Project **Agenda decision**

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

Introduction

1. At the May 2010 IFRS Interpretation Committee ('Committee') meeting, 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. Although the issue identified in the request is in the context of financial assets recognised and measured in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*, a similar issue (the second issue explained in paragraph 7(b)) may also arise within the context of IFRS 9 *Financial Instruments*.

3. The Committee discussed the issue further in the July 2010 meeting, with the July 2010 IFRIC Update reporting that:

> The Committee discussed responses received on the previous tentative agenda decision published in the May 2010 IFRIC Update. The Committee continued to support the intent of the views expressed in the tentative agenda decisions in relation to the specific fact pattern presented to the Committee. However the Committee requested that the staff present revised wording for the agenda decision at the next meeting, clarifying the situation addressed and the decisions made by the Committee.

4. In the September 2010 Committee meeting, the staff proposed, and the Committee agreed, to take more time and bring an updated analysis of the issue

in November because of the complexity of the issue and the staff's anticipation that they would receive additional information from the constituents. The September 2010 IFRIC Update states:

> In May 2010, the Committee discussed 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. In the May 2010 IFRIC *Update*, the Committee published the tentative agenda decision noting that IAS 12 provides sufficient guidance on the recognition of deferred tax assets relating to AFS debt securities and that it did not expect diversity in practice. At the July 2010 meeting, the Committee discussed responses received on this tentative agenda decision. The Committee continued to support the intent of the views expressed in the tentative agenda decisions in relation to the specific fact pattern presented to the Committee. However the Committee requested that the staff should present revised wording for the agenda decision at the next meeting, clarifying the situation addressed and the decisions made by the Committee.
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> As a result of further comment letters received on this issue, the staff conducted various outreach meetings, including discussions with the respondents. At the September 2010 meeting, the staff presented an overview of this outreach. The Committee agreed that the staff should bring an updated analysis of this issue to the next Committee meeting, together with a staff recommendation on the next steps of the project, including consideration of clarifying IAS 12 to address this issue.

Outreach activities after the July Committee meeting

5. After the July Committee meeting, two further comment letters[1] were received relating to the Committee's tentative agenda decision. The staff also held various outreach meetings with interested parties including some who had previously responded.

[1] Ernst & Young and The European Insurance CFO Forum.

6. After the September Committee meeting, the Committee received one additional letter as a follow-up to a meeting held with one of the respondents[2] .

7. As a result of those outreach activities, the staff have received the following messages from interested parties:

   (a) The fact pattern described in the request and therefore considered in May 2010 by the Committee, is different from specific fact patterns in practice. The Committee's conclusion might be different if its consideration was based on those other fact patterns.

   (b) In reaching the tentative agenda decision in May 2010, the Committee considered one of the two issues involved in the request, but not the other one.

   The first issue is whether a deferred tax asset relating to AFS debt securities should be assessed separately. The second issue is whether an entity's action to hold an AFS debt security until maturity is a source of taxable profit.

   The Committee discussed the first issue in May and reached a tentative conclusion that a deferred tax asset relating to AFS debt securities should be assessed in combination with other deferred tax assets. This is consistent with a proposal in the exposure draft for *Financial Instruments* issued by the Financial Accounting Standard Board (FASB) of the United States. However, some believe that it is still not clear how this should apply in a situation when an entity has capital loss and tax law permits offsetting the capital loss only against future capital gain.

   Some interested parties believe that the Committee did not sufficiently discuss the second issue in May 2010. They think that the Committee discussed whether such an action qualifies as a tax planning opportunity but did not discuss whether such an action is <u>akin to</u> a tax

[2] The European Insurance CFO Forum

planning opportunity. They also pointed out a potential divergence from practice under US GAAP if the Committee does not think such an entity's action is a source of taxable profit. This is because they think that such an action is considered a source of taxable income under US GAAP.

(c) The issue is significant in practice and there are concerns about the impact of the agenda decision if it is finalised.

This leads to the respondents' view that the Committee should amend IAS 12 as part of *Annual Improvements*, rather than finalise the agenda decision taken in May 2010. This could provide transition provisions for those applying an approach that may be inconsistent with the views that the Committee expressed in May 2010.

There is also a timing issue. Entities had a large amount of unrealised losses on AFS debts securities at the end of 2008. However, most of those losses reversed during 2009 and 2010. Some entities expect to have unrealised gains rather than unrealised loss at the end of 2010. For those entities, the tentative agenda decision will merely require restatement of the comparable reporting period in 2008 without affecting the financial numbers at the end of 2010.

Responses to concerns raised by some respondents

The fact pattern explained in the request and, therefore considered in the May 2010 by the Committee, is different from specific fact patterns in practice

8. In order to respond to this concern, the staff prepared an example in Appendix A and used this example in analysing the issues in the section *The staff analysis* below.

9. The example in Appendix A compares:

(a) an entity that can deduct the unrealised loss on the AFS debt security in accordance with tax law (Entity A), with

(b) another entity in a different tax jurisdiction where it cannot deduct the unrealised loss until it is realised (Entity B). This Entity B is an entity that exhibits the specific fact patterns that are observed in practice.

In reaching the tentative agenda decision in May 2010, the Committee considered one of the issues involved in the request but not the other one

10. As a result of the outreach activities following the July and September meetings, the staff understand that some respondents think that the Committee needs additional analysis of the following issues involved in the request:

    (a) Should a deferred tax asset be assessed separately if tax law limits utilisation of capital loss only against future capital gain?

    (b) Is the entity's action <u>akin to a </u>tax planning opportunity and, if so, should it be considered to be another source of taxable profit?

11. In the section *The staff analysis* below, the staff analyse these issues.

The issue is significant in practice and there is much concern about the impact of the agenda decision if it is finalised

12. In response to this concern, the staff have identified the following alternative approaches to concluding this issue, and discuss these approaches in the section *Alternative approaches* below:

    (a) revision of the wording in the tentative agenda decision in the form of Appendix B (Alternative 1);

    (b) an *Annual Improvement* in the form of Appendix C (Alternative 2); or

    (c) taking this issue onto its agenda or amendment to IAS 12 (Alternative 3).

The staff analysis

13. See the example in Appendix A.

Should a deferred tax asset be assessed separately if tax law limits utilisation of capital loss only against capital gain?

14. IAS12.24 requires future taxable profit against which deductible temporary differences can be utilised in order to recognise a deferred tax asset for those deductible temporary differences. If tax law calculates taxable profit on a combined basis (inclusive of both taxable capital gain and ordinary taxable profit), a deduction as a result of reversing a deductible temporary difference can be offset against any taxable income.

15. However, if tax law specifically distinguishes specific types of income (eg capital gains) from other taxable profit, a deduction as a result of reversing a deductible temporary difference can offset only against taxable profit of a type for which tax law permits such an offset. Consequently, a natural reading of IAS 12.24 will lead to a separate assessment of each type of taxable profit for which tax law requires separate assessment. IAS12.24 states:

> **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 ventures, a deferred tax asset shall be recognised in accordance with paragraph 44.**

16. The staff believe the conclusion above is obvious but if the constituents think that it is in fact not obvious, the Committee may consider clarifying the wording in IAS 12. US GAAP includes some clarifying words which could be considered for inclusion in IAS 12.24 (Deductible temporary differences) and 34 (Unused tax losses and unused tax credits). US GAAP Topic 740-10-30-18 states:

> Future realization of the tax benefit of an existing deductible temporary difference or carryforward ultimately depends on the

> existence of sufficient taxable income of <u>the appropriate character (for example, ordinary income or capital gain)</u> within the carryback, carryforward period available under the tax law. (emphasis added)

Question 1
Does the Committee agree that additional words should be added to IAS 12 to explain that separate assessment should be made to each type of taxable profit if tax law specifically distinguishes specific types of income (eg capital gains) from other taxable profit?

Is the entity's action akin to a tax planning opportunity and, if so, should it be considered to be another source of taxable profit?

17. Using this example, the staff considered the following questions:

    (a) Does Entity A's and/or Entity B's action in holding the AFS debt security until it matures on 31 December 20X5 qualify as a tax planning opportunity in accordance with IAS 12.30?

    (b) If not, are Entity A's or Entity B's actions <u>akin to</u> tax planning opportunities in accordance with IAS 12.30?

    (c) If Entity A's or Entity B's actions are <u>akin to</u> tax planning opportunities, does IAS 12 allow an entity to recognise a deferred tax asset for a deductible temporary difference based on its action that does not qualify as a tax planning opportunity, but is <u>akin to</u> it?

18. The staff think that:

    (a) Entity A's action in holding the AFS debt security until it matures on 31 December 20X5 qualifies as a tax planning opportunity in accordance with IAS 12.30, and it can recognise a deferred tax asset for CU 20[3]. This is because such an action will result in creating or increasing taxable profit (see "Consideration of tax planning opportunity" in the example in Appendix A):

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[3] This is based on the assumption that Entity A does not hold the AFS debt security until its maturity if there is no need to consider a tax planning opportunity. The conclusion as to whether Entity A can recognise a deferred tax asset would be the same if Entity A, in its normal course of business, holds the

(b) Entity B's action in holding the AFS debt security until it matures on 31 December 20X5 does not meet the definition of a tax planning opportunity in accordance with IAS 12.30, because such an action, although it avoids a loss being realised, does not create or increase taxable profit (taxable capital gain in the example) (see "Consideration of tax planning opportunity" in the example in Appendix A);

(c) Entity B's action may be akin to a tax planning opportunity. Neither IAS 12 nor other IFRSs provide any criteria to determine what action is akin to a tax planning opportunity. However, some could make the following argument to assert that Entity B's action is akin to Entity A's action that qualifies as a tax planning opportunity.
'There is an inherent assumption in IAS 12 that an entity will recover the carrying amount of an asset and a deductible temporary difference will be deducted in computation of taxable profit in future. Because of that assumption in IAS 12, Entity B is assumed to deduct the unrealised loss and create a notional capital loss for tax purposes in future. This assumption puts Entity B in an equivalent deferred tax position as Entity A that has deducted the unrealised loss and created a capital loss in accordance with tax law. While Entity A's action creates or increases future taxable profits, Entity B's action avoids a capital loss being realised. However, because that assumption has resulted in a notional capital tax loss for Entity B, its action to avoid the loss being realised should be considered an action to offset that notional capital loss against the future notional capital tax gain on reversal of the accounting loss. Entity B's action should be viewed as akin to Entity A's because it creates or increases those future notional capital tax gains.': but

(d) IAS 12 does not allow Entity B to recognise a deferred tax asset for a deductible temporary difference based on its action that does not

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AFS debt security until its maturity and expects to create taxable profit of CU20 for periods from 20X1 to 20X5.

qualify as a tax planning opportunity, even if it is akin to a tax planning opportunity. This is because IAS 12.24 permits recognition of deferred tax assets only when taxable profit will be available from specific actions that qualify as tax planning opportunities.

19. In determining whether Entity A's action qualifies as a tax planning opportunity, the staff assume that Entity A does not have other capital losses in the future. If Entity A is making other capital losses that add up to more than the unrealised loss on the AFS debt security, its action in holding the AFS debt security until maturity, thereby avoiding a loss being realised, will not result in taxable profit. It will merely reduce the other capital losses in the future.

20. From the viewpoint of convergence with US GAAP, the respondent argues that the FASB's proposal consists of following two positions:

    (a) A deferred tax asset relating to unrealised loss on AFS debt security should not be assessed discretely; and

    (b) the recovery of book basis would provide a source of future taxable income, but it should not be considered in isolation.

21. The respondent further argues that the tentative agenda decision in May 2010 would achieve convergence with respect to the first position but would create divergence with respect to the second position.

22. The staff note that the FASB's exposure draft on *Financial Instruments* does not address the second position, although it may have been discussed during its deliberation.

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

Question 2
Does the Committee agree that Entity A's action in holding the AFS debt security until it matures on 31 December 20X5 qualifies as a tax planning opportunity and that Entity A can recognise a deferred tax asset for CU 20?

Question 3

Does the Committee agree that Entity B's action in holding the AFS debt security until it matures on 31 December 20X5 does not meet the definition of a tax planning opportunity in accordance with IAS 12.30?

Question 4

Does the Committee agree that such an action by Entity B could be akin to a tax planning opportunity in accordance with IAS 12.30 and, if so, does the Committee agree that IAS 12 does not allow an entity to recognise a deferred tax asset for a deductible temporary difference based on an entity's action that does not qualify as a tax planning opportunity but is akin to it?

Alternative approaches

Alternative 1—Finalisation of the tentative agenda decision

24. The revised wording in Appendix B is written based on the staff responses in paragraph 18, and includes additional words to explain the separate assessment of each type of taxable profit in accordance with tax law. If the Committee comes to different conclusions relating to the questions in paragraph 17, the staff will revise the proposed wording in Appendix B accordingly.

Alternative 2—Annual improvements

25. The staff have considered the following two alternative potential *Annual Improvements* that could be made to address this issue:

    (a) Amendment to IFRS 9 *Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement* (Proposal 1)

    This proposal introduces into IFRS 9 or IAS 39 guidance similar to that proposed by the FASB in its exposure draft for Financial Instruments.

    (b) Amendment to IAS 12 (Proposal 2)

    This proposal clarifies in IAS 12 that certain actions by an entity are not a tax planning opportunity. It also clarifies that a deferred tax asset is assessed on a separate assessment based on taxable profit of appropriate character (ordinary income or capital gain) in accordance with tax law.

Proposal 1 – amendment to IFRS 9 or IAS 39

26. The FASB included the following guidance in the exposure draft and the following paragraph in the Basis for Conclusions:

> Deferred Tax Assets
>
> 35. An entity shall evaluate the need for a valuation allowance on a deferred tax asset related to a financial instrument for which qualifying changes in fair value are recognized in other comprehensive income in combination with the entity's other deferred tax assets. (See Topic 740 for guidance on accounting for income taxes.)
>
> Background Information, Basis for Conclusions, and Alternative Views
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> BC166. The Board concluded that the assessment of a valuation allowance for a deferred tax asset relating to the change in fair value recognized in other comprehensive income of debt instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income should be performed in combination with other deferred tax assets and liabilities of the entity. The Board believes that deferred tax assets relating to the change in fair value of debt instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income should be accounted for consistently with other deferred tax assets and liabilities recognized for items recognized in other comprehensive income under Topic 740 on income taxes. The Board also believes this approach would be consistent with Topic 740's requirements that the ultimate income tax calculation be based on the entity's entire tax position. Therefore, the Board believes that the tax calculation should not be segregated by tax amounts on the entity's specific assets and liabilities.

27. The FASB asked if constituents agree that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at fair value, with qualifying changes in fair value recognised in other comprehensive income in combination with other deferred tax assets of the entity (rather than segregated and analysed separately).

28. This guidance relates to the first issue in paragraph 20 regarding whether a deferred tax should be assessed separately. The FASB exposure draft does not

address the second issue regarding whether the recovery of book basis would provide a source of future taxable income.

29. The IASB staff considered adding guidance similar to that proposed by the FASB in its exposure draft. The IASB staff also consider, if we add the guidance, whether it should be in IFRS 9 or IAS 39.

30. The IASB staff do not support adding this guidance to IFRS 9 or IAS 39. The FASB's proposal deals with a deferred tax asset related to financial instruments measured at fair value, for which qualifying changes in fair value are recognised in other comprehensive income (OCI). However, IFRS 9 does not permit any debt instruments to be subsequently measured at fair value through OCI (as discussed in more detail in the May 2010 agenda paper).

31. IAS 39 permits debt instruments to be designated as available-for-sale financial assets. However, the available-for-sale classification will no longer be available on or after 1 January 2013 when IFRS 9 will take effect. The staff think that guidance should not be added to a standard that will be withdrawn in a couple of years.

Proposal 2 – amendment to IAS 12

32. If the Committee supports Alternative 2, the staff support proposal 2, which gives more clarity in IAS 12.30 as part of *Annual Improvements* to clarify that the reversal of temporary differences without creating or increasing taxable profit does not qualify as a tax planning opportunity.

33. The staff also propose to amend IAS 12.24 and IAS 12.34 to clarify the assessment of future taxable profit of the appropriate character (for example, ordinary income or capital gain).

34. The proposed wording for the *Annual Improvement* is included in Appendix C.

Annual Improvements criteria assessment

35. Below, the staff conduct an assessment of the inclusion of the issue against the proposed enhanced criteria for *Annual Improvements*:

(a) The proposed amendment has one or both of the following characteristics:

   (i) clarifying—the proposed amendment would improve IFRSs by:

   - clarifying unclear wording in existing IFRSs, or
   - providing guidance where an absence of guidance is causing concern.

   A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle.

   (ii) correcting—the proposed amendment would improve IFRSs by:

   - resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or
   - addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs.

   A correcting amendment does not propose a new principle or a change to an existing principle, but may create an exception from an existing principle.

(b) The proposed amendment has a narrow and well-defined purpose, ie the consequences of the proposed change have been considered sufficiently and identified.

(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach agreement on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.

(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a pressing need to make the amendment sooner than the project would.

36. In the staff's opinion, the issue satisfies the above proposed *Annual Improvements* criteria:

(a) The staff think that the change proposed would clarify unclear words in existing IAS 12 without changing the principle in IAS 12 and without proposing a new principle in IAS 12.

(b) In the staff's opinion, the change proposed is not expected to produce unintended consequences.

(c) The staff think that the Board could reach a conclusion on a timely basis on this issue.

(d) Income Tax project includes, in its scope, introduction of a concept of a valuation allowance and guidance on assessing the need for a valuation allowance. However, the staff believe that there is a pressing need to clarify this through *Annual Improvements* sooner than the project would.

Staff recommendation

37. Among the staff, there are split views on which alternative the staff should recommend.

38. Some staff prefer Alternative 1 because they think that the responses in paragraph 18 are right and believe that they can be derived without adding words in IAS 12. From this viewpoint, the proposed wording for *Annual Improvements* in Appendix C is redundant.

39. A majority of staff think that Alternative 2 is a desirable approach. They also agree with the responses in paragraph 18 but prefer taking a route of *Annual Improvements* in Alternative 2 because the significant contrary views that have been adopted in practice suggest that IAS 12 is not sufficiently clear on this matter. They think that the wording in Appendix C will provide additional clarity in IAS 12 and, therefore, satisfies the *Annual Improvements* criteria.

40. The staff would like to put the following question to the Committee:

Question 6
Which alternatives would the Committee prefer in order to conclude this issue?

Appendix A – Deferred tax on AFS debt security—Example

<table>
<tr><th></th><th>Entity A</th><th>Entity B</th></tr>
<tr><td>Transaction</td><td colspan="2">Entity A and Entity B both purchase a 5-year fixed maturity debt security for CU100 on 1 January 20X0 and classify it as available-for-sale (AFS) in accordance with IAS 39.
On 31 December 20X0, the AFS debt security has a fair value of CU80.
Both entities recognise an unrealised loss of CU20 (CU100 -CU80) relating to the AFS debt security in other comprehensive income (OCI) in their 31 December 20X0 IFRS financial statements.</td></tr>
<tr><td>Business of entities</td><td colspan="2">Assume both entities have:
(a) business operations including a business of holding and operating the AFS debt security that they purchased on 1 January 20X0 as their only activity that is capital in nature for tax purposes;
(b) probable taxable profit in the future and no tax losses, both of which are not capital in nature;
(c) a large amount of capital losses for tax purposes brought forward from prior years that an entity does not expect to be able to utilise in the foreseeable future (ie no probable taxable capital gain in the future); and
(d) a 31 December annual reporting and tax filing period.</td></tr>
<tr><td>Ability and intent relating to the debt security</td><td colspan="2">Both entities generally do not plan to hold the debt security until its maturity but have the ability and intent to do so in order to utilise tax losses or avoid incurring a tax loss.</td></tr>
</table>

Rules established by the tax authorities	• Classify income and loss incurred in relation to the AFS debt security as capital gains and capital losses which are not able to be offset against ordinary losses and ordinary income. • Allow unrealised losses on AFS debt security to be deducted from taxable profit (ie tax base of AFS debt security is reduced from 100 to 80). • Allow an entity to carry forward all tax losses (capital loss and ordinary loss) indefinitely.	• Classify income and loss incurred in relation to the AFS debt security as capital gains and capital losses which are not able to be offset against ordinary losses and ordinary income. • Do not allow unrealised losses on AFS debt security to be deducted from taxable profit (ie tax base of AFS debt security remains at 100). • Allow an entity to carry forward all tax losses (capital loss and ordinary loss) if any indefinitely.
December 20X0 tax return	• Deducts the unrealised loss of CU20 in computing taxable capital gains and capital losses. • Results in reporting a capital loss of CU20 for tax purposes.	• Does not deduct the unrealised loss of CU20 in computing either ordinary taxable profit or taxable capital gains. • Results in no effect to ordinary profit and reporting zero taxable capital gains.
Deferred tax asset for deductible temporary differences (IAS 12.24)	• No deductible temporary difference at 31 December 20X0 (carrying amount is 80, tax base is 80). •	• A deductible temporary difference of CU 20 exists at 31 December 20X0 and needs to be assessed for recoverability (carrying amount is 80, tax base is 100). .
Deferred tax asset for tax loss carry-forward (IAS 12.34)	• Needs to be assessed at 31 December 20X0 for both: o the large amount of unused capital losses for tax purposes; and o the additional capital loss carryforward of CU20 at 31 December 20X0.	• Needs to be assessed at 31 December 20X0 for only: o the large amount of unused capital losses for tax purposes.

Recognition of a deferred tax asset <u>without considering tax planning opportunities</u>	• If Entity A expects to hold the AFS debt security until its maturity, a deferred tax asset at 31 December 20X0 can be recognised to the extent of taxable capital gain of CU20 which will be recognised when the unrealised loss reverses. This is because increase in fair value of the asset, ie reversal of the previous loss, creates taxable profits against which the tax loss carryforward can be utilised. • If Entity A does not expect to hold the AFS debt security until its maturity, no deferred tax asset at 31 December 20X0 can be recognised unless there is a tax planning opportunity. This tax planning opportunity may exist if Entity A has the ability and intent to hold the AFS debt security until maturity in order to utilise the CU20 of capital losses[4].	• No deferred tax asset at 31 December 20X0 can be recognised unless there is a tax planning opportunity to create taxable capital gain in the future. This is because, without a tax planning opportunity, there is no other probable future taxable capital gain or taxable temporary differences that will give rise to taxable capital gain.
Consideration of tax planning opportunities (IAS 12.30)	• An action to hold the AFS debt security until it matures on 31 December 20X5 qualifies as a tax planning opportunity because such an action will create an additional CU20 of capital gains in taxable profits for periods from 1 January 20X1 to 31 December 20X5. The CU 20 capital gain arises from the realisation of income of CU100 on maturity of the AFS debt security for which the tax base is CU80. The tax loss carried forward is applied	• An action to hold the AFS debt security until it matures on 31 December 20X5 does not qualify as a tax planning opportunity because such an action will not create taxable profits for periods from 1 January 20X1 to 31 December 20X5. The realisation of income of CU100 at maturity of the AFS debt security is reduced to CU0 by the tax base of the AFS debt security of CU100. • In accordance with IAS 12.29(b) no deferred tax asset

[4] IAS12.29 distinguishes (a) taxable profits that it is probable that an entity will have and (b) tax planning opportunities that will create taxable profits. This paragraph implies that tax planning opportunities are those that will create taxable profit which an entity ordinarily might not have, but would make to prevent an operating loss or tax credit carryforward from expiring unused.

	against this taxable profit to reduce taxable profit to zero. • In accordance with IAS 12.36 (d), a deferred tax asset is recognised for the tax loss of CU20 relating to the AFS debt security.	is recognised for the deductible temporary difference of CU20 relating to the AFS debt security.

Summary of deferred tax computations			**31/21/20X0**	**From 20X1 to 20X5**			**31/21/20X0**	**From 20X1 to 20X5**
		Accounting profit / (loss) recognised in OCI	(CU 20)	CU 20		Accounting profit / (loss) recognised in OCI	(CU 20)	CU 20
		Taxable profit / (tax loss)	(CU 20)	CU 20		Taxable profit (tax loss)	CU 0	CU 0
		Tax loss utilised	-	(CU 20)		Tax loss utilised	-	-
		Current tax liability	CU 0	CU 0		Current tax liability	CU 0	CU 0
		DTA @ 30%—Ordinary business	CU 0	CU 0		DTA @ 30%—Ordinary business	CU 0	CU 0
		DTA @ 30%—Tax planning Opportunity	CU 6	CU 0		DTA @ 30%—Tax planning opportunity	CU 0	CU 0

Possible argument based on an actions that are <u>akin to</u> tax planning opportunities	• As shown above, the deferred tax consequence of unused capital losses for tax purposes incurred by Entity A is different from that of a deductible temporary difference incurred by Entity B in the same economic circumstances. This is due to a single difference in tax laws of their jurisdictions regarding the deductibility of unrealised loss on AFS debt securities. • However, because IAS 12 assumes that the carrying amount will be recovered, and related deductible temporary differences will be deducted in the future, some make the following argument: o IAS 12 assumes that the carrying amount of CU80 will be recovered at CU80 and the tax base of CU100 for Entity B will be deducted in future. This will lead to an assumption that B will ultimately create a capital tax loss of CU20 in the future because Entity B does not have future taxable profits that are capital in nature. o An action by Entity B to hold the AFS debt security until it matures on 31 December 20X5 does not create or increase taxable profit. It does not create a tax loss either. However, this contradicts the above assumption that Entity B will ultimately suffer a tax loss of CU20. o To be consistent with the above assumption that Entity B will ultimately suffer a tax loss of CU20, Entity B's action in holding the AFS debt security until it matures should be deemed to create taxable capital gain of CU20 that will offset the capital loss of CU20 that is inherent in IAS 12's assumption that the entity will recover only the carrying amount and no more, resulting in zero taxable profit. o Such an action does not meet the definition of tax planning opportunities under IAS 12.30 but, because Entity B is deemed to create taxable profit of CU20 that will offset the capital loss of CU20 as a result of the above-mentioned inherent assumption used in IAS 12, it should be considered an action <u>akin to</u> the tax planning opportunities. • Some also argue that, by analogy to IAS 12.29(b), Entity B should recognise a deferred tax asset for CU 20 at the end of 20X0 based on an action that is not a tax planning opportunity but is <u>akin to</u> it.

Appendix B – Revised wording for agenda decision (Alternative 1)

B1 The staff propose the following wording for the final agenda decision if the Committee supports Alternative 1 (new text is underlined and deleted text is struck through when compared to the May tentative agenda decision wording).

> **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’) that create a deductible temporary difference. The request asks for guidance in a situation when the entity may have insufficient taxable temporary differences and insufficient probable future taxable profits against which the deductible temporary difference can be utilised. 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~~s~~ 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, at the end of the reporting period, of the asset or liability. The Committee also noted that, in the context of the fact pattern in the request, the entity’s actions ~~to hold~~ in holding the AFS debt securities until a loss reverses ~~to maturity~~ do not meet the definition in paragraph 30 of IAS 12 of a tax planning opportunity~~.~~ because such an action does not create or increase taxable income. Such actions could be akin to a tax planning opportunity; however, paragraph 29 of IAS 12 does not permit recognition of deferred tax assets based on an action that is not a tax planning opportunity but is akin to it. 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 for each type of taxable profit of appropriate character (for example, ordinary income or capital gain) 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.

Appendix C – Proposal for the Annual Improvement (Alternative 2)

C1 The staff propose following amendment to IAS 12 as a part of *Annual Improvement* if the Committee supports Alternative 2.

Paragraphs 24, 30 and 34 are amended (new text is underlined and deleted text is struck through).

24 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit <u>of the appropriate character (for example, ordinary income or capital gain)</u> 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 ventures, a deferred tax asset shall be recognised in accordance with paragraph 44.

30 Tax 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. For example, in some jurisdictions, taxable profit may be created or increased by:

(a) electing to have interest income taxed on either a received or receivable basis;

(b) deferring the claim for certain deductions from taxable profit;

(c) selling, and perhaps leasing back, assets that have appreciated but for which the tax base has not been adjusted to reflect such appreciation; and

(d) selling an asset that generates non-taxable income (such as, in some jurisdictions, a government bond) in order to purchase another investment that generates taxable income.

Where tax planning opportunities advance taxable profit from a later period to an earlier period, the utilisation of a tax loss or tax credit carryforward still depends on the existence of future taxable profit from sources other than future originating temporary differences. <u>An action that results in reversal of existing deductible temporary differences without creating or increasing taxable profit in the future is not a tax planning opportunity.</u>

34 **A deferred tax asset shall be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit <u>of the appropriate character (for example, ordinary income or capital gain)</u> will be available against which the unused tax losses and unused tax credits can be utilised.**