# STAFF PAPER

**IFRS Interpretations Committee meeting** **January 2014**

Previous IFRS Interpretations Committee meeting: Nov 2013

| **Project** | **IAS 12 *Income Taxes*—Recognition and measurement of deferred tax assets when an entity is loss making** | | |
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## Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') received a request for guidance on the recognition and measurement of deferred tax assets when an entity is loss-making. The Interpretations Committee was asked to clarify:

   (a) whether IAS 12 *Income Taxes* requires that a deferred tax asset is recognised regardless of an entity's expectations of future tax losses when there are suitable reversing taxable temporary differences ('Issue 1'); and

   (b) how the guidance in IAS 12 is applied when tax laws limit the extent to which losses can be recovered against future profits ('Issue 2').

2. Regarding Issue 1[1], in its November 2013 meeting, the Interpretations Committee noted that according to paragraphs 28 and 35 of IAS 12, a deferred tax asset is recognised to the extent of the taxable temporary differences of an appropriate

[1] For further details on Issue 1, see Agenda Paper 13 for the November 2013 meeting: http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2013/November/AP13%20-%20IAS%2012%20-%20Recognition%20of%20DTA%20when%20an%20entity%20is%20loss%20making.pdf

type that reverse in an appropriate period. The reversing taxable temporary differences enable the utilisation of the deductible temporary differences and are sufficient to justify the recognition of deferred tax assets. Consequently, it is not necessary to take into consideration future tax losses. The Interpretations Committee tentatively decided that the agenda criteria were not met for Issue 1 and asked the staff to prepare a tentative agenda decision for discussion at its January 2014 meeting.

3. The proposed wording for the tentative agenda decision is in Appendix A of this paper.

4. In the November 2013 meeting, the Interpretations Committee had a preliminary discussion on Issue 2 and directed the staff to do some further analysis, including presenting a recommendation at a future Interpretations Committee meeting.

## Objective

5. The objective of this paper is to:

   (a) provide background information on Issue 2;

   (b) provide an analysis of Issue 2;

   (c) make a recommendation that the Committee should not take Issue 2 onto its agenda; and

   (d) ask the Committee whether they agree with the staff recommendation.

## Background information

6. Paragraphs 28 and 29 of IAS 12 state that:

   > 28 It is probable that taxable profit will be available against which a deductible temporary difference can be utilised when there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity which are expected to reverse:
   >
   > (a) in the same period as the expected reversal of the deductible temporary difference; or

> (b) in periods into which a tax loss arising from the deferred tax asset can be carried back or forward.
>
> In such circumstances, the deferred tax asset is recognised in the period in which the deductible temporary differences arise.
>
> 29 When there are insufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, the deferred tax asset is recognised to the extent that:
>
> (a) it is probable that the entity will have sufficient taxable profit relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference (or in the periods into which a tax loss arising from the deferred tax asset can be carried back or forward). In evaluating whether it will have sufficient taxable profit in future periods, an entity ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from these deductible temporary differences will itself require future taxable profit in order to be utilised; or
>
> (b) tax planning opportunities are available to the entity that will create taxable profit in appropriate periods.

7. Similarly, paragraphs 35 and 36 of IAS 12 state that:

> 35 The criteria for recognising deferred tax assets arising from the carryforward of unused tax losses and tax credits are the same as the criteria for recognising deferred tax assets arising from deductible temporary differences. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity. In such circumstances, paragraph 82 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.

36 An entity considers the following criteria in assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised:

(a) whether the entity has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;

(b) whether it is probable that the entity will have taxable profits before the unused tax losses or unused tax credits expire;

(c) whether the unused tax losses result from identifiable causes which are unlikely to recur; and

(d) whether tax planning opportunities (see paragraph 30) are available to the entity that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

To the extent that it is not probable that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the deferred tax asset is not recognised.

## Staff analysis

### *Description of Issue 2*

8. Issue 2 assumes that the answer to Issue 1 is that a deferred tax asset is recognised to the extent of the taxable temporary differences of an appropriate type that reverse in an appropriate period.

9. The submitter asked the Interpretations Committee to clarify how the guidance in IAS 12 should be applied when tax laws restrict the recovery of tax losses to a certain portion of taxable profits in each year.

10. The fact pattern is the following:

(a) an entity has tax losses carried forward of CU100[2] and taxable temporary differences of CU100 that will reverse next year and create CU100 of taxable profit;

(b) the entity expects to incur losses before and after the reversal of the taxable temporary differences; and

(c) the tax law restricts the recovery of tax losses to 60 per cent of taxable profit in each year.

11. The submitter thinks that there are two views on this issue:

(a) **View 1: deferred tax asset restricted to 60 per cent of the taxable temporary differences**. It is not probable that there will be future taxable profits in excess of reversing taxable temporary differences, and consequently the deferred tax asset recognised is restricted to 60 per cent of the taxable temporary difference.

(b) **View 2: deferred tax asset recognised to the full extent of sufficient taxable temporary differences**. The tax law restricts the recovery of tax losses to 60 per cent of the taxable profit. If the entity expects to incur tax losses in the future, the tax law restriction is not relevant, because the actual taxable profit will be zero (or it will be a tax loss). Consequently, the deferred tax asset is recognised to the full extent of the taxable temporary differences.

*View 1: deferred tax asset restricted to 60 per cent of the taxable temporary differences*

12. Proponents of this view think that the deferred tax asset should be restricted to the extent allowed by the tax law. A law that limits the recovery of tax losses means that the tax losses brought forward will reduce the obligation to pay tax arising from the reversing taxable temporary difference, but only to the extent allowed by the law.

[2] In this paper, currency amounts are denominated in ‘currency units’ (CU).

13. In their view, if the entity expects that it is not probable that there will be future taxable profits in excess of reversing taxable temporary differences, then the deferred tax asset should be restricted to 60 per cent of the taxable temporary differences.

14. They also think that restricting the recognition of the deferred tax asset to 60 per cent of the taxable temporary differences better reflects the entity's financial position, because the recognition of the additional 40 per cent would result in an asset that will not embody any economic benefits. In their view, this would be inconsistent with the principles in IAS 12 and with the definition of an asset in the *Conceptual Framework*. They think that the 'asset' would be written off in a subsequent period, although there would be no change in circumstances.

*View 2: deferred tax asset recognised to the full extent of sufficient taxable temporary differences*

15. Proponents of this view note that the tax law restricts the recovery of tax losses to a certain percentage of actual taxable profits. In their view, if the entity expects to incur tax losses in the future, the restriction in the legislation does not have any impact on the recognition of the deferred tax asset.

16. They think that the reversal of taxable temporary differences results in the recognition of a deferred tax asset in accordance with IAS 12, regardless of expected future losses and that the tax law restriction is only relevant if there are taxable profits.

17. For example:

    (a) if the accounting result of an entity is zero and a reversing taxable temporary difference of CU100 creates an actual taxable profit of CU100, then the tax law restriction is relevant. Consequently only a part (eg 60 per cent) of the tax losses carried forward can be used against that profit.

    (b) However, if an entity makes an accounting loss that exceeds the reversing taxable temporary difference (eg an accounting loss of CU150), then there is no actual taxable profit (ie there is an actual tax loss).

Consequently, the tax law restriction is not relevant and the general requirements of paragraphs 28 and 35 of IAS 12 apply. This means that the tax losses carried forward of CU100 can be used in full against the reversing taxable temporary difference of CU100.

18. Consequently, in their view, the key question is whether the entity expects future taxable profits, because:

    (a) if the entity expects future taxable profit, only a part (eg 60 per cent) of the tax losses carried forward can be used against that profit; but

    (b) if the entity expects future tax losses, the tax law limitation is not relevant and the losses carried forward can be used in full against the reversing taxable temporary difference.

*Staff view*

19. We support View 1, because we think that the guidance in IAS 12 on the recognition of deferred tax assets can be summarised in two steps:

    (a) the first step is that according to paragraphs 28 and 35 of IAS 12, a deferred tax asset is recognised to the extent of the taxable temporary differences of an appropriate type that reverse in an appropriate period (this means that an entity should first offset the "appropriate" taxable temporary differences against its losses carried forward); and

    (b) the second step is that according to paragraph 29 and 36 of IAS 12, when there are insufficient taxable temporary differences of an appropriate type, the deferred tax asset is recognised to the extent that:

        (i) it is probable that the entity will have taxable profits in future periods; or

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

    This means, in our view, that an entity should look at future taxable profits and tax planning opportunities only if the "appropriate" reversing taxable temporary differences are lesser than the losses carried forward.

20. We note that in the fact pattern described in paragraph 8 of this paper:

    (a) the entity has reversing taxable temporary differences of CU100 that create CU100 of taxable profit and tax losses carried forward of CU100; and

    (b) the tax law restricts the recovery of tax losses to 60 per cent of taxable profit in each year.

21. We think that in this fact pattern, the "appropriate" taxable temporary differences that can be offset against the tax losses carried forward are CU60, because of the tax law restriction. Consequently, in our view, the entity should look at future taxable profits and tax planning opportunities to recognise a deferred tax asset on the remaining tax losses carried forward (CU40).

22. In this fact pattern the entity does not expect future taxable profit. Consequently, we think that the additional deferred tax asset on the remaining CU40 cannot be recognised (assuming that there are no tax planning opportunities and there are no other taxable temporary differences that are expected to reverse in subsequent periods that could be offset against the unutilised tax losses).

## Agenda criteria assessment

23. Our assessment against the Interpretations Committee's agenda criteria is as follows:

| Source of issue | |
|---|---|
| Issues could include: the identification of divergent practices that have emerged for accounting for particular transactions, cases of doubt about the appropriate accounting treatment for a particular circumstance or concerns expressed by investors about poorly specified disclosure requirements (5.14). | |
| Criteria | |
| We should address issues(5.16): | |
| that have widespread effect and have, or are expected to have, a material effect on those affected; | On the basis of our outreach[3] this tax law |

[3] For further details see Agenda Paper 13 for the November 2013 meeting: http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2013/November/AP13%20-%20IAS%2012%20-%20Recognition%20of%20DTA%20when%20an%20entity%20is%20loss%20making.pdf

| Source of issue | |
|---|---|
| where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and<br>that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*. | restriction exists in four jurisdictions (out of the 18 jurisdictions that responded to our outreach request). In these four jurisdictions diversity in practice has been noted (or different views exist). |
| In addition: | |
| Can the Interpretations Committee address this issue in an efficient manner (5.17)? | Not applicable |
| Will it be effective for a reasonable time period (5.21)? Only take on the topic of a forthcoming Standard if short-term improvements are justified. | Not applicable |

### Staff recommendation

24. On the basis of the previous Interpretations Committee's discussions and of our analysis, we think that the guidance in IAS 12 on the recognition and measurement of deferred tax assets when an entity is loss-making is sufficiently clear. Consequently, we recommend that the Interpretations Committee should take neither Issue 1 nor Issue 2 onto its agenda.

25. Our proposed tentative agenda decision is included in Appendix A of this paper.

| Questions for the Interpretations Committee |
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| 1. Does the Interpretations Committee agree that deferred tax asset should be restricted to the extent allowed by the tax law (when tax laws limit the extent to which losses can be recovered against future profits in each year)?<br><br>2. Does the Interpretations Committee agree with the staff's recommendation that it should not take these issues onto its agenda?<br><br>3. Does the Interpretations Committee have any comments on the proposed wording for the tentative agenda decision in Appendix A? |

# Appendix A—Proposed wording for tentative agenda decision

A1 The proposed wording for the tentative agenda decision is presented below.

**IAS 12 *Income Taxes*—Recognition and measurement of deferred tax assets when an entity is loss-making**

The Interpretations Committee received a request for guidance on the recognition and measurement of deferred tax assets when an entity is loss-making. The Interpretations Committee was asked to clarify two issues:

- whether IAS 12 *Income Taxes* requires that a deferred tax asset is recognised regardless of an entity's expectations of future tax losses when there are suitable reversing taxable temporary differences; and
- how the guidance in IAS 12 is applied when tax laws limit the extent to which losses can be recovered against future profits.

The Interpretations Committee noted that according to paragraphs 28 and 35 of IAS 12:

- a deferred tax asset is recognised to the extent of the taxable temporary differences of an appropriate type that reverse in an appropriate period. The reversing taxable temporary differences enable the utilisation of the deductible temporary differences and are sufficient to justify the recognition of deferred tax assets. Consequently, it is not necessary to take into consideration future tax losses.
- when tax laws limit the extent to which losses can be recovered against future profits in each year, the reversing taxable temporary differences that should be offset against the tax losses carried forward are limited to the extent allowed by the tax law. A deferred tax asset on the remaining tax losses carried forward is recognised if the requirements in paragraphs 29 and 36 of IAS 12 are met (ie to the extent that it is probable that the entity will have appropriate future taxable profit, or to the extent that tax planning opportunities are available to the entity that will create appropriate taxable profit).

On the basis of the analysis above the Interpretations Committee [decided] not to add these issues to its agenda.