IFRS

STAFF PAPER

IFRS Interpretations Committee meeting **May 2014**

IFRS Interpretations Committee meetings:
Nov 2013 and Jan 2014

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. The Interpretations Committee discussed this issue in the November 2013 and January 2014 meetings.

3. In the January 2014 meeting, the Interpretations Committee tentatively decided not to add these issues to its agenda, because it noted that the guidance in IAS 12 on the recognition and measurement of deferred tax assets is sufficiently clear.

4. We received five comment letters on the tentative agenda decision. We analyse the comment letters in the following paragraphs.

Comment analysis

5. Three respondents support the Interpretations Committee's tentative decision not to add these issues to its agenda for the reasons provided in the tentative agenda decision.[1]

6. One of these three respondents (Deloitte) suggests that the agenda decision could be made clearer by referring to 'existing taxable temporary differences'. This could address any confusion over whether future originating taxable temporary differences are included in the assessment of future reversals of temporary differences that might support recognition of a deferred tax asset.

7. We agree with the proposed clarification. In the final agenda decision we propose to refer to 'existing taxable temporary differences' and not to 'taxable temporary differences'. Our proposed changes are shown in Appendix A of this paper.

8. One respondent (KPMG) disagreed with the Interpretations Committee's tentative decision not to add this issue to its agenda and urged the Interpretations Committee to include the issue as part of a wider project.

9. We reproduce below the main comments provided by KPMG:

> We note that it remains unclear whether 'taxable profit' as a criterion for recognition of a deferred tax asset (paragraphs 24 et seq and 34 et seq of IAS 12) is the same figure as 'taxable profit' as defined in paragraph 5 of IAS 12 – i.e. the 'bottom line' on a tax return determined in accordance with a tax law. In our experience, this confusion contributes to diverging interpretations in practice, as illustrated by the issue that is the subject of this letter.
>
> The question of how 'taxable profit' as a recognition criterion is determined has been causing significant challenges and triggered another submission to the Committee – i.e. on recognition of deferred tax assets for

[1] ACSB, Deloitte and PWC.

> unrealised losses. In response to that submission, the Committee is currently working on a project, which is expected to result in clarifying amendments to IAS 12. These amendments are expected to relate to, but not fully resolve, the issues of how 'taxable profit' is determined. They would not address the existing divergence in interpretations and practices in relation to recognition and measurement of deferred tax assets by loss-making entities.
>
> Given this, we believe that the Committee should address all issues related to determining 'taxable profit' in a comprehensive manner. Dealing with them on a piecemeal basis may result in guidance that is unclear when applied to other cases, inconsistent decisions in relation to similar issues or unintended consequences. Such an approach would not improve the financial reporting. We believe that the Committee's active project on recognition of deferred tax assets for unrealised losses offers an opportunity to address the wider issue of how 'taxable profit' is determined in a holistic manner.
>
> Whilst we have no objection to the accounting outcome of the agenda decision itself, we are concerned that the agenda decision implicitly includes an interpretation of IAS 12 rather than a clarification only. There are other interpretations in respect of this issue that are equally supportable based on the current definitions and requirements of IAS 12. Therefore, we disagree with the Committee's decision not to address the issue of recognition and measurement of deferred tax assets by loss-making entities and urge the Committee to include the issue as part of the wider project.

10. We think that the Interpretations Committee's tentative agenda decision does not implicitly include an interpretation of IAS 12. It only clarifies that, according to paragraphs 28 and 35 of IAS 12, the reversal of taxable temporary differences enables the utilisation of unused tax losses and is sufficient to justify the recognition of deferred tax assets.

11. In our view, it addresses the two issues identified by the submitter and does not address the additional issue raised by the respondent (ie how taxable profit is determined). We think that this tentative decision does not prejudge a potential debate on how taxable profit should be determined.

12. We also note that the respondent has *no objection to the accounting outcome of the agenda decision itself.*

13. Another respondent (the Accounting Standards Committee of Germany—ASCG) does not support the Interpretations Committee's tentative decision on 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).

14. We reproduce below the main comments provided by ASCG:

> As a matter of fact, we note that in our jurisdiction tax law limits the extent to which tax losses can be recovered against future profits, i.e. only 60 % of future profits can be utilised for deducting tax losses carried forward in any given year. Thus, the issue is relevant and widespread. Recognition of a DTA without limitation (resulting from minimum taxation) is the pre-dominant practice.
>
> We note that a minimum taxation by tax law would not apply (ie. does not have any implication) in case future losses were expected. Thus, it appears inappropriate if in that case the amount to be recognised as a DTA was restricted.
>
> However, due to the main underlying rationale for the IFRS IC's decision on issue #1 – which we clearly support –, the expectation of tax losses (or taxable profits) is not taken into account when determining the amount of a DTA to be recognised. Hence, recognising a DTA solely depends on the existence of reversing taxable temporary differences (being a deferred tax liability (DTL)), irrespective of whether future tax losses are expected. Thus, even in loss-making periods a DTA would be recognised in full, provided that a DTL was available.
>
> If this rationale was carried over to issue #2, since future tax losses (or profits) were not taken into consideration, taxable temporary differences that allowed for recognising a DTA should not be limited to a certain percentage due to a minimum taxation requirement.
>
> From a conceptual perspective, the decision on both issues should primarily depend on the existence of a DTL and not on the availability of future taxable profits or tax losses. As this is the underlying rationale for the TAD on issue #1, it should, consequently, result in supporting view

2 (or 1B) for issue #2 – which would be that a DTA is recognised without limitation by minimum taxation.

To summarise our reservations: It appears, as confirmed by the IFRS IC in its TAD on issue #1, that IAS 12 applies a formalistic approach in assessing the recognition of DTAs when DTLs are recognised at the same time. If sufficient DTLs were recognised one would not have to assess whether sufficient taxable amounts would be available against which the DTAs could be used. This implies that the actual tax impact in the year when the temporary difference reverses is not relevant as long as there are sufficient DTLs recognised. This becomes especially clear, when the DTA results from a tax loss carry-forward, as those unused losses cannot be used if no sufficient taxable income is available. From our point of view, the same formalistic approach needs to be applied in a tax regime where there is a minimum tax restriction. Otherwise, the recognition of a DTA, when actually tax losses are expected, would depend on the arbitrary assumption of the actual tax implications when no tax losses are expected under this tax regime. So far, the current decisions on both issues do not follow the same rationale and are, thus, inconsistent with each other.

15. We think that the tentative decision on Issue 2 is not inconsistent with the tentative decision on Issue 1, because:

(a) The decision on Issue 1 (the general issue) concludes that the reversal of taxable temporary differences enables the utilisation of unused tax losses and is sufficient to justify the recognition of deferred tax assets. It says that future tax losses are not considered, but does not say that tax laws limitations should not be considered.

(b) The decision on Issue 2 says that when tax laws limit the extent to which unused tax losses can be recovered against future taxable profits in each year, the amount of deferred tax assets recognised from unused tax losses as a result of suitable taxable temporary differences is restricted as specified by the tax law (eg 60% of the taxable profit of the year). This is because when the suitable taxable temporary differences reverse, the amount of tax losses that can be utilised by that reversal is reduced as

specified by the tax law. This limitation is the difference between the two issues and it is the basis for the Interpretations Committee's decision.

Staff recommendation

16. After considering the comments received on the tentative agenda decision, we recommend that the Interpretations Committee should finalise its decision not to add this issue to its agenda. However, on the basis of this comment analysis, we propose changes to the wording of the tentative agenda decision as illustrated in Appendix A of this paper.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff's recommendation that the Interpretations Committee should finalise its decision not to add this issue to its agenda?
2. Does the Interpretations Committee have any comments on the proposed wording in Appendix A for the final agenda decision?

Appendix A—Proposed wording for the final agenda decision

A1 The proposed wording for the final agenda decision is as follows (new text is underlined and deleted text is struck through):

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 for the carryforward of unused tax losses when there are suitable reversing taxable temporary differences regardless of an entity's expectations of future tax losses; and
- how the guidance in IAS 12 is applied when tax laws limit the extent to which tax losses brought forward can be recovered against future taxable profits.

In the tax systems considered for the second issue, the amount of tax losses brought forward that can be recovered in each tax year is limited to a specified percentage of the taxable profits of that year.

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

- A deferred tax asset is recognised for the carryforward of unused tax losses to the extent of the existing taxable temporary differences, of an appropriate type, that reverse in an appropriate period. The reversal of those taxable temporary differences enables the utilisation of the unused tax losses and justifies the recognition of deferred tax assets. Consequently, future tax losses are not considered.
- When tax laws limit the extent to which unused tax losses can be recovered against future taxable profits in each year, the amount of deferred tax assets recognised from unused tax losses as a result of suitable existing taxable temporary differences is restricted as specified by the tax law. This is because when the suitable taxable temporary differences reverse, the amount of tax losses that can be utilised by that reversal is reduced as specified by the tax law.
- In both cases, if the unused tax losses exceed the amount of suitable existing taxable temporary differences (after taking into account any restrictions), an additional deferred tax asset is recognised only 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 concluded that neither an Interpretation nor an amendment to the Standard was needed and consequently [decided] not to add these issues to its agenda.

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Wayne Upton
Chairman of the
IFRS Interpretations Committee
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Berlin, 7 April 2014

Dear Wayne,

IFRS IC tentative agenda decisions in its January 2014 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on several IFRS IC tentative agenda decisions, published in the January 2014 *IFRIC Update*. We list the decisions and our detailed comments in appendix A to this letter.

Further, we comment on one issue on which a final agenda decision has been made (see appendix B). We are particularly concerned about the short and probably incomplete rationale for this (final) decision as conveyed in the *IFRIC January 2014 Update*.

If you would like to discuss our views further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr

President

Appendix A – Comments on recent tentative agenda decisions

IAS 1 – Issues related to the application of IAS 1

We agree with the IFRS IC's decision in general. In particular, we agree with the rationale that IAS 1 is designed to allow for diversity in practice, as this supports financial information to be presented in a decision-useful manner – depending on the individual entity and/or business. Thus, diversity cannot be marked as negative in all cases; it is rather essential to allow for individually useful presentation.

This said, we would not support if specific presentation formats, (dis)aggregation levels, etc. were mandated and fixed. This might be in the particular interest of some constituents, but not in the interest of IFRS financial reporting in general. Any change requiring more prescriptive presentation schemes would have to be the outcome of a comprehensive project to revise IAS 1.

However, to our understanding the IFRS IC makes a judgement on one particular issue amongst the numerous issues mentioned in the submission. If we understand it correctly, the IFRS IC concludes that additional pro-forma columns in the primary statements are unlikely to comply with IAS 1.112(c). We deem this statement being made unintentionally; otherwise it would conflict with the central idea of the general decision of not prescribing specific presentation. This might warrant amending the wording of this decision.

Nevertheless, we think there are indeed some examples for which (existing or expected) diversity might not be in line with IAS 1. However, it is difficult to determine for which particular issue diversity is deemed appropriate (and which, thus, may not be restricted by IAS 1) and for which it is not. In the examples given in the submission, we acknowledge that:

- example a.1) ("presentation of amortisation and impairment losses on capitalised development cost") would demonstrate that there were circumstances where a required way of presentation would be appropriate;
- example b.3) ("presentation of the share of profit or loss of associates or and joint ventures accounted for using the equity method") would demonstrate that there were circumstances (e.g. different subsidiaries within a group presenting it differently) where a required single-line presentation would not be appropriate.

Thus, we would support if clarification or guidance on these or any other examples were developed only through a more comprehensive review, e.g. as part of the current disclosure

initiative. The IASB and the IFRS IC should ensure that such clarification or guidance is not developed only for selected issues that have been raised incidentally through a submission, but rather on a systematic manner.

IAS 12 – Recognition and measurement of DTA when an entity is loss-making

We do not support the outcome of recent discussions of issue #2 in the respective submission, which is whether a deferred tax asset (DTA) shall be recognised at a restricted amount when there is a legal "minimum taxation restriction". Whilst we acknowledge that this is not yet a tentative agenda decision (TAD), we deem our early comments being appropriate since a TAD on the related issue #1 of the very same submission has already been made by the IFRS IC. That former TAD (and its rationale) on issue #1 in particular make the outcome from recent discussions of issue #2 look surprising, or even inconsistent.

As a matter of fact, we note that in our jurisdiction tax law limits the extent to which tax losses can be recovered against future profits, i.e. only 60 % of future profits can be utilised for deducting tax losses carried forward in any given year. Thus, the issue is relevant and widespread. Recognition of a DTA without limitation (resulting from minimum taxation) is the predominant practice.

We note that a minimum taxation by tax law would not apply (ie. does not have any implication) in case future losses were expected. Thus, it appears inappropriate if in that case the amount to be recognised as a DTA was restricted.

However, due to the main underlying rationale for the IFRS IC's decision on issue #1 – which we clearly support –, the expectation of tax losses (or taxable profits) is not taken into account when determining the amount of a DTA to be recognised. Hence, recognising a DTA solely depends on the existence of reversing taxable temporary differences (being a deferred tax liability (DTL)), irrespective of whether future tax losses are expected. Thus, even in loss-making periods a DTA would be recognised in full, provided that a DTL was available.

If this rationale was carried over to issue #2, since future tax losses (or profits) were not taken into consideration, taxable temporary differences that allowed for recognising a DTA should not be limited to a certain percentage due to a minimum taxation requirement.

From a conceptual perspective, the decision on both issues should primarily depend on the existence of a DTL and not on the availability of future taxable profits or tax losses. As this is the underlying rationale for the TAD on issue #1, it should, consequently, result in supporting

view 2 (or 1B) for issue #2 – which would be that a DTA is recognised without limitation by minimum taxation.

To summarise our reservations: It appears, as confirmed by the IFRS IC in its TAD on issue #1, that IAS 12 applies a formalistic approach in assessing the recognition of DTAs when DTLs are recognised at the same time. If sufficient DTLs were recognised one would not have to assess whether sufficient taxable amounts would be available against which the DTAs could be used. This implies that the actual tax impact in the year when the temporary difference reverses is not relevant as long as there are sufficient DTLs recognised. This becomes especially clear, when the DTA results from a tax loss carry-forward, as those unused losses cannot be used if no sufficient taxable income is available. From our point of view, the same formalistic approach needs to be applied in a tax regime where there is a minimum tax restriction. Otherwise, the recognition of a DTA, when actually tax losses are expected, would depend on the arbitrary assumption of the actual tax implications when no tax losses are expected under this tax regime. So far, the current decisions on both issues do not follow the same rationale and are, thus, inconsistent with each other.

IAS 12 – Threshold of recognition on an asset if the tax position is uncertain

We support the decision. However, the question being answered here is also relevant in other circumstances, which look similar but are not within the scope of IAS 12 – i.e. taxes other than *income* taxes. The IFRS IC's decision leaves open how to account for these issues. While discussing similar issues, another (third) view has emerged: Payments to escrow accounts or deposits in court are similar to a deposit and would constitute a financial asset; hence, IAS 39 / IFRS 9 would likely be the relevant standard in these circumstances, and they require recognition of an asset.

IAS 19 – Guaranteed return on contributions or notional contributions

We note the IFRS IC’s view that this issue is too broad to be addressed in an efficient manner. Nevertheless, as the IFRS IC observed, these plans are part of a growing range of plan designs and the accounting for these plans results in diversity in practice. Therefore, we would welcome guidance on how to account for these plans.

This issue is the second IAS 19 issue recently removed from the IFRS IC's agenda because it was deemed too broad to be addressed by the IFRS IC. In addition, there are other issues relating to IAS 19 that are, or have recently been, under discussion (e.g. discount rates, regional market issue, etc.). This shows that a more fundamental review of IAS 19 by the IASB

is warranted in the near future. Thus, we urge the IASB to carry out a comprehensive review of IAS 19 rather than a piecemeal approach.

Furthermore, we suggest that the IASB clearly define the scope of issues the IFRIC IC is able to solve. This should allow for a process that leads to answering issues rather than rejecting them for formal reasons; and it may result in adjustments to the due process handbook in order to clarify the borderline of responsibilities between the IASB and the IFRS IC, either in a general sense or, at least, with regard to potential minor "narrow-scope amendments" and/or interpretations.

Appendix B – Comments on a recent (final) agenda decision

IAS 32 – MCB convertible upon a contingent "non-viability" event

We basically support the IFRS IC's decision not to add this issue to its agenda. In our opinion, though, the decision is not well explained. We do not agree with the wording of the agenda decision as it does not include any statement by the IFRS IC on how to account for the submitted case. So far, it remains unclear whether the instrument may be considered a hybrid instrument and how its components (notional amount, interest payments) are to be accounted for.

More generally, we note that numerous requests with respect to IAS 32 have been submitted to the IFRS IC during the recent years. In our impression, these issues have been dealt with in a casuistic manner. Thus, we are concerned about IAS 32 related interpretations and decisions being inconsistent. Therefore, we recommend the IFRS IC to deliberate further whether the recent decision on the issue mentioned above is consistent with other interpretations/decisions made by the IFRS IC regarding IAS 32.

Deloitte.

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Wayne Upton
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7 April 2014

Dear Mr Upton

Tentative agenda decision - IAS 12 *Income Taxes*: Recognition and measurement of deferred tax assets when an entity is loss-making

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the January IFRIC Update of the tentative decision not to take onto the Committee's agenda a request for guidance on the recognition of deferred tax assets when an entity is loss-making.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision but would suggest that the agenda decision could be made clearer by referring to "existing taxable temporary differences." This could address any confusion over whether future originating taxable temporary differences are included in the assessment of future reversals of temporary differences that might support recognition of a deferred tax asset.

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

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April 14, 2014

(By email to ifric@ifrs.org)

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

Re: Tentative agenda decision on IAS 12 *Income Taxes* – recognition and measurement of deferred tax assets when an entity is loss-making

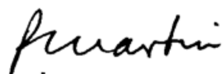
This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's tentative agenda decision on the above topic, as published in the January 2014 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the AcSB staff but do not necessarily represent a common view of the AcSB or its staff. Views of the AcSB are developed only through due process.

We agree with the Committee's decision not to add this item to its agenda for the reasons provided in the tentative agenda decision.

We would be pleased to provide more detail if you require. If so, please contact me at + 1 416 204 3276 (email pmartin@cpacanada.ca) or Greg Edwards, Principal, at + 1 416 204 3462 (email gedwards@cpacanada.ca).

Yours truly,



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Our ref MV/288
Contact Mark Vaessen

14 April 2014

Dear Mr Upton

Tentative agenda decision: IAS 12 - Recognition and measurement of deferred tax assets when an entity is loss-making

We appreciate the opportunity to comment on the IFRS Interpretations Committee's (Committee) tentative agenda decision, *IAS 12 Income Taxes - Recognition and measurement of deferred tax assets when an entity is loss-making* (IFRIC Update January 2014). We have consulted with, and this letter represents the views of, the KPMG network.

We note that it remains unclear whether 'taxable profit' as a criterion for recognition of a deferred tax asset (paragraphs 24 et seq and 34 et seq of IAS 12) is the same figure as 'taxable profit' as defined in paragraph 5 of IAS 12 - i.e. the 'bottom line' on a tax return determined in accordance with a tax law. In our experience, this confusion contributes to diverging interpretations in practice, as illustrated by the issue that is the subject of this letter.

The question of how 'taxable profit' as a recognition criterion is determined has been causing significant challenges and triggered another submission to the Committee - i.e. on recognition of deferred tax assets for unrealised losses. In response to that submission, the Committee is currently working on a project, which is expected to result in clarifying amendments to IAS 12. These amendments are expected to relate to, but not fully resolve, the issues of how 'taxable profit' is determined. They would not address the existing divergence in interpretations and practices in relation to recognition and measurement of deferred tax assets by loss-making entities.

Given this, we believe that the Committee should address all issues related to determining 'taxable profit' in a comprehensive manner. Dealing with them on a piecemeal basis may result in guidance that is unclear when applied to other cases, inconsistent decisions in relation to similar issues or unintended consequences. Such an approach would not improve the financial reporting. We believe that the Committee's active project on recognition of deferred tax assets for unrealised losses offers an opportunity to address the wider issue of how 'taxable profit' is determined in a holistic manner.

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Whilst we have no objection to the accounting outcome of the agenda decision itself, we are concerned that the agenda decision implicitly includes an interpretation of IAS 12 rather than a clarification only. There are other interpretations in respect of this issue that are equally supportable based on the current definitions and requirements of IAS 12. Therefore, we disagree with the Committee's decision not to address the issue of recognition and measurement of deferred tax assets by loss-making entities and urge the Committee to include the issue as part of the wider project.

Please contact Mark Vaessen +44 (0)20 7694 8871 or Thomas Schmid + 41 58 249 2922 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

Mr Michael Stewart
Director of Implementation Activities
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14 April 2014

Dear Mr Stewart

Tentative agenda decisions on IAS 12 Income Taxes:

- recognition and measurement of deferred tax assets when an entity is loss-making
- impact of an internal reorganisation on deferred tax amounts related to goodwill
- threshold of recognition of an asset in the situation in which the tax position is uncertain

We are responding to the invitation to comment on the above tentative agenda decisions, published in the January 2014 edition of IFRIC Update, on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the tentative agenda decisions. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We agree with the Committee's decision not to take these items onto the agenda because of the reasons set out in the tentative agenda decisions. We however suggest a clarification to the tentative agenda decision on the impact of an internal reorganisation on deferred tax amounts related to goodwill. The tentative agenda decision only addresses the narrow set of facts included in the submission, rather than the principle that intra-group transfers of assets would not typically affect the consolidated financial statements unless there is an effect on the tax base of assets or liabilities, the tax rate applicable to the recovery or settlement of those assets or liabilities or the recoverability of any related deferred tax asset.

We believe that the Committee discussed this principle and thus suggest that the following might be added to the tentative agenda decision to reflect that discussion:

> The Interpretations Committee also noted that an intra-group transfer of assets would not typically affect the consolidated financial statements if there is no effect on the tax base of assets, the tax rate applicable to the recovery of those assets or liabilities, the tax rate applicable to the recovery or settlement of those assets or liabilities or the recoverability of any related deferred tax asset.

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If you have any questions in relation to this letter please do not hesitate to contact John Hitchins (020 7804 2497).

Yours sincerely

PricewaterhouseCoopers International Ltd