Project **Agenda decision**

Topic **IAS 12 *Income Taxes* – Recognition of deferred tax assets for unrealised losses on available-for-sale debt securities**

Introduction

1. In May 2010, the Committee published a tentative agenda decision not to add to its agenda a request for guidance relating to how an entity determines, in accordance with IAS 12 *Income Taxes*, whether to recognise a deferred tax asset relating to unrealised losses on available-for-sale debt securities (AFS debt securities).

2. The Committee noted that the objectives of IAS 12, and the deferred tax recognition principle relating to deductible temporary differences, are based on recovering or settling the carrying amount of the asset or liability at the reporting date.

3. The Committee also noted that, in the context of the fact pattern in the request, the entity's actions to hold the AFS debt securities to maturity do not meet the definition in IAS 12.30 of a tax planning opportunity. In addition, the approach in IAS 12.24-31 requires an entity to assess the probability of realising deferred tax assets on a combined basis that is consistent with the rules established by the taxation authorities.

4. The Committee noted that IAS 12 provides sufficient guidance on the recognition of deferred tax assets relating to AFS debt securities, and that the Committee does not expect significant diversity in practice. Consequently, the Committee tentatively decided not to add this issue to its agenda.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IFRS Interpretations Committee.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRS Interpretations Committee or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

Comments received

5. The Committee received six comment letters[1] on this issue.

6. The first comment letter agreed with the tentative agenda decision made by the Committee.

7. Five other comment letters disagreed with the tentative decision made by the Committee. Many of them believe that due process can only be applied if the issue is addressed through either an interpretation to clarify the intent of current IFRSs or through an amendment to IFRSs.

8. They made the following technical arguments against the tentative agenda decision:

   (a) the entity does not expect the unrealised loss to ever be realised in a future reporting period. As a result, the deductible temporary difference relating to the AFS debt securities will reverse automatically. Consequently, the unrealised losses will never require any other source of future taxable income to demonstrate realisation of the deferred tax assets; and

   (b) the term 'tax planning opportunity' in IAS 12.30 should include not only actions to generate taxable income before the expiry of a tax loss, or a tax credit carryforward, but also actions deferring the claim for certain deductions from taxable profit in accordance with IAS 12.30(b).

9. They also made the following arguments against the wording in, and the form of, the tentative agenda decision:

   (a) The issue is not clear within the context of IAS 12. The issue is widespread, and significant divergence exists both in the USA and in Europe. Consequently, this issue should be addressed through a clarification in the form of an interpretation or by an amendment to

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[1] Deloitte Touche Tohmatsu, Ernst & Young, the American Council of Life Insurers, The European Insurance CFO Forum, Dutch Accounting Standards Board and HSBC Holdings plc.

IAS 12. This issue should not merely be subject to a tentative agenda decision.

(b) The Committee or the Board should consider including effective date and transitional guidance for entities applying an alternative approach in existing practice. This is because the agenda decision could lead to:

(i) divergence between US GAAP and IFRSs, at least until the FASB finalise the comment letter process and redeliberations relating to the Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivatives and Hedge Accounting* (the 'ED'); and

(ii) concerns that entities that took a different view will have to restate previously- issued financial statements.

Staff analysis

Arguments based on a view that temporary differences relating to AFS debt securities will reverse without affecting taxable profit

10. Some comment letters included arguments that a deferred tax asset should be recognised for temporary differences relating to AFS debt securities that are to be held until a loss reverses. This is because these temporary differences will reverse without affecting taxable profit.

11. The staff believe that the Committee has already considered this argument and tentatively concluded that this view conflicts with the principle in IAS 12, which is based on an assumption that the carrying amount of an asset or a liability will be recovered or settled.

12. Furthermore, the staff would argue that an extension of this view is that because the unrealised loss will reverse without affecting taxable profit, there should not be a tax asset at the reporting date, because there will not be a tax deduction in future.

13. The staff do not believe that the Committee needs to reconsider the conclusion that it reached in May, because the comment letters do not introduce any additional technical arguments.

Arguments based on a tax planning opportunity to include actions to defer the claim of certain deductions

14. The Committee has tentatively concluded that in the context of the fact pattern in the request, the entity's actions in holding the AFS debt securities to maturity do not meet the definition of a tax planning opportunity.

15. After analysis of the comment letters, the staff do not believe that the Committee needs to change its tentative conclusion, but they do think that the wording in IAS 12.30 could be clarified.

16. US GAAP uses the term 'taxable income' as a net income subject to income tax[2]. However, IAS 12 does not define 'taxable income' but defines 'taxable profit' as net income subject to income tax[3].

17. IAS 12.30 defines tax planning opportunities as actions to create or increase taxable **income**. IAS 12.30(b) also includes examples of tax planning opportunities, when there is an action to defer the claim of certain deductions from taxable **profit**.

18. The staff think that this is intended to mean that actions to defer the claim of deductions against taxable income (**revenue**) is a tax planning opportunity to the extent that the entity has potential taxable **profit** that would not be offset by the deduction if such action is taken.

19. If the staff understanding above is correct, the entity's intent and ability to hold the AFS debt securities until a loss reverses is not sufficient to qualify as a tax planning opportunity.

20. In addition, this situation requires an entity to have potential taxable profit that would not be offset by the loss from the AFS debt securities if such action is taken.

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[2] ASC Topic 740-20-20 defines the term 'taxable income' as 'the excess of taxable revenues over tax deductible expenses and exemptions for the year as defined by the governmental taxing authority'.

[3] The IFRIC Agenda Decision in March 2006 noted that the term 'taxable profit' implies a notion of a net rather than a gross amount.

21. In the fact pattern in the request, an entity has no probable future taxable profit and thus would not have taxable profit even if such action is taken. Consequently, such actions should not qualify as a tax planning opportunity.

22. In the March 2010 Board meeting, the Board tentatively decided to include guidance in the exposure draft *Income Tax* on the assessment of valuation allowances. This may incorporate additional guidance on tax planning strategies from US GAAP.

23. If the Board does include guidance on tax planning strategies, this may clarify concerns relating to the meaning of a tax planning opportunity.

Arguments against the wording in, or the form of, the tentative agenda decision

24. The staff considered the following alternatives as responses to the arguments against the wording in, or the form of, the tentative agenda decision:

    (a) Finalise the May 2010 tentative agenda decision, subject to certain drafting suggestion proposed by the respondents (Alternative 1);

    (b) Suspend finalisation of the agenda decision until the FASB publishes final guidance on the issue (Alternative 2);

    (c) Reject to taking this issue onto the agenda because of the Board project on *Income Tax* (Alternative 3); and

    (d) Take this issue onto the IFRS Interpretations Committee agenda as an item to be clarified either by an interpretation, or by an amendment to be included in *Annual Improvements* (Alternative 4).

Alternative 1: finalise the May 2010 tentative agenda decision, subject to certain drafting suggestions proposed by the respondents

25. Alternative 1 is consistent with the approach proposed by the Committee in May 2010, but it amends some wording to reflect the drafting suggestions that were included in the comment letters.

26. The objectives of IAS 12 and the deferred tax recognition principle relating to deductible temporary differences are based on recovering or settling the carrying amount of the asset or liability at the reporting date.

27. In the context of the fact pattern in the request, the entity's actions to hold the AFS debt securities until a loss reverses **is not sufficient to be, or to be akin to,** a tax planning opportunity as defined in IAS 12.30.

28. In addition, the approach in IAS 12.24-31 **presumes** that an entity will assess the probability of realising deferred tax assets on a combined basis that is consistent with the rules established by the taxation authorities.

29. If this alternative is chosen, the staff agree that divergence with US GAAP could arise in the short term because of a current lack of authoritative guidance in US GAAP.

30. However the staff note that the divergence with US GAAP would be temporary, because:

    (a) the FASB has included in the Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivatives and Hedge Accounting* (the 'ED') guidance for recognition of a deferred tax asset for unrealised loss on debt securities, in the fair value through other comprehensive income (FVTOCI) category.

    This guidance is consistent with the approach proposed in the Committee's tentative agenda decision in May 2010; and

    (b) once an entity applies IFRS 9 *Financial Instruments*, categorisation of a debt instrument as AFS or FVTOCI is not permitted under IFRSs.

31. The amended draft wording is included in Appendix A with new sentences underlined and deleted sentences struck through.

Alternative 2: suspend finalisation of the agenda decision until the FASB finalises the ED

32. The staff acknowledge that the FASB has issued, as part of its ED, a new proposal to address a similar issue in US GAAP. As a result, the proposal will be subject to a formal FASB comment letter process.

33. Consequently, although it is not required by the *Due Process Handbook for the IFRS Interpretation Committee*, the Committee may consider an appropriate due

process step to review comment letters that the FASB receives from its own constituents on the issue.

34. If the Committee chooses Alternative 2, finalisation of the tentative agenda decision will probably be delayed for a lengthy period, because of the FASB's comment letter and redeliberations process. In the meantime, any existing or emerging diversity in practice in applying IFRSs will continue.

35. The significance of the issue may be reduced when IFRS 9 becomes effective for annual periods beginning on or after 1 January 2013, although some contend that a similar issue could arise in relation to debt instruments classified in the fair value through profit or loss (FVTPL) category under IFRS 9.

Alternative 3: reject taking this issue onto the agenda because of the Board project on Income Tax

36. The Committee could reject taking this issue onto the agenda because, as part of the Board project on *Income Tax*, the Board may provide further guidance on tax planning opportunities.

37. Under this scenario, any existing diversity existing or emerging in practice in applying IFRSs will continue.

Alternative 4: take this issue onto the agenda

38. The Committee could decide that the number of comment letters received on this issue indicates that significant diversity in practice exists, and that the guidance in IAS 12 relating to this issue is not clear and should be clarified either by an interpretation, or as part of *Annual Improvements*.

39. If this alternative is chosen:

    (a) the potential temporary divergence with US GAAP can be monitored through the redeliberations of comment letters that the FASB receives on the ED;

    (b) the interpretation or amendment would be subject to a longer public comment process; but

(c) the existing diversity in practice within the context of IFRSs will continue until the new guidance in effective.

40. Consideration would need to be given as to the effective date of replacing IAS 39 with IFRS 9. If the interpretation is issued within the context of IFRS 9, it could only be guidance relating to debt instruments in the FVTPL category, because the AFS categorisation is no longer permitted.

41. In this regard, it should be noted that the FASB did not propose to provide guidance in the ED on deferred tax asset for debt instruments in the FVTPL category.

Staff recommendation

42. Although the staff acknowledge the number of comment letters received on this issue, the staff recommend choosing Alternative 1:finalising the agenda decision that was taken in May, including certain drafting suggestions, because:

(a) the comment letters have not introduced any new technical arguments that were not considered by the Committee in May 2010, other than those to be reflected in the amended wording of the agenda decision;

(b) the tentative agenda decision has already been exposed to public comments and the Committee has satisfied the required due process;

(c) the divergence with US GAAP is temporary, and convergence with it should not be pursued at the cost of extended diversity in practice within IFRSs;

(d) IAS 39 will be replaced by IFRS 9, and there will no longer be debt instruments in the AFS category or in the FVTOCI category; and

(e) the FASB did not include in the ED a similar question relating to debt securities in the FVTPL category.

Question to the Committee

43. The staff would like to put the following questions to the Committee:

Staff recommendation and proposed wording of the final agenda decision
1. The staff recommend that the Committee should finalise the tentative agenda decision in May 2010, subject to some drafting changes. Does the Committee agree with the recommendation? 2. Appendix A includes the staff's proposed wording for the final agenda decision. Does the Committee agree with the proposed wording?

Appendix A – Proposed wording for agenda decision

IAS 12 *Income Taxes* – Recognising deferred tax assets for unrealised losses on available-for-sale debt securities

The Committee received a request for guidance relating to how an entity determines, in accordance with IAS 12, whether to recognise a deferred tax asset relating to unrealised losses on available-for-sale debt securities ('AFS debt securities'). The request asks if an entity's ability and intent to hold the AFS debt securities until the unrealised losses reverse is akin to a tax planning opportunity. If so, it raises the question of whether recognition of a deferred tax asset relating to the unrealised losses can be assessed separately from the recognition of other deferred tax assets.

The Committee noted that the objectives of IAS 12 and the deferred tax recognition principle relating to deductible temporary differences are based on recovering or settling the carrying amount of the asset or liability at the reporting date. The Committee also noted that, in the context of the fact pattern in the request, the entity's actions to hold the AFS debt securities until a loss reverses ~~to maturity do not~~ is not sufficient to meet the definition in paragraph 30 of IAS 12 of a tax planning opportunity or to be akin to a tax planning opportunity. In addition, the approach in paragraphs 24-31 of IAS 12 requires an entity to assess the probability of realising deferred tax assets on a combined basis that is consistent with the rules established by the taxation authorities.

The Committee noted that IAS 12 provides sufficient guidance on the recognition of deferred tax assets relating to AFS debt securities, and that it does not expect significant diversity in practice. Consequently, the Committee ~~[~~decided~~]~~ not to add this issue to its agenda.

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June 14, 2010

Mr. Robert Garnett, Chairman
International Financial Reporting Interpretations Committee
30 Cannon Street
London, ECAM 6XH
United Kingdom

Dear Mr. Garnett:

The American Council of Life Insurers[1] (ACLI) appreciates the opportunity to share with you our concerns regarding IFRIC's tentative decision at the May 2010 meeting regarding the recognition of deferred tax assets for unrealized losses on available for sale debt securities.

We contend that, by interpreting this issue through an agenda rejection, IFRIC has not applied due process. As such, we respectfully request that IFRIC reconsider adding this issue to its agenda. The drafting of a formal interpretation would provide constituents with the opportunity to comment in detail on both the IFRIC proposal and the FASB's tentative position taken in the Exposure Draft on Financial Instruments issued on May 26, 2010 ("ED") before either standard setter finalizes interpretations, guidance and transition guidance related thereto.

We are aware that diversity exists in the interpretation and application of the rules relating to these deferred tax assets in Europe and in the U.S. We believe IFRIC's tentative decision will create further divergence in practice between IFRS and U.S. GAAP, which we do not believe was intended. Accounting for Income Taxes was identified as an important area for convergence in the Memorandum of Understanding, as agreed to by the IASB and FASB boards. It is our belief that IFRIC should expose this issue in order to give full consideration to convergence issues with U.S. GAAP.

A change in the guidance affecting the recognition of deferred tax assets related to unrealized losses could significantly affect the capital positions of insurers doing business in the U.S. if substantial unrealized losses on available for sale debt securities exist at the reporting date. European insurers' capital will be reduced as compared to their U.S. competitors if the IASB does not recognize holding securities with unrealized loss positions to recovery as a tax planning opportunity, while deferred tax assets related to unrealized losses on available for sale debt securities continue to be recognized under U.S. GAAP based on utilizing the tax planning strategy to hold those securities to recovery.

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[1] The American Council of Life Insurers represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States. These member companies represent over 90% of the assets and premiums of the U.S life insurance and annuity industry.

IFRIC's basis for rejection was that a clear interpretation can be made based on the language in IAS 12. We respectfully disagree. In contrast to IFRIC's conclusion, we believe that the language in both IAS 12 and U.S. GAAP – ASC 740 Income Taxes is not clear and obvious. We are aware that different interpretations have been taken under U.S. GAAP and IFRS. This diversity in interpretation has resulted in companies applying different recognition criteria. The letter from Fannie Mae and Freddie Mac dated February 18, 2009, outlines discussions held with the SEC and the fact that the SEC accepts the diversity in practice.

IFRIC has stated that the ability and intent to hold available for sale debt securities until recovery does not meet the definition of a tax planning opportunity because it does not create "taxable profit"; it merely impacts the timing or avoidance of realized losses. We are concerned that this is a very literal and narrow interpretation of the term "tax planning opportunities". IAS 12, paragraph 30 states that "(t)ax planning opportunities are actions that the entity would take in order to create or increase taxable income in a particular period before the expiry of a tax loss or tax credit carryforward. Paragraph 30(b) of IAS 12 provides that "deferring the claim for certain deductions from taxable profit" is an example of creating or increasing taxable profit. Similarly, we believe that the ability and intent to hold securities in an unrealized loss position to recovery should be considered a valid tax planning strategy. Both are examples of an entity effectively increasing their taxable income by not incurring a tax item that would reduce its taxable income.

The term "tax-planning strategies" has been interpreted more broadly under U.S. GAAP and we believe that a similar consideration should also be given under IFRS. ASC 740 contains guidance that is more principle based. For instance, while ASC 740-10-30-18 similarly refers to a tax planning strategy as a possible source of taxable income, ASC 740-10-30-19 expands upon the definition to indicate that a tax planning strategy includes "… actions .. that (a) are prudent and feasible, (b) an enterprise ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in the realization of deferred tax assets." ASC 740-10-55-43 further provides that tax planning strategies also may shift the estimated pattern and timing of future reversals of temporary differences, such as with respect to temporary differences related to unrealized losses. The FASB's recent ED does not readdress the definition of tax planning strategies and specifically, whether or not the intent to hold strategy allows for the ability to recognize deferred tax assets.

In addition to our belief that the ability and intent to hold these debt securities to recovery be considered a valid tax planning opportunity, we also believe that it should be considered positive evidence of future taxable income. The SEC has accepted this for U.S. GAAP purposes and we believe it also qualifies under IAS 12, paragraph 29. Paragraph 29 states "…the deferred tax asset is recognized to the extent that it is probable that the entity will have sufficient taxable profit". In most cases this paragraph relates to DTAs that will generate a taxable loss upon their reversal. However, where temporary unrealized losses on available for sale debt securities exist and the entity has the ability and intent to hold until recovery, the entity does not expect the unrealized losses to ever be recognized in the entity's income statement or the income tax return in any period and thus the unrealized losses will never require any source of future taxable income to demonstrate realization of the related deferred tax assets. In other words, there always will be sufficient taxable profit under IAS 12, paragraph 29 since there never will be a tax loss.

We appreciate your consideration of our concerns and respectfully request that you reconsider your rejection of this issue by either adding it to the IFRIC agenda or considering it as a possible issue for the IASB Income Tax Project that is focused on resolution of problems in practice under IAS 12. In any event, convergence is of paramount concern for our European and U.S. members conducting business in the U.S.

Sincerely,

Michael Monahan
Director, Accounting Policy
Copy to FASB Board Members

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11 June 2010

Subject: Tentative IFRIC rejection on recognition of deferred tax assets for unrealised losses on available-for-sale debt securities

Dear Sirs

Summary

This letter has been drafted by the European Insurance CFO Forum, which is a body representing the views of 20 of Europe's largest insurance companies. The question of recognition of DTA's relating to unrealised losses on AFS debt securities is a significant issue for a number of our members. Accordingly, this letter represents the consensus views of a significant element of the European insurance industry.

We strongly disagree with IFRIC's tentative agenda decision in relation to the accounting treatment of unrealised losses on available-for-sale ("AFS") debt securities for deferred tax asset ("DTA") purposes as debated by IFRIC during its May 2010 meeting. We believe there is diversity in practice and that this issue is of great relevance to us, as it is to other insurers and companies holding AFS debt securities.

The staff proposal states that IAS 12 is clear about this issue and therefore the issue should not be added to the agenda. We believe that:

- there is diversity in practice in terms of how IAS 12 is applied in accounting for DTA's relating to unrealised losses on AFS debt securities, and that:

- IAS 12.29 allows recognition of DTA's relating to unrealised losses on AFS debt securities based on the ability and intent of a company to hold these investments until the unrealised losses reverse, which at the latest happens automatically through maturity of the investment (absent default).

Accordingly, this issue should be added to the IFRIC agenda or, alternatively, considered within the IASB's project on Income Taxes, so that it receives appropriate deliberation and due

process. In this letter, we set out our detailed comments, concerns and technical arguments on the tentative decision as follows:

1. IFRIC staff has interpreted this matter beyond the factual requirements in IAS 12
2. IAS 12.29 allows recognition of DTA's on unrealised losses from AFS debt securities
3. The recognition of a DTA for unrealised losses on investments in debt securities has economic substance and is of relevance for the users of financial statements
4. IAS 12 is not consistently applied in current practice
5. The IFRIC tentative decision creates more divergence with US GAAP
6. The scope in which IFRIC is considering this matter is too narrow

1. IFRIC staff has interpreted this matter beyond the factual requirements in IAS 12

Currently, diversity in accounting arises because IAS 12 is not clear about the issue. As part of their analysis of the issue, IFRIC staff considered whether a deductible temporary difference ("DTD") exists at the balance sheet date and if so, whether this DTD should be evaluated for recognition of a DTA together with all other temporary differences. The staff concluded that based on the guidance provided by IAS 12, a DTD at the balance sheet date does exist and that IAS 12 is clear in requiring that all temporary differences are assessed on a combined basis.

We do not see the latter being clearly mentioned anywhere in IAS 12 paragraphs 24 to 31. Throughout paragraphs 24 to 31, IAS 12 explores various scenarios where a DTD could arise. IAS 12 requires that a DTA is recognised for a DTD only when it is probable that taxable profits will be available against which the DTD can be utilised (IAS 12.27). This can occur only in three scenarios:
(1) if the entity has offsetting taxable temporary differences ("TTD") (IAS 12.28); or
(2) if the entity has sufficient (future) taxable income (IAS 12.29 (a)); or
(3) if the entity can avail itself of tax planning opportunities (IAS 12.29 (b)).

IAS 12 seeks this conservative approach because when the operating activities of a company give rise to operating losses, in the absence of TTD's to ensure the reversal of these DTD's, the entity would have to resort to tax planning opportunities or strategies to realise the DTA's. These conditions "effectively guarantee" the realisation of the DTA's (a much higher hurdle than "probable") and one can understand the need for this conservatism in those situations where a company has realised tax losses and a number of corresponding negative indicators accompanying these losses (history of losses, lack of future taxable income, etc).

However, IAS 12 stops here and neither discusses the possibility when a DTA could be recognised nor envisages the impact of this solution on a situation where a company has DTD's from unrealised losses on investments which have not yet been, and may never be, recognised in IFRS P&L or for tax purposes.

In the situation of unrealised losses on debt securities, one needs to question whether this high degree of conservatism is justified, is appropriate and whether it reflects the economic substance of the transaction. Unlike realised tax losses or other operating losses, where one has to take affirmative action through tax planning strategies to ensure utilisation (in the absence of TTD's), unrealised losses on debt securities can and indeed do reverse simply by the passage of time. The terms to maturity for these investments range from as short as 1 year to as long as 10 to 20 years. If the related investments are held to recovery or maturity (and assuming the company has the financial and regulatory ability to hold the investments to recovery or maturity), one does not require a tax planning strategy to ensure the reversal of

these unrealised losses – they just reverse. This is because these investments are not impaired – they are simply below cost / face value because of interest rate movements or illiquidity in the financial markets. As long as the issuer of the investment is not in financial difficulties and continues to meet its obligations as and when they fall due (in other words, the investment is not impaired), the company will collect all the amounts due under the securities and the DTD's will automatically reverse without any action of the holder being necessary.

Often, unrealised (IFRS and tax) losses on debt securities reverse at a much faster rate and even before the investments mature – for example, when markets improve and/or interest rates change, the same securities start showing unrealised gains. This is not an unrealistic assertion – recent events in the markets have proven this.

If there was no possibility for the unrealised losses from debt securities to reverse, this would indicate impairments on the same investments, which when recognised would translate into realised IFRS losses that upon realisation for tax purposes would translate into tax losses. Given the fact that debt securities normally decrease in value when interest rates rise, taxable income could be generated by simply reinvesting the consideration received and then collecting higher interest income. However, whether a company can utilise realised tax losses or not before they expire is another issue which was not the subject of IFRIC's tentative agenda decision. This is where tax planning strategies would come into the picture. Companies in the financial sector often utilise a number of techniques to ensure that unrealised losses are realised as and when required and that realised losses are utilised before they expire. Techniques such as wash sales and repo transactions, which enable a company to control the timing of the realisation of the unrealised losses, are akin to a tax planning strategy provided one looks at the definition of a tax planning strategy in a broader sense than IFRIC staff have currently interpreted it. Companies in the financial sector have always had this extra tool should they choose not to hold the investments in debt securities to recovery or maturity.

In our opinion, the above arguments supporting the assertion that the DTD's on unrealised losses on debt securities will reverse certainly satisfy the hurdle of "probable" which is required by IAS 12.27.

2. *We believe that IAS 12.29 allows recognition of DTA's on unrealised losses from AFS debt securities*

The above arguments, which were not considered in the above level of detail when IFRIC staff were interpreting the issue, are indirectly addressed in IAS 12.29(a).

DTA's related to unrealised losses from AFS debt securities which have not been realised for tax purposes should be recognised because the condition stated in IAS 12.29(a) is always met given the intention and the capacity of the entity to hold the investment in debt securities until its recovery in value: 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. Indeed, the unrealised loss will never be materialised because it will automatically reverse upon maturity of the instrument (absent default): its reversal will not be replaced by a deductible realised loss. As a result, there will be no tax loss to be absorbed by a taxable profit. This is why the taxable profit will inevitably be sufficient. The assessment of the future taxable profit may only take in consideration relevant forecasts that are based on expected operations and transactions of the entity; in no case could it include losses that the entity has no intention to realise and has the capacity to avoid. We believe that it is the line of IAS 12.29(a), having in mind that the wording used refers more to the case of deductible temporary differences that will result in realised losses rather than to recoveries in value.

From an alternative point of view, if a broader interpretation of IAS 12 is taken – one where the ability to control the timing of when tax losses occur, or when taxable income arises qualifies as a tax planning strategy – many of the above arguments can be addressed. This is because financial institutions, and especially insurance companies, generally apply sophisticated asset liability matching ("ALM") techniques which not only attempt to manage market risks but are also often used to optimise the entity's tax situation. Companies thus often take decisions to either hold or dispose debt securities, or perform other transactions (like wash sales, securitisations, etc.) to manage and optimise their tax situation. Such activities, whilst not directly generating taxable income, can also be considered tax planning strategies. We believe this is the reason why when this issue was raised for IFRIC to interpret, the question asked whether holding investments in debt securities to maturity is akin to a tax planning strategy.

IFRIC staff, when analysing the definition of a tax planning strategy, have focused on the literal wording contained in IAS 12.30 that a tax planning strategy is only an action that creates or increases taxable income. Whilst the interpretation of staff complies with what is factually written in IAS 12, one could also question whether IAS 12, being a principle based standard, has specifically not included more explanations over what could the term "tax planning strategy" include. For example, under the comparable US GAAP ASC 740 Income Taxes, tax planning strategies also include actions which seek to either utilise tax losses in some situations or to avoid tax losses in other situations.

3. The recognition of a DTA for unrealised losses on investments in debt securities also has economic substance and is of relevance for the users of financial statements.

For a company investing a large portion of its assets in investments in debt securities (e.g. a financial institution) as opposed to a company holding tangible & intangible fixed assets, unrealised gains on investments would require the company to record DTL's however, DTA's could not be booked for any unrealised losses despite the fact that from one accounting period to another, the unrealised gains could turn into losses and vice versa. These movements and the related income tax impacts are of significant economic impact. For example, consider the economic impact from 31 December 2007 to 31 December 2008 and again from 31 December 2008 to 31 December 2009

These significant economic consequences are highly relevant to the users of the financial statements. The current accounting treatment supported by IFRIC would give rise to unnecessary distortions to the tax balances in the balance sheet which we believe is counter-intuitive and gives an incorrect view of the economic situation in the financial statements. Whether or not a DTA should result from unrealised losses on debt securities should be determined as described in the discussion in section 1 supra. Any other process effectively denies the user of the financial statements valuable knowledge concerning the financial position of the reporting entity.

4. IAS 12 is not consistently applied in current practice

This issue has been applied in a broader, and, we believe, more appropriate manner over recent years by several companies reporting under IFRS, who have applied IAS 12 such that the recognition of a DTA has always been possible for unrealised losses on AFS debt securities. This is acknowledged by application guidance issued by large accounting firms and auditors have concurred with this application. This issue is thus widespread and there is indeed diversity in application.

5. The IFRIC tentative agenda decision creates more divergence with US GAAP

This issue has also been applied in a broader, and, we believe, more appropriate manner, in the US environment. Under (existing) US GAAP, the recognition of a DTA has always been possible for unrealised losses on AFS debt securities. This is not only acknowledged by application guidance issued by the large accounting firms, but also by the SEC when it was considering the issue for Freddie Mac and by auditors who have concurred with this application.

We acknowledge that the FASB have discussed this issue as part of their debate on the accounting for Financial Instruments and have taken a tentative decision during their March 2010 meeting which has been reflected in their recently issued ED on Financial Instruments. However, this is only a proposed change to US GAAP and one that has been limited to analysing whether a discrete or combined approach to assessing temporary deductible differences should be adopted. Tax planning strategies have not been part of this debate. Furthermore, the ED (with this tentative decision) still has to go through due process, whereby not only will companies have the opportunity to debate and comment on the FASB decision but they will also receive time and appropriate transitional guidance to apply the revised interpretation.

6. The scope in which IFRIC is considering this matter is too narrow

The considerations in the IFRIC staff papers and in the tentative IFRIC agenda decision refer only to AFS debt securities that are accounted for under IAS 39. We believe however that this matter may be equally relevant for certain debt securities accounted for under the fair value option (under either IAS 39 or IFRS 9) and for debt securities that must be reported at fair value through profit or loss under IFRS 9. Because this matter therefore may have a much wider impact than considered by IFRIC staff so far, we believe that further consideration should be given to the wider impact and that this should not be interpreted through an agenda rejection.

Conclusion

The IFRIC, by rejecting the issue from its agenda, would not only create a difference between existing US GAAP and IFRS but would also not consider a number of the arguments presented above, and not provide companies with time and transitional guidance to change existing accounting. We strongly believe IFRIC should take either of the following two actions:

- Since current IAS 12 does not satisfactorily address the accounting of deferred taxes under such situations, IFRIC could refer the matter to the IASB to consider as part of its revisions to IAS 12. As part of this course of action, IFRIC could reject this issue from its agenda, but should then refrain from any interpretation or guidance in its agenda decision. This would imply that current practice continues under IAS 39. Any divergence in practice would automatically be resolved by the implementation of IFRS 9 and revisions to IAS 12.

- Given the diversity in practice, we believe that if the issue is to be interpreted, it should go through due process and should be added to IFRIC's agenda so that the debate takes account of the various technical and economic arguments we have presented above, a formal draft interpretation is issued and companies are provided with the full opportunity to comment in detail to the proposals before any interpretation is finalised; such interpretation should include due consideration of effective date and transitioning.

Should you wish to further discuss any of the issues we have raised, please do not hesitate to contact us.

Yours sincerely

Dieter Wemmer
Chairman – CFO Forum

Deloitte.

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Mr Robert Garnett
Chairman
International Financial Reporting Interpretations Committee
30 Cannon Street
London
United Kingdom
EC4M 6XH

Email: ifric@iasb.org

14 June 2010

Dear Mr Garnett,

Tentative agenda decision: IAS 12 *Income Taxes* — Recognising deferred tax assets for unrealised losses on available-for-sale debt securities

Deloitte Touche Tohmatsu is pleased to respond to the IFRIC's publication in the May 2010 IFRIC Update of the tentative decision not to take onto the IFRIC's agenda a request for an Interpretation of IAS 12 *Income Taxes* with respect to recognising a deferred tax asset relating to unrealised losses on available-for-sale debt securities.

We agree with the IFRIC's decision not to take this item onto its agenda for the reasons set out in the tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely,

Veronica Poole
Global IFRS Leader - Technical

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International Financial Reporting Standards Interpretations Committee
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15 June 2010

Dear Interpretations Committee members

Tentative Agenda Decision – IAS 12 *Income Taxes* – Recognising deferred tax assets for unrealised losses on available-for-sale debt securities

The global organisation of Ernst & Young is pleased to submit its comments on the above Tentative Agenda Decision as published in the May 2010 IFRIC Update.

The IFRS Interpretations Committee ("Committee") was asked for guidance "relating to how an entity determines, in accordance with IAS 12, whether to recognise a deferred tax asset relating to unrealised losses on available-for-sale debt securities ('AFS debt securities')." The Committee issued a Tentative Agenda Decision not to add this issue to its Agenda, noting that "IAS 12 provides sufficient guidance on the recognition of deferred tax assets relating to AFS debt securities and that it does not expect diversity in practice.

For the reasons set out in the Agenda Request we are not convinced IAS 12 provides sufficient guidance on this issue and would ask the Committee to reconsider its agenda decision and discuss whether it or the Board should take the same steps the FASB decided to take in providing guidance on this issue in a standard. We believe a clarification/amendment of the standard rather than an agenda decision is the right approach to address the issue of recoverability of deferred tax assets, given the implications this agenda decision, the need for due process and the current divergence in practice which we believe may have arisen because of the guidance under US GAAP prior to any clarification which may result from the FASB's further considerations.

If the Committee decides to proceed with this agenda decision and not to add this issue to its agenda and not to ask the Board to amend IAS 12, we would recommend amending the text of the Agenda Decision.

The Tentative Agenda Decision may lead to confusion as, contrary to the Agenda Paper discussed, it does not address the precise question asked, nor does it reflect some of the conclusions reached by the Committee at its meeting.

The Tentative Agenda Decision states in the second sentence of the first paragraph:

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"The request asks if an entity's ability and intent to hold the AFS debt securities until the unrealised losses reverse **is** a tax planning opportunity. (emphasis added)"

However, we note that the Agenda Request reproduced in Appendix B of Agenda Paper 15 is as follows:

"Some entities argue that management's intent and ability to hold available-for-sale debt securities with unrealised losses until recovery (which may be maturity) can be considered **akin to** a tax planning opportunity as defined by paragraph 30 of IAS 12, since the strategy serves to prevent the related hypothetical tax loss from occurring (the same objective as the use of an appropriate tax planning opportunity to create taxable profit). (emphasis added)"

The Tentative Agenda Decision only concludes that the entity's action to hold the AFS debt securities to maturity does not meet the definition in paragraph 30 of IAS 12 of a tax planning opportunity. However, paragraphs 27 and 36(a) of Paper 15 provide a rationale why paragraph 29(b) of IAS 12 cannot be applied to the entity's actions to hold the AFS debt securities to maturity by analogy. That is, preventing losses from being realized is not the same or similar to creating taxable income. This rationale is not reflected in the Tentative Agenda Decision. If the Committee agrees with the rationale set out in the agenda paper, we believe it should say so explicitly to avoid misunderstanding about the meaning of the Agenda Decision.

For the reasons above, if the Committee decides not to add this issue to its agenda or refer it to the Board and it decides to retain its conclusion, we believe that the Tentative Agenda Decision should be clarified as indicated below to avoid confusion.

"The Committee received a request for guidance relating to how an entity determines, in accordance with IAS 12, whether to recognise a deferred tax asset relating to unrealised losses on available-for-sale debt securities ('AFS debt securities'). The request asks if an entity's ability and intent to hold the AFS debt securities until the unrealised losses reverse is akin to a tax planning opportunity. If so, it questions whether recognition of a deferred tax asset relating to the unrealised losses can be assessed separately from the recognition of other deferred tax assets.

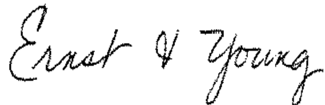
The Committee noted that the objectives of IAS 12 and the deferred tax recognition principle relating to deductible temporary differences are based on recovering or settling the carrying amount of the asset or liability at the reporting date. The Committee also noted that preventing losses from being realised is not the same as or similar to creating or increasing taxable income. Based on the requirement to recognise deferred tax assets only when it is probable that they will be realised, paragraph 30 of IAS 12 limits tax planning opportunities to actions of the entity that create or increase taxable income. Consequently, applying paragraph 29 of IAS 12 by analogy in the context of the fact pattern in the request, i.e. the entity's actions to hold the AFS debt securities until the unrealised losses reverse~~, to maturity~~, is

unwarranted. In addition, the approach in paragraphs 24-31 of IAS 12 requires an entity to assess the probability of realising deferred tax assets on a combined basis that is consistent with the rules established by the taxation authorities.

The Committee noted that IAS 12 provides sufficient guidance on the recognition of deferred tax assets relating to AFS debt securities and that it does not expected diversity in practice. Consequently, the Committee [decided] not to add this issue to its agenda."

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully



Russell C Picot
Group Chief Accounting Officer

IFRS Interpretations Committee
30 Cannon Street
London
EC4M 6XH

17 June 2010

Dear Sir or Madam

IAS 12 Income Taxes – Recognising deferred tax assets for unrealised losses on available-for-sale debt securities

We are writing to comment on the tentative agenda decision made at the May 2010 IFRS Interpretations Committee ('IFRIC') meeting in respect of the recognition of deferred tax assets on unrealised losses on available-for-sale ('AFS') debt securities and to request that the IFRIC reconsiders its tentative conclusion on this issue.

HSBC is one of the largest banking and financial services organisations in the world, with assets of US$2,364 billion at 31 December 2009. Headquartered in London, HSBC serves customers worldwide from more than 8,000 offices in 88 countries and territories in six geographical regions. HSBC's businesses encompass a very broad range of financial services and products, including personal financial services, commercial lending, global banking and markets, private banking, asset management and insurance.

The request to the IFRIC asked if an entity's ability and intent to hold AFS debt securities until the unrealised losses reverse represents a tax planning opportunity and, if so, whether recognition of a deferred tax asset relating to the unrealised losses can be assessed separately from the recognition of other deferred tax assets.

We agree with the IFRIC that the objectives of IAS 12 and the deferred tax recognition principle relating to deductible temporary differences are based on recovering or settling the carrying amount of the asset or liability at the reporting date. We also agree that an entity's intention to hold AFS debt securities to maturity does not meet the definition in paragraph 30 of IAS 12 of a tax planning opportunity.

If an entity expects to hold to maturity AFS debt securities which were originally purchased at par, any difference between the carrying amount (the fair value) and the tax base will reverse provided no impairment arises in the future. A deductible temporary difference arises when the fair value of a debt security falls below the amortised cost value, typically because the current market rate of interest applicable to that debt security is higher than the contractual rate of interest. This has been a feature of the recent financial crisis, as markets have become more risk averse and liquidity has reduced thereby causing credit spreads to widen and fair value to fall.

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Therefore, provided that the assets are held until maturity and do not become impaired, the deductible temporary differences will reverse over time and no additional taxable profits are required to utilise such temporary differences. If the intention is to sell the assets and crystallise the tax benefits in the form of realised losses, then clearly taxable profits would be needed against which the deductible temporary differences could be utilised.

We understand that there is not a consistent practice in the market at this time and accordingly we believe that there would be value in establishing clear principles in these cases.

We would be pleased to discuss our comments with you in further detail if that would be helpful.

Yours sincerely,

Russell Picot

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Committee
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Our ref : AdK
Date : Amsterdam, 14 June 2010
Direct dial : Tel.: (+31) 20 301 0391 / Fax: (+31) 20 301 0302
Re : *Tentative IFRIC Agenda decisions in the May IFRIC meeting*

CC: EFRAG Technical Expert Group

Dear Mr. Garnett,

We would like to take this opportunity to comment on certain tentative agenda decisions of the IFRS Interpretations Committee (IFRIC) meeting of May 2010, as published on the IASB website.

Our concerns relate to three of the tentative decisions where we question the use of decisions not to add an issue to the agenda both from a procedural and from an accounting technical point of view:

- IAS 1 Financial Statement Presentation ─ Going concern disclosure;
- IAS 12 Income Taxes – Recognising deferred tax assets for unrealised losses on available-for-sale debt securities; and
- IAS 39 Financial Instruments: Recognition and Measurement ─ Impairment of financial assets reclassified from available-for-sale to loans and receivables.

Procedural point of view
In our view it is inappropriate to use agenda rejections as important interpretations with potentially widespread consequences. In the three instances referred to above, IFRIC decided not to take issues on the agenda whilst at the same time including accounting guidance in the rejection notice. In our opinion:

- the approach followed by IFRIC obstructs due process; and
- if the agenda criteria are not met, IFRIC should not make any IFRS interpretations.

Technical point of view (IAS 12 and IAS 39 related)
With regard to the agenda rejection of deferred tax assets for unrealised losses on AFS debt securities, we would like to highlight the following:

- In our opinion, IFRIC has not adequately reviewed all relevant aspects of this matter.

- IAS 12 *Income Taxes* is clearly written with deferred tax assets (DTA's) established through the P&L in mind. IFRIC is taking a very literal reading of IAS 12 and applies that by analogy to DTA's established through OCI.
    - Furthermore, we believe that AFS reserves are by definition of a temporary nature, as impaired assets do not have any unrealised losses in OCI under IAS 39.
- Because the approach rejected by IFRIC is used widely in practice, the IFRIC agenda decision could have a significant impact and result in significant restatements to published financial statements based on an agenda rejection only.
- The proposed IFRIC decision would create a difference with existing US GAAP. It is our understanding that both methods as described in the staff paper are currently allowed under US GAAP. We note that these matters are also under consideration of the FASB in the US, but through a regular procedure with appropriate due process.

With regard to the agenda rejection of impairment of reclassified AFS, we would like to highlight the following:

- There is in practice no uniform interpretation of IAS 39 in this respect. The relevant paragraphs appear to be contradictory on certain points.
- The only approach that IFRIC now accepts, will lead to "over-impairments" in the period of an incurred loss, reversed through a too high effective interest rate in the periods after.
- We believe that the accounting approach prescribed by the draft rejection notice provides potential inappropriate information to users of the financial statements.

Obviously, we would be happy to discuss the above with you in more detail.

Yours sincerely,

Hans de Munnik
Chairman Dutch Accounting Standards Board