying amount of an asset is relevant only to determining temporary differences. The carrying amount of an asset does not limit the estimation of probable future taxable profit. In its estimate of probable future taxable profit, an entity includes the probable inflow of taxable economic benefits that results from recovering an asset. This probable inflow of taxable economic benefits may exceed the carrying amount of the asset.

BC50 Moreover, a limitation on the estimate of probable future taxable profit by the carrying amount of assets can lead to inappropriate results in other scenarios. For example, a significant part of the assets of a profitable manufacturing entity is property, plant and equipment and inventories. Property, plant and equipment may be measured using the cost model (paragraph 30 of IAS 16 *Property, Plant and Equipment*) and inventories are measured at the lower of cost

and net realisable value (paragraph 9 of IAS 2 Inventories). If such an entity expects to generate future taxable profit, it may be inconsistent to assume that it will only recover these assets for their carrying amount. This is because a significant part of the manufacturing entity's probable future taxable profit results from using those assets to generate taxable profit in excess of their carrying amount.

BC51 If a limitation such as the one described in paragraph BC50 was made, then, for the purpose of consistency, the entity would need to assume that it will not recover any of its assets for more than their carrying amount. The Board decided that it would not be appropriate to limit the estimate of probable future taxable profit to the carrying amount of related assets only for assets to which temporary differences are related, because there is no basis for a different assessment that would depend on whether a deductible temporary difference is related to an asset or not.

BC52 Some respondents to the Exposure Draft expressed concern that the guidance might be applied more broadly, and in their view, inappropriately, to other assets, and not merely to debt instruments measured at fair value. Some other respondents were concerned that any guidance would give the false impression that future taxable profit should be estimated on an individual asset basis. The Board noted that the principle that the estimate of probable future taxable profit includes an expected recovery of assets for more than their carrying amounts is not limited to any specific type or class of assets.

BC53 However, the Board also noted that there are cases in which it may not be probable that an asset will be recovered for more than its carrying amount. An entity should not inappropriately assume that an asset will be recovered for more than its carrying amount. The Board thought that this is particularly important when the asset is measured at fair value. In response to that concern, the Board noted that entities will need to have sufficient evidence on which to base their estimate of probable future taxable profit, including when that estimate involves the recovery of an asset for more than its carrying amount. For example, in the case of a fixed-rate debt instrument measured at fair value, the entity may judge that the contractual nature of future cash flows, as well as the assessment of the likelihood that those contractual cash flows will be received, adequately supports the conclusion that it is probable that it will recover the fixed-rate debt instrument for more than its carrying amount, if the expected cash flows exceed the debt instrument's carrying amount. The Board thought that such an example could enhance understanding and reduce the risk of arbitrary estimates of future taxable profit.

BC54 The Board has added paragraph 29A to IAS 12 to clarify to what extent an entity's estimate of future taxable profit (paragraph 29) includes amounts from recovering assets for more than their carrying amounts.

**Probable future taxable profit against which deductible temporary differences are assessed for utilisation**

BC55 The Interpretations Committee observed that there is uncertainty about how to determine probable future taxable profit against which deductible temporary differences are assessed for utilisation when this profit is being assessed to

determine the recognition of all deferred tax assets. The uncertainty relates to whether the probable future taxable profit should include or exclude deductions that will arise when those deductible temporary differences reverse.

- BC56 The Board noted that deductible temporary differences are utilised by deduction against taxable profit, excluding deductions arising from reversal of those deductible temporary differences. Consequently, taxable profit used for assessing the utilisation of deductible temporary differences is different from taxable profit on which income taxes are payable, as defined in paragraph 5 of IAS 12. If those deductions were not excluded, then they would be counted twice. The Board has amended paragraph 29(a) to clarify this.

### **Combined versus separate assessment**

- BC57 The Board considered the guidance in IAS 12 on the recognition of deferred tax assets. Paragraph 24 of IAS 12 requires deferred tax assets to be recognised only to the extent of probable future taxable profit against which the deductible temporary differences can be utilised. Paragraph 27 explains that:

- (a) the deductible temporary differences are utilised when their reversal results in deductions that are offset against taxable profits of future periods; and
- (b) economic benefits in the form of reductions in tax payments will flow to the entity only if it earns sufficient taxable profits against which the deductions can be offset.

- BC58 The Board noted that:

- (a) tax law determines which deductions are offset against taxable income in determining taxable profits. The Board also noted that paragraph 5 of IAS 12 defines taxable profit as the profit of a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable.
- (b) no deferred tax asset is recognised if the reversal of the deductible temporary difference will not lead to tax deductions.

- BC59 Consequently, if tax law offsets a deduction against taxable income on an entity basis, without segregating deductions from different sources, an entity carries out a combined assessment of all its deductible temporary differences relating to the same taxation authority and the same taxable entity. However, if tax law offsets specific types of losses only against a particular type, or types, of income (for example, if tax law limits the offset of capital losses to capital gains), an entity assesses a deductible temporary difference in combination with other deductible temporary differences of that type(s), but separately from other deductible temporary differences. Segregating deductible temporary differences in accordance with tax law and assessing them on such a basis is necessary to determine whether taxable profits are sufficient to utilise deductible temporary differences. The Board has added paragraph 27A to IAS 12 to clarify this.

### **Transition**

- BC60      The Board decided to require the adjustment of comparative information for any earlier periods presented. However, this amendment allows the change in opening equity of the earliest comparative period presented that arises upon the first application of the amendment to be recognised in opening retained earnings (or in another component of equity, as appropriate), without the need to allocate the change between opening retained earnings and other components of equity. This is to avoid undue cost and effort.
- BC61      The Board noted that, with the exception of the amounts that would have to be adjusted within equity, the accounting required by these proposed amendments is based on amounts and estimates at the end of the reporting periods. The changes to the accounting are mechanical in nature and so the Board expects that the cost of adjusting comparatives should not exceed the benefits of greater comparability.
- BC62      The Board has not added additional transition relief for first-time adopters. This is consistent with the fact that IFRS 1 *First-time Adoption of International Financial Reporting Standards* does not include an exception to, or exemption from, the retrospective application of the requirements in IAS 12.

**Amendments to the Illustrative examples on IAS 12 *Income Taxes***

Example 7—Debt instruments measured at fair value is added. New text is underlined.
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**Example 7—Debt instruments measured at fair value****Debt instruments**

At 31 December 20X1, Entity Z holds a portfolio of three debt instruments:

<b>Debt Instrument</b>	<b>Cost (CU)</b>	<b>Fair value (CU)</b>	<b>Contractual interest rate</b>
<b>A</b>	2,000,000	1,942,857	2.00%
<b>B</b>	750,000	778,571	9.00%
<b>C</b>	2,000,000	1,961,905	3.00%

Entity Z acquired all the debt instruments on issuance for their nominal value. The terms of the debt instruments require the issuer to pay the nominal value of the debt instruments on their maturity on 31 December 20X2.

Interest is paid at the end of each year at the contractually fixed rate, which equalled the market interest rate when the debt instruments were acquired. At the end of 20X1, the market interest rate is 5 per cent, which has caused the fair value of Debt Instruments A and C to fall below their cost and the fair value of Debt Instrument B to rise above its cost. It is probable that Entity Z will receive all the contractual cash flows if it continues to hold the debt instruments.

At the end of 20X1, Entity Z expects that it will recover the carrying amounts of Debt Instruments A and B through use, ie by continuing to hold them and collecting contractual cash flows, and Debt Instrument C by sale at the beginning of 20X2 for its fair value on 31 December 20X1. It is assumed that no other tax planning opportunity is available to Entity Z that would enable it to sell Debt Instrument B to generate a capital gain against which it could offset the capital loss arising from selling Debt Instrument C.

The debt instruments are measured at fair value through other comprehensive income in accordance with IFRS 9 *Financial Instruments* (or IAS 39 *Financial Instruments: Recognition and Measurement*<sup>2</sup>).

**Tax law**

The tax base of the debt instruments is cost, which tax law allows to be offset either on maturity when principal is paid or against the sale proceeds when the debt instruments are sold. Tax law specifies that gains (losses) on the debt instruments are taxable (deductible) only when realised.

Tax law distinguishes ordinary gains and losses from capital gains and losses. Ordinary losses can be offset against both ordinary gains and capital gains. Capital losses can only be offset against capital gains. Capital losses can be carried forward for 5 years and ordinary losses can be carried forward for 20 years.

<sup>2</sup> IFRS 9 replaced IAS 39. IFRS 9 applies to all items that were previously within the scope of IAS 39.

Ordinary gains are taxed at 30 per cent and capital gains are taxed at 10 per cent.

Tax law classifies interest income from the debt instruments as 'ordinary' and gains and losses arising on the sale of the debt instruments as 'capital'. Losses that arise if the issuer of the debt instrument fails to pay the principal on maturity are classified as ordinary by tax law.

## **General**

On 31 December 20X1, Entity Z has, from other sources, taxable temporary differences of CU50,000 and deductible temporary differences of CU430,000, which will reverse in ordinary taxable profit (or ordinary tax loss) in 20X2.

At the end of 20X1, it is probable that Entity Z will report to the tax authorities an ordinary tax loss of CU200,000 for the year 20X2. This tax loss includes all taxable economic benefits and tax deductions for which temporary differences exist on 31 December 20X1 and that are classified as ordinary by tax law. These amounts contribute equally to the loss for the period according to tax law.

Entity Z has no capital gains against which it can utilise capital losses arising in the years 20X1–20X2.

Except for the information given in the previous paragraphs, there is no further information that is relevant to Entity Z's accounting for deferred taxes in the period 20X1–20X2.

## **Temporary differences**

At the end of 20X1, Entity Z identifies the following temporary differences:

	<b>Carrying amount (CU)</b>	<b>Tax base (CU)</b>	<b>Taxable temporary differences (CU)</b>	<b>Deductible temporary differences (CU)</b>
Debt Instrument A	1,942,857	2,000,000		57,143
Debt Instrument B	778,571	750,000	28,571	
Debt Instrument C	1,961,905	2,000,000		38,095
Other sources	Not specified		50,000	430,000

The difference between the carrying amount of an asset or liability and its tax base gives rise to a deductible (taxable) temporary difference (see paragraphs 20 and 26(d) of the Standard). This is because deductible (taxable) temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base, which will result in amounts that are deductible (taxable) in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled (see paragraph 5 of the Standard).

## **Utilisation of deductible temporary differences**

With some exceptions, deferred tax assets arising from deductible temporary differences are recognised to the extent that sufficient future taxable profit will be available against which the deductible temporary differences are utilised (see paragraph 24 of the Standard).

Paragraphs 28–29 of IAS 12 identify the sources of taxable profits against which an entity can utilise deductible temporary differences. They include:

- (a) future reversal of existing taxable temporary differences;
- (b) taxable profit in future periods; and
- (c) tax planning opportunities.

The deductible temporary difference that arises from Debt Instrument C is assessed separately for utilisation. This is because tax law classifies the loss resulting from recovering the carrying amount of Debt Instrument C by sale as capital and allows capital losses to be offset only against capital gains (see paragraph 27A of the Standard).

The separate assessment results in not recognising a deferred tax asset for the deductible temporary difference that arises from Debt Instrument C because Entity Z has no source of taxable profit available that tax law classifies as capital.

In contrast, the deductible temporary difference that arises from Debt Instrument A and other sources are assessed for utilisation in combination with one another. This is because their related tax deductions would be classified as ordinary by tax law.

The tax deductions represented by the deductible temporary differences related to Debt Instrument A are classified as ordinary because the tax law classifies the effect on taxable profit (tax loss) from deducting the tax base on maturity as ordinary.

In assessing the utilisation of deductible temporary differences on 31 December 20X1, the following two steps are performed by Entity Z.

**Step 1: Utilisation of deductible temporary differences because of the reversal of taxable temporary differences (see paragraph 28 of the Standard)**

Entity Z first assesses the availability of taxable temporary differences as follows:

	(CU)
<u>Expected reversal of deductible temporary differences in 20X2</u>	
From Debt Instrument A	57,143
From other sources	430,000
<u>Total reversal of deductible temporary differences</u>	<u>487,143</u>
<u>Expected reversal of taxable temporary differences in 20X2</u>	
From Debt Instrument B	(28,571)
From other sources	(50,000)
<u>Total reversal of taxable temporary differences</u>	<u>(78,571)</u>
<u>Utilisation because of the reversal of taxable temporary differences (Step 1)</u>	<u>78,571</u>
<u>Remaining deductible temporary differences to be assessed for utilisation in Step 2 (487,143 – 78,571)</u>	<u>408,572</u>

In Step 1, Entity Z can recognise a deferred tax asset in relation to a deductible temporary difference of CU78,571.

## **Step 2: Utilisation of deductible temporary differences because of future taxable profit (see paragraph 29(a) of the Standard)**

In this step, Entity Z assesses the availability of future taxable profit as follows:

	(CU)
<u>Probable future tax profit (loss) in 20X2 (upon which income taxes are payable (recoverable))</u>	<u>(200,000)</u>
<u>Add back: reversal of deductible temporary differences expected to reverse in 20X2</u>	<u>487,143</u>
<u>Less: reversal of taxable temporary differences (utilised in Step 1)</u>	<u>(78,571)</u>
<b><u>Probable taxable profit excluding tax deductions for assessing utilisation of deductible temporary differences in 20X2</u></b>	<b><u>208,572</u></b>
<u>Remaining deductible temporary differences to be assessed for utilisation from Step 1</u>	<u>408,572</u>
<b><u>Utilisation because of future taxable profit (Step 2)</u></b>	<b><u>208,572</u></b>
<u>Utilisation because of the reversal of taxable temporary differences (Step 1)</u>	<u>78,571</u>
<b><u>Total utilisation of deductible temporary differences</u></b>	<b><u>287,143</u></b>

The tax loss of CU200,000 includes the taxable economic benefit of CU2 million from the collection of the principal of Debt Instrument A and the equivalent tax deduction, because it is probable that Entity Z will recover the debt instrument for more than its carrying amount (see paragraph 29A of the Standard).

The utilisation of deductible temporary differences is not, however, assessed against probable future taxable profit for a period upon which income taxes are payable (see paragraph 5 of the Standard). Instead, the utilisation of deductible temporary differences is assessed against probable future taxable profit that excludes tax deductions resulting from the reversal of deductible temporary differences (see paragraph 29(a) of the Standard). Assessing the utilisation of deductible temporary differences against probable future taxable profits without excluding those deductions would lead to double counting the deductible temporary differences in that assessment.

In Step 2, Entity Z determines that it can recognise a deferred tax asset in relation to a future taxable profit, excluding tax deductions resulting from the reversal of deductible temporary differences, of CU208,572. Consequently, the total utilisation of deductible temporary differences amounts to CU287,143 (CU78,571 (Step 1) + CU208,572 (Step 2)).

## **Measurement of deferred tax assets and deferred tax liabilities**

Entity Z presents the following deferred tax assets and deferred tax liabilities in its financial statements on 31 December 20X1:

	(CU)
<u>Total taxable temporary differences</u>	<u>78,571</u>
<u>Total utilisation of deductible temporary differences</u>	<u>287,143</u>
<u>Deferred tax liabilities (78,571 at 30%)</u>	<u>23,571</u>
<u>Deferred tax assets (287,143 at 30%)</u>	<u>86,143</u>

The deferred tax assets and the deferred tax liabilities are measured using the tax rate for ordinary gains of 30 per cent, in accordance with the expected manner of recovery (settlement) of the underlying assets (liabilities) (see paragraph 51 of the Standard).

### **Allocation of changes in deferred tax assets between profit or loss and other comprehensive income**

Changes in deferred tax that arise from items that are recognised in profit or loss are recognised in profit or loss (see paragraph 58 of the Standard). Changes in deferred tax that arise from items that are recognised in other comprehensive income are recognised in other comprehensive income (see paragraph 61A of the Standard).

Entity Z did not recognise deferred tax assets for all of its deductible temporary differences at 31 December 20X1, and according to tax law all the tax deductions represented by the deductible temporary differences contribute equally to the tax loss for the period. Consequently, the assessment of the utilisation of deductible temporary differences does not specify whether the taxable profits are utilised for deferred tax items that are recognised in profit or loss (ie the deductible temporary differences from other sources) or whether instead the taxable profits are utilised for deferred tax items that are recognised in other comprehensive income (ie the deductible temporary differences related to debt instruments classified as fair value through other comprehensive income).

For such situations, paragraph 63 of the Standard requires the changes in deferred taxes to be allocated to profit or loss and other comprehensive income on a reasonable pro rata basis or by another method that achieves a more appropriate allocation in the circumstances.

ISBN 978-1-911040-14-9



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The IASB is the independent standard-setting body of the IFRS Foundation®

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