

## STAFF PAPER

24-25 Mar 2015

## IFRS Interpretations Committee Meeting

IFRS IC meetings : May-Nov 2010,  
Nov 2012, May 2013, Jan and Mar 2014  
IASB meetings: Sep 2011, Dec 2012,  
May and June 2014

Project	<b><i>Exposure Draft of proposed amendments to IAS12 (ED/2014/3)—Comment letter analysis</i></b>		
Paper topic	Recognition of Deferred Tax Assets for Unrealised Losses		
CONTACT(S)	Jooeun Chung	jchung@ifrs.org	+44 (0)20 7246 6453

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

## Introduction

1. The Exposure Draft ED/2014/3 *Recognition of Deferred Tax Assets for Unrealised Losses* (proposed amendments to IAS 12) was published in August 2014 (the ‘ED’) to clarify the guidance on recognition of a deferred tax asset that is related to a debt instrument measured at fair value in circumstances in which:
  - (a) changes in the market interest rate decrease the fair value of the debt instrument below cost;
  - (b) it is probable that the debt instrument’s holder will receive all the contractual cash flows if it holds the debt instrument until maturity;
  - (c) the debt instrument’s holder has the ability and intention to hold the debt instrument until the decrease in its fair value reverses (which may be at its maturity);
  - (d) the tax base of the debt instrument remains at cost until the debt instrument is sold or until maturity.

- (e) The tax base of the debt instrument is not reduced by an impairment loss, because the criteria for recognising an impairment loss for tax purposes are not met; and
- (f) the probable future taxable profits of the debt instrument's holder are insufficient for the utilisation of all of its deductible temporary differences.

## Objective

- 2. The objective of this paper is to provide an analysis of the comment letters received on the proposal to amend IAS 12 and to obtain a recommendation from the IFRS Interpretations Committee ('the Interpretations Committee') for the IASB to proceed with the amendment.
- 3. The proposal in the ED was based on the concerns identified by the Interpretations Committee and the recommendations that it made to the IASB. Consequently, this paper is intended to draw on the Interpretations Committee's experience on these issues and to ask whether it agrees that the staff's recommendations are adequate.

## Structure of the paper

- 4. This paper:
  - (a) provides a description of the issue that led to the proposed amendments;
  - (b) analyses the comments received as part of the Exposure Draft process; and
  - (c) asks the Interpretations Committee whether it agrees with the staff recommendation to proceed with the proposed amendments.

## Description of the issue

5. The Interpretations Committee received a request to clarify the accounting for a deferred tax asset for unrealised losses on debt instruments measured at fair value.
6. The issue had initially been considered as part of the Exposure Draft *Annual Improvements to IFRSs 2010-2012 Cycle*(ED/2012/1) which proposed to clarify that:
  - (a) an entity assesses whether to recognise the tax effect of a deductible temporary difference as a deferred tax asset in combination with other deferred tax assets; and
  - (b) taxable profit against which an entity assesses a deferred tax asset for recognition is the amount excluding any reversal of deductible temporary differences.
7. However, on the basis of the comment letters received, the IASB decided that a narrow-scope amendment would be required to address two additional issues:
  - (a) whether an unrealised loss on a debt instrument gives rise to a deductible temporary difference when the holder expects to recover the carrying amount of the asset by holding it to maturity and collecting all the contractual cash flows; and
  - (b) whether an entity can assume recovery of an asset for more than its carrying amount when estimating probable future taxable profits against which deductible temporary differences can be utilised.
8. The IASB observed that there is diversity in practice because of uncertainty about the application of some of the principles in IAS 12.
9. At its meeting in May 2014, the IASB agreed with the Interpretations Committee's recommendation that the following aspects should be clarified in IAS 12, mainly by adding an illustrative example:

- (a) an unrealised loss on a debt instrument measured at fair value gives rise to a deductible temporary difference even if:
    - (i) the debt instrument holder expects to recover the instrument's carrying amount by holding it to maturity and collecting all of the contractual cash flows; and
    - (ii) the loss is not tax-deductible until realised.
  - (b) an entity assesses the utilisation of deductible temporary differences related to unrealised losses on debt instruments measured at fair value in combination with other deductible temporary differences. If tax law, however, restricts the utilisation of deductible temporary differences so that they are deductible only against the taxable profits of a specific type, the entity still assesses utilisation of such deductible temporary differences in combination with other deductible temporary differences, but only of the appropriate type.
  - (c) an entity's estimate of future taxable profit includes amounts from recovering assets for more than their carrying amounts.
  - (d) an entity's estimate of future taxable profit excludes tax deductions resulting from the reversal of deductible temporary differences.
10. However, the IASB decided that the items in paragraph 9 (a)-(c) of this paper should also be addressed by amending the mandatory guidance in IAS 12, in addition to providing an illustrative example.
11. The IASB also proposed to require limited retrospective application of the proposed amendments for entities already applying IFRS to avoid undue cost and effort. This proposed limited retrospective application does not require restatements of the opening retained earnings or other components of equity of the earliest comparative period presented.

## Comment letter analysis

12. In this section, we discuss and analyse the comments received from interested parties on the ED during the comment period, which ended on 18 December 2014.
13. The ED asked five questions that were answered individually for each proposed amendments:
  - (a) **Question 1 (Existence of a deductible temporary difference):** The IASB proposes to confirm that decreases in the carrying amount of a fixed-rate debt instrument for which the principal is paid on maturity give rise to a deductible temporary difference if this debt instrument is measured at fair value and if its tax base remains at cost. This applies irrespective of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use, ie by holding it to maturity, or whether it is probable that the issuer will pay all the contractual cash flows. Do you agree with the IASB's proposal to amend the Standard as described in the Exposure Draft? If not, why and what alternative do you propose?
  - (b) **Question 2 (Recovering an asset for more than its carrying amount):** The IASB proposes to clarify the extent to which an entity's estimate of future taxable profit (paragraph 29) includes amounts from recovering assets for more than their carrying amounts. Do you agree with the proposed amendment? Why or why not? If not, what alternative do you propose?
  - (c) **Question 3 (Probable future taxable profit against which deductible temporary differences are assessed for utilisation):** The IASB proposes to clarify that an entity's estimate of future taxable profit (paragraph 29) excludes tax deductions resulting from the reversal of

deductible temporary differences. Do you agree with the proposed amendment? Why or why not? If not, what alternative do you propose?

- (d) **Question 4 (Combined versus separate assessment):** The IASB proposes to clarify that an entity assesses whether to recognise the tax effect of a deductible temporary difference as a deferred tax asset in combination with other deferred tax assets. If tax law restricts the utilisation of tax losses so that an entity can only deduct tax losses against income of a specified type or specified types (eg if it can deduct capital losses only against capital gains), the entity must still assess a deferred tax asset in combination with other deferred tax assets, but only with deferred tax assets of the appropriate type. Do you agree with the proposed amendment? Why or why not? If not, what alternative do you propose?
- (e) **Question 5 (Transition):** The IASB proposes to require limited retrospective application of the proposed amendments for entities already applying IFRS. This is so that restatements of the opening retained earnings or other components of equity of the earliest comparative period presented should be allowed but not be required. Full retrospective application would be required for first-time adopters of IFRS. Do you agree with the proposed amendment? Why or why not? If not, what alternative do you propose?

14. The IASB received 68 comment letters on the ED. From these comment letters:

- (a) most respondents agreed with the general clarification in the proposed amendments of IAS 12, but more than one-third expressed views on Questions 1 to 4; and

- (b) several respondents did not support the proposed limited retrospective application for entities already applying IFRS and several of them requested further clarification on the transition proposals.

***Analysis of Question 1 (Existence of a deductible temporary difference)***

15. With reference to the respondents who replied to Question 1:
  - (a) most respondents fully agreed with the proposed amendments to IAS 12;
  - (b) more than one-third of the respondents who agreed with the proposed amendments expressed concerns or requested further clarification; and
  - (c) a couple of respondents disagreed with the proposed amendments.
16. The main reasons why a majority of respondents *support* the IASB's proposal are because they think that the proposed amendments:
  - (a) are consistent with the principle in paragraphs 20 and 26(d) of IAS 12;
  - (b) clarify in the example illustrating paragraph 26(d) that the decrease below the cost in the carrying amount of a debt instrument measured at fair value for which the principal is paid at maturity gives rise to a deductible temporary difference; and
  - (c) reduce the risk of diversity in practice.
17. Respondents who generally agreed, or who disagreed, with the principle in the proposed amendment expressed the following comments:
  - (a) the existence of a deductible temporary difference irrespective of expected manner of recovery should be further clarified (hereafter, Issue 1);

- (b) the proposed example illustrating paragraph 26(d) is not necessary (hereafter, Issue 2);
- (c) the requirements of IFRS 9 should be considered in the proposed example illustrating paragraph 26(d) (hereafter, Issue 3); and
- (d) the proposed example illustrating paragraph 26(d) should be shortened to focus on its purpose of illustrating 26(d) (hereafter, Issue 4).

18. We will analyse each of these issues in the following paragraphs.

***Issue 1: the existence of a deductible temporary difference irrespective of expected manner of recovery should be further clarified***

19. Some respondents<sup>1</sup> think that we should clarify why the expected manner of recovery is not relevant for determining if a deductible temporary difference exists in the proposed example illustrating paragraph 26(d). For example, one respondent said:

...it might be argued that the proposal would not necessarily align well with paragraph 51 of IAS 12, which requires the measurement of deferred tax liabilities and assets to reflect the tax consequences that would follow from the manner in which an entity expects to recover or settle the carrying amount of its assets or liabilities. In particular, for a fixed-rate debt instrument as described in the proposed example to paragraph 26(d) that is expected to be held to maturity, any deductible temporary differences arising from unrealised losses are expected to unwind over time merely as a result of the entity continuing to hold the instrument to maturity. Hence, the recognition of deferred tax assets (assuming that the recognition

---

<sup>1</sup> For example, KPMG IFRG Limited and the Singapore Accounting Standards Council (ASC).

criteria in paragraph 24 are met) for such deductible temporary differences would appear at odds with the 'expected manner of recovery' principle in IAS 12 because the manner in which such deductible temporary differences are expected to reverse would not result in any tax deductions. [Singapore Accounting Standards Council (ASC)]

20. Another respondent raised a question about the recognition of a deferred tax asset regarding this issue:

...We believe that it is not useful to create a notional deferred tax asset in respect of a decrease in market value of an instrument that there is no intention to sell. There is no future cash flow to support this asset, and we question whether it meets the definition of an asset. [Quoted Companies Alliance]

*Staff analysis and recommendation*

21. We do not think that the proposed amendments should be further clarified. This is because paragraphs 20 and 26(d) of IAS 12 specify that a difference between the carrying amount of an asset measured at fair value and its higher tax base gives rise to a deductible temporary difference.
22. As explained in paragraphs BC3 to BC7, this applies irrespective of the expected manner of recovery or settlement, ie whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by holding it to maturity.
23. The tax base of the debt instrument is deducted against the inflow of taxable economic benefits resulting from the repayment of the principal. The fact that the reversal of deductible temporary differences would not result in any tax

deductions is because the tax base equals the inflow of the taxable economic benefits resulting from the repayment of the principal.

24. The economic benefit embodied in the related deferred tax asset results from the fact that the holder of the debt instrument can achieve taxable gains in the amount of the deductible temporary difference without paying taxes on it.
25. Consequently, we disagree that the proposed amendments need further clarification, because the explanation above is already included in the Basis for Conclusions of the proposed amendments.

***Issue 2: the proposed example illustrating paragraph 26(d) is not necessary***

26. Some respondents<sup>2</sup> think that the example illustrating paragraph 26(d) should be removed because the principle is clear from paragraphs 20 and 26(d) and duplicates much of the proposed illustrative computation in paragraphs IE16 to IE24. For example, one respondent said:

...the example provided in the body of the proposed amended standard to explain IAS 12.26(d) is excessive: Example 7 of the proposed amendments to the illustrative computations and presentation section of the ED also covers all the aspects needed for clarification, so the example in the standard should be excluded. [Austrian Financial Reporting and Auditing Committee (AFRAC)]

***Staff analysis and recommendation***

27. We noted diversity in practice with regard to this issue from the analysis of the comment letters on the Exposure Draft *Annual Improvements to IFRSs 2010-2012 Cycle*.

---

<sup>2</sup> For example, the Austrian Financial Reporting and Auditing Committee (AFRAC) and PricewaterhouseCoopers (PwC).

28. We observed that the existence of a deductible temporary difference is not self-evident for a fixed-rate debt instrument measured at fair value that pays interest at the end of each year and the principal is repaid on maturity when the holder also deducts the tax base of the asset.
29. At its meeting in March 2014, the Interpretations Committee decided to recommend to the IASB that IAS 12 should be amended, mainly by adding an illustrative example to clarify the accounting for deferred tax assets for unrealised losses on debt instruments measured at fair value.
30. However, at its meeting in June 2014, the IASB concluded that this issue should be addressed in the mandatory guidance in IAS 12, by adding an example after paragraph 26(d) of IAS 12. This was based on the consideration that the mandatory guidance would be required to reduce diversity in practice.
31. Consequently, we consider that the example illustrating paragraph 26(d) is necessary to reduce diversity in practice with regard to this issue.

***Issue 3: the requirements of IFRS 9 should be considered in the proposed example illustrating paragraph 26(d)***

32. Some respondents<sup>3</sup> think that the wording of the example illustrating paragraph 26(d) should be amended in order to be compatible with both IFRS 9 and IAS 39. They think that the fact pattern of the example, when referring to holding the asset until maturity, mostly uses the applicable wording in IAS 39. For example, one of the respondents said:

... Given that under IFRS 9 the entity has to choose between hold or sell and the entity is going to hold the debt instrument until maturity, the measurement base would be

---

<sup>3</sup> For example, the Accounting Standards Committee of Germany (ASCG) and the European Financial Reporting Advisory Group (EFRAG).

at cost. Thus, there would be no deferred tax asset when the tax base is the original cost, too [Accounting Standards Committee of Germany (ASCG)]

*Staff analysis and recommendation*

33. According to section 4.1 of IFRS 9, the classification of debt instruments depends on both a 'cash flow test' and 'business model test'. The cash flow test is that the contractual terms give rise to cash flows on specified dates, and that those payments are solely payments of principal and interest.
34. If debt instruments meet the cash flow test and are held for the collection of cash flows on the basis of business model, they shall be measured at amortised cost. Debt instruments that are held both to collect cash flows and to be sold, they shall be measured at fair value through other comprehensive income (FVOCI). If debt instruments meet the business model, but fail the cash flow test, they will be measured at fair value through profit or loss (FVTPL). However, it does not mean that debt instruments measured at FVOCI or FVTPL would not be held to maturity.
35. Accordingly, we think that the fact pattern of the example, in which it is probable that an entity will receive all the contractual cash flows if it holds the debt instrument until maturity, does not necessarily mean that the debt instrument should be measured at amortised cost.
36. Furthermore, we think that classification is not necessary information for the purpose of identification of a deductible temporary difference, except for the information that the debt instrument is measured at fair value. This is because decreases in the carrying amount of the debt instrument give rise to a deductible temporary difference if the debt instrument is measured at fair value, irrespective of its classification (eg FVOCI or FVTPL in IFRS 9 or AFS in IAS 39).

37. However, in the proposed example illustrating paragraph 26(d), there is no explicit information on classification. It could be inferred from the following explanation in the example that it is measured at fair value:

*The difference between the carrying amount of the debt instrument in Entity A's statement of financial position of CU918 and its tax base of CU1,000 gives rise to a deductible temporary difference of CU82 at the end of Year 2*

38. Consequently, we propose to the Interpretations Committee that it should recommend to the IASB that it should clarify that the debt instrument is measured at fair value in the example.

***Issue 4: the proposed example illustrating paragraph 26(d) should be shortened to focus on its purpose of illustrating 26(d)***

39. Some respondents<sup>4</sup> noted that the proposed example contains details that are not relevant to the purpose of illustrating the principle in paragraph 26(d). For example, one of the respondents said:

...The proposed drafting of paragraph 26 is ambiguous whether the example illustrating paragraph 26(d) relates only to the existence of the deductible temporary difference or it could also be used when estimating future taxable profits. [ESMA]

***Staff analysis and recommendation***

40. The objective of the proposed example illustrating paragraph 26(d) is to illustrate the identification of a deductible temporary difference in the case of an unrealised loss on a fixed-rate debt instrument measured at fair value, which pays interest at

---

<sup>4</sup> For example, the Institute of Chartered Accountants in England and Wales (ICAEW) and the European Securities and Markets Authority (ESMA).

the end of each year and for which the principal is repaid on maturity. At that time, the holder also deducts the tax base of the asset.

41. The existence of a deductible temporary difference follows from the identification of the tax deduction. Accordingly, we think that it is important to clarify that in this case the tax base of the debt instrument is deducted against the inflow of taxable economic benefits.
42. However, we agree that the facts and circumstances explained in the example, such as tax law, impairment and taxable profit, are superfluous to the objective of the example to illustrate the existence of a deductible temporary difference.
43. For example, we think that it is unnecessary to include the information about impairment reproduced below, because the explanation in the example, ‘the tax base of the debt instrument is its original cost’, is sufficient:

The tax base of the debt instrument is its original cost...Furthermore, the tax base of the debt instrument is reduced by the deduction of impairment losses. However, the criteria for deducting impairment losses for tax purposes are not met in the case of this debt instrument.

44. Consequently, we think that the Interpretations Committee should recommend to the IASB that the detailed information in the example about tax law should be shortened and that the unnecessary information about impairment and taxable profit be removed. Our proposed edits are included in Agenda Paper 3A.

***Analysis of Question 2 (Recovering an asset for more than its carrying amount)***

45. With reference to the respondents who replied to Question 2:
  - (a) there were no respondents who disagreed with the principle of the proposed amendment; and

- (b) some respondents who agreed with the proposed amendments nevertheless expressed concerns or requested further clarification.

46. The main reasons that respondents gave for their *support* of the IASB's proposal are because they think that the proposed amendments:

- (a) will reduce diversity in practice on the assessment of whether an entity can recover an asset for more than its carrying amount when estimating future taxable profits; and
- (b) will clarify that determining temporary differences and estimating probable taxable profits are two separate steps and that the carrying amount of an asset does not theoretically limit the estimation of probable future taxable profits obtained from this asset.

47. Some respondents who generally agreed with the proposed amendment expressed the following comments:

- (a) the last two sentences of paragraph 29A should be deleted (hereafter, Issue 5); and
- (b) more guidance about recovering an asset for more than its carrying amount should be provided (hereafter, Issue 6).

48. We will analyse these issues in the following paragraphs.

***Issue 5: the last two sentences of paragraph 29A should be deleted***

49. Some respondents<sup>5</sup> expressed concern that the examples in the last two sentences of paragraph 29A could be misinterpreted as meaning that an entity should assess future taxable profit on an individual asset basis, which is irrelevant to most

---

<sup>5</sup> For example, the French standard-setting body(ANC) and the Japanese Institute of Certified Public Accountants (JICPA).

entities in practice, and that such a misapprehension could result in inappropriate judgements.

50. One of the respondents noted that the example explained in paragraph 29A is not consistent with the requirement of IFRS 9:

...We are not sure how the reference to 'impairment' in the next-to-last sentence of paragraph 29A relates to the application of IFRS 9. IFRS 9 requires recognition of expected credit losses (as a 12-month or full (remaining) lifetime consideration) and does not refer to classical 'impairment' on incurred losses bases. We have the strong view, that in general the recognition of loss allowances for expected credit losses in accordance with requirements of IFRS 9 for FVOCI securities does not automatically exclude the assumption that the financial asset can be recovered for more than its carrying amount. [German Insurance Association]

51. Consequently, they suggested that last two sentences should be removed. For example, one of the respondents said:

...the second half of the paragraph should be omitted from the final standard. This would avoid the risk of departing from the principle-based standard to prescribing specific rules. [The Federation of European Accountants (FEE)]

52. Furthermore, one of the respondents suggested that the examples in the last sentence of paragraph BC15 should be removed:

...The reference to 'fair value' is confusing in the context of the instruments addressed by the proposed amendment. It implies that future taxable income from available for sale instruments recorded at fair value should be excluded from an assessment of future taxable profit. [PwC]

*Staff analysis and recommendation*

53. As explained in paragraphs BC9 to BC16, paragraph 29A was added to explain that the carrying amount of an asset does not limit the estimation of probable future taxable profit. This is because a limitation on the estimate of probable future taxable profits by taking into account only the carrying amount of assets could lead to inappropriate results. This is illustrated in paragraph BC13, which gives an example for a profitable manufacturing entity.
  
54. The IASB was also concerned that this clarification might lead entities to assess that they would recover assets for more than their carrying amounts, in circumstances in which this assessment would be inappropriate. Consequently, the latter parts of paragraph 29A and paragraph BC 15 were added to explain that there are cases in which it may not be probable that an asset will be recovered for more than its carrying amount.
  
55. However, we agree with the concern that the examples in the last two sentences of paragraph 29A could be misinterpreted. We observe that the first two sentences of paragraph 29A should be sufficient on their own, and entities will still have to justify their assessment that recovery of assets more than their carrying amount is probable, considering all relevant facts and circumstances.
  
56. Consequently, we think that the Interpretations Committee should recommend the IASB that it should remove the last two sentences of paragraph 29A and the examples in the last sentence of paragraph BC15.

***Issue 6: more guidance about recovering an asset for more than its carrying amount should be provided***

57. Some respondents<sup>6</sup> think that more guidance regarding the application of the proposed paragraph 29A should be provided, because the proposed amendments are not sufficiently clear about the estimate of probable future taxable profits.

58. One of the respondents suggested that any clarification should be restricted to situations in which an entity has both the contractual right and the intention to recover the asset for more than its carrying amount or its fair value:

...without such limitation to contractual relationship (or other specific circumstances when the deductible temporary difference mechanically reverses over time such as actuarial gains and losses), the proposed amendment could generate unintended consequences. [ESMA]

59. Another respondent expressed a concern about unintended consequences:

... we believe that the IASB should strengthen the reasoning in the Basis for Conclusions and establish clear limits on the circumstances under which an entity is required to assume recovery of assets for amounts in excess of their carrying amount. The introduction and invitation to comment seem to explicitly limit the scope of the ED to 'fixed-rate debt instruments', but the proposed amendment actually establishes a much broader principle that could also apply to other classes of assets (e.g., investment property or equity instruments, where entities might believe they have cause to assume that market values will increase over the longer term). [EY]

---

<sup>6</sup> For example, the European Securities and Markets Authority (ESMA) and UBS-Liverpool Street

*Staff analysis and recommendation*

60. We do not think that more guidance about recovering an asset for more than its carrying amount is necessary. We think that paragraph 29A, which is quoted in part as follows, is sufficient for general guidance about assessment:

that estimating taxable profit in future periods requires assessing whether and to what extent it is probable that the assets of the entity will be recovered for more than their carrying amount. An entity considers all relevant facts and circumstances when making this assessment.

61. We are concerned that more guidance would increase confusion, as raised in the previous discussion on Issue 5, because an entity should determine probable future taxable profit by taking into account all relevant facts and circumstances.
62. Furthermore, at its meeting in March 2014, the Interpretations Committee concluded that the proposed amendments would not result in unintended consequences for non-financial assets measured at fair value.
63. Consequently, we do not think that more guidance should be added, because the proposed amendments are sufficient and more guidance could create unnecessary confusion.

***Analysis of Question 3 (Probable future taxable profit against which deductible temporary differences are assessed for utilisation)***

64. With reference to the respondents who replied to Question 3:
- (a) most respondents fully agreed with the proposed amendments to IAS 12;
  - (b) more than one-third of the respondents who agreed with the proposed amendments expressed concerns or requested further clarification; and

- (c) one respondent disagreed with the proposed amendments, because that respondent thinks that the deferred tax asset should be fully recognised without the requirement of probable reduction in future tax payment, if the temporary deductible differences are expected to reverse over time.
65. The main reason why most of the respondents *support* the IASB's proposal is because they think that the proposed amendments clarify how to determine the estimate of future taxable profit to be used in assessing recoverability of deferred tax assets.
66. Respondents who generally agreed with the proposed amendment expressed comments as follows:
- (a) a simple illustrative example should be added in the body of the Standard for clarification (hereafter, Issue 7); and
  - (b) the difference in definition between *taxable profit* used for assessing the utilisation of deductible temporary differences and *taxable profit* on which income taxes are payable is confusing (hereafter, Issue 8).
67. We will analyse these issues in the following paragraphs.

***Issue 7: a simple illustrative example should be added in the body of the Standard for clarification***

68. Some respondents<sup>7</sup> noted that paragraph 29(a)(i) is difficult to read and suggested that an illustrative example should be introduced into the body of the Standard for clarification.

---

<sup>7</sup> For example, the European Financial Reporting Advisory Group (EFRAG) and the Indonesian Institute of Accountants (IAI).

*Staff analysis and recommendation*

69. We do not think that an illustrative example should be included in the body of the Standard. This is because we think that the proposed Illustrative Example 7 is sufficient for understanding how to determine future taxable profit in assessing the recoverability of deferred tax assets.

***Issue 8: the difference in definition between taxable profit used for assessing the utilisation of deductible temporary differences and taxable profit on which income taxes are payable is confusing***

70. Some respondents<sup>8</sup> expressed concern that a single term ‘taxable profit’ is used for two different concepts (ie *taxable profit* used for assessing the utilisation of deductible temporary differences and *taxable profit* on which income taxes are payable), which may be misleading or be a source of confusion.

71. They suggested different alternatives to resolve this issue. For example, one of the respondents suggested adding a definition:

...we recommend the addition of a definition in paragraph 5, which could be "Adjusted taxable profit (tax loss) is the taxable profit (tax loss) that excludes tax effects resulting from the reversal of existing temporary differences". [French association for the participation of businesses in the convergence of accounting standards (ACTEO)]

72. Another respondent requested further clarification:

...we would suggest to state explicitly that taxable profit used for assessing the utilisation of deductible temporary differences is different to taxable profit on which income taxes are payable. [Allianz]

---

<sup>8</sup> For example, Allianz and KPMG IFRG Limited.

73. One of the respondents suggested removing paragraph 29(a)(i):

...similar criteria for the recognition of deferred tax assets resulting from tax losses carried forward is provided by paragraph 34 of IAS 12, which states that a deferred tax asset shall be recognised for tax losses to the extent that it is probable that future taxable profit will be available against which the unused tax losses can be utilised...some may argue that the taxable profits are the ones defined in paragraph 5. [Austrian Financial Reporting and Auditing Committee (AFRAC)]

*Staff analysis and recommendation*

74. We do not think that the clarification in the proposed amendments raises the possibility of confusion in application, because Illustrative Example 7 makes clear that taxable profit for assessing utilisation of deductible temporary differences is a different term from the one that is defined in paragraph 5.
75. In particular, paragraph IE38 states explicitly as follows:

The utilisation of deductible temporary differences is not, however, assessed against probable future taxable profit for a period upon which income taxes are payable (see paragraph 5 of IAS 12). The utilisation of deductible temporary differences is assessed against probable future taxable profit that excludes tax deductions resulting from the reversal of deductible temporary differences (see paragraph 29(a) of IAS 12).

76. Furthermore, paragraph 35 states as follows:

The criteria for recognising deferred tax assets arising from the carryforward of unused tax losses are the same as the

criteria for recognising deferred tax assets arising from deductible temporary differences.

77. Accordingly, we do not think that the proposed amendment will increase confusion. However, we think that further clarification would be helpful to address the concerns.
78. Consequently, we propose to the Interpretations Committee that it should recommend that the IASB that it should add following sentence in paragraph BC18 to clarify this issue:

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

#### ***Analysis of Question 4 (Combined versus separate assessment)***

79. With reference to the respondents who replied to Question 4:
  - (a) most respondents fully agreed with the proposed amendments to IAS 12;
  - (b) some respondents who agreed with the proposed amendments expressed concerns or requested further clarification; and
  - (c) one respondent disagreed with the proposed amendments.

80. The main reason why respondents *support* the IASB's proposal is because they think that the proposed amendments will clarify the principle on how entities must group deductible temporary differences when assessing their utilisation.
81. The main reason why one respondent *disagrees* with the IASB's proposal is because that respondent thinks that the assessment of a deferred tax asset should not be combined with other different tax assets (hereafter, Issue 9).
82. Some respondents who generally agreed with the principle in the proposed amendment expressed the view that the amendments about combined assessment should be simplified. (hereafter, Issue 10)
83. We will analyse these issues in the following paragraphs.

***Issue 9: the assessment of a deferred tax asset should not be combined with other different tax assets***

84. One of the respondents think that the assessment of a deferred tax asset should not be combined with other different tax assets:

... the assessment of a deferred tax asset should be applied on an item by item basis initially and not automatically combined with other different tax assets. Where the creation of a deferred tax asset in respect of unrealised losses arises in a situation where a loss is not expected to crystallise and consequently having no effect on actual tax payable. The nature of the asset is purely one of disclosing the tax benefits of a timing difference of revaluation losses spread over a number of accounting periods. Consequently, the nature of the asset is significantly different to other different tax assets. [Association of Accounting Technicians (AAT)]

*Staff analysis and recommendation*

85. We disagree with this comment that the assessment of a deferred tax asset should be on an individual asset basis, because deferred tax assets are, subject to restrictions by tax law, assessed on a combined basis.
  
86. Paragraph 24 of IAS 12 requires that deferred tax assets are recognised to the extent that the probable future taxable profits will be available against which the deductible temporary differences can be utilised. It is not a recognition choice.
  
87. Paragraph 27 of IAS 12 explains that deductible temporary differences are utilised when the tax deductions resulting from their reversal are offset against taxable profits of future periods and so reduce future tax payments.
  
88. In addition, it is tax law that determines the taxable profits against which specific tax deductions are offset. This is because taxable profit is defined in paragraph 5 of IAS 12 as the profit of a period that is determined in accordance with the rules established by the taxation authorities and upon which income taxes are payable.
  
89. Consequently, all deductible temporary differences, for which tax law offsets the tax deductions resulting from their reversal against the same taxable profit, must be assessed for utilisation in combination with each other. Only such a combined assessment can determine whether taxable profits are sufficient to utilise deductible temporary differences.

***Issue 10: the amendments about combined assessment should be simplified***

90. Some respondents<sup>9</sup> expressed doubts that the proposed amendment paragraph 27A should be added because they think that paragraph 27A is excessive and it can be simplified by extending the existing paragraph 27.
91. PwC suggested extending paragraph 27 by one sentence: ‘a deductible temporary difference is assessed in combination with all other deductible temporary differences unless tax law restricts the sources of income against which the deduction can be utilised’ instead of adding a new paragraph 27A.

***Staff analysis and recommendation***

92. We do not consider that proposed paragraph 27A as following is excessive, because the conclusion in proposed paragraph 27A is not explicitly given in IAS 12. Instead, it results from a combined analysis of paragraphs 5, 24 and 27 as explained in the previous Issue 9. This has resulted in diversity in practice on how to group deductible temporary differences in assessing their utilisation.

When an entity assesses whether taxable profits will be available against which it can utilise a deductible temporary difference, the entity considers whether tax law restricts the sources of taxable profits against which the entity may make deductions on the reversal of that deductible temporary difference. If tax law imposes no such restrictions, an entity assesses a deductible temporary difference in combination with all of its other deductible temporary differences. However, if tax law restricts the utilisation of losses to deduction against income of a specific type, a deductible temporary

---

<sup>9</sup> For example, the Accounting Standards Committee of Germany (ASCG) and the German Insurance Association (GDV).

difference is assessed in combination only with other deductible temporary differences of the appropriate type.

93. We think that the clarification achieved by adding this paragraph will enhance understanding and reduce diversity in practice.

### ***Analysis of Question 5 (Transition)***

94. With reference to the respondents who replied to Question 5:
- (a) a majority of respondents fully agreed with the proposed amendments to IAS 12;
  - (b) several respondents disagreed with the proposed amendments; and
  - (c) some respondents who agreed with the proposed amendments requested further clarification.
95. The main reason why most respondents *support* the IASB's proposal is because they think that the proposed transition guidance avoids undue cost and effort in applying the Standard.
96. Some respondents who generally agree or disagree with the proposed amendment expressed the following comments:
- (a) the proposed transition guidance diminishes comparability (hereafter, Issue 11); and
  - (b) the proposed transition guidance is unclear and confusing (hereafter, Issue 12).
97. We will analyse these issues in the following paragraphs.

***Issue 11: the proposed transition guidance diminishes comparability***

98. Some respondents <sup>10</sup> think that limited retrospective application limits comparability.
99. They think that it is more appropriate to refer to paragraphs 23 to 27 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, because they already contain limitations on retrospective application when it is impractical to do so.

***Staff analysis and recommendation***

100. We do not consider that limited retrospective application has a significant impact on comparability. This provides relief to preparers already applying IFRS by not requiring the allocation of the changes between other comprehensive income and other components of equity. However, this applies only to the equity section of the earliest comparative period presented. In other words, the amounts of assets, liabilities, income and expenses are adjusted for all comparative periods presented.
101. We think that full retrospective application of the amendments would require a substantial re-analysis to allocate the changes between other comprehensive income and other components of equity at the state of the earliest comparative period presented. We also think that the benefit of this retrospective application could outweigh its cost.

***Issue 12: the proposed transition guidance is unclear and confusing***

102. Some respondents <sup>11</sup> think that paragraph 98G and the Basis for Conclusions should be further clarified with regard to limited retrospective application. For example, one of the respondents said:

---

<sup>10</sup> For example, the European Securities and Markets Authority (ESMA) and the Brazilian Committee for Accounting Pronouncements (CPC).

...The drafting of the transitional relief is ambiguous as it is not clear whether it merely applies to the restatement of the equity section ('...an entity is not required to restate the opening retained earnings or other components of equity of the earliest comparative period') or whether it does not require restatement of the deferred tax balances. In addition, there is some confusion in the ED as to whether the IASB is proposing 'to require limited retrospective application' (Question 5), 'limited mandatory retrospective application' (paragraph BC24) or that 'an entity is not required to restate' (paragraph 98G). [EY]

#### *Staff analysis and recommendation*

103. We agree with the concern that the proposed transitional requirements might be unclear. Accordingly, we think that the Interpretations Committee should recommend to the IASB that paragraph BC24 should be amended to address the respondents' concerns, as follows:

The IASB proposes a limited ~~mandatory~~ retrospective application for entities already applying IFRS. ~~Restatements of the opening retained earnings or other components of equity of the earliest comparative period presented should be allowed but not be required.~~ The difference from retrospective application is that any changes in opening equity of the earliest comparative period presented that arise upon adoption of the amendment may be recognised in any component of equity, without the need to allocate those changes

---

<sup>11</sup> For example, the Belgian Accounting Standards Board (CBN) and the French association for the participation of businesses in the convergence of accounting standards (ACTEO).

between opening retained earnings and other components of equity. This is to avoid undue cost and effort.

***Analysis of other issues regarding Illustrative Example 7***

104. With regard to Illustrative Example 7, some respondents expressed the following comments:
- (a) Illustrative Example 7 is too detailed and complex (hereafter, Issue 13); and
  - (b) paragraph IE43 conflicts with paragraph 63 (hereafter, Issue 14).
105. We will analyse these issues in the following paragraphs.

***Issue 13: Illustrative Example 7 is too detailed and complex***

106. Some respondents<sup>12</sup> expressed concern that the proposed Illustrative Example 7 is too detailed and complex and contains too many principles being explained in only one example.
107. They suggested that the illustration should focus on the key aspects of the amendments, thereby reducing the complexity of the illustration. They suggest, for example, that the explanations provided in words should be shortened, because the numerical illustrations of the principles are, to a large extent, sufficient to understand the principles.

***Staff analysis and recommendation***

108. We think that the detailed explanations in Illustrative Example 7 could enhance understanding. It was drafted to meet the demands for clarification of the key

---

<sup>12</sup> For example, the European Financial Reporting Advisory Group (EFRAG) and the South African Institute of Chartered Accountants (SAICA).

facts. However, we also agree with the concern that a detailed and lengthy example might prevent the reader from understanding the key facts.

109. Consequently, we think that the Interpretations Committee should recommend to the IASB that it should simplify Illustrative Example 7, mainly by shortening the detailed explanations without losing the context. The staff draft for a simplified illustrative example is presented in Agenda Paper 3A.

***Issue 14: paragraph IE43 conflicting with paragraph 63***

110. Some respondents<sup>13</sup> noted that paragraph IE43 does not fully represent the requirements of paragraph 63 of IAS 12 in respect of the allocation of current and deferred tax to profit or loss, other comprehensive income or elsewhere in equity, because they think that it is incomplete.
111. They suggest adding the phrase from paragraph 63 ‘or other method that achieves a more appropriate allocation in the circumstances’ to paragraph IE43.

***Staff analysis and recommendation***

112. We acknowledge that paragraph IE43 is not fully consistent with paragraph 63.
113. Consequently, we think that the Interpretations Committee should recommend to the IASB that it should add the phrase ‘or other method that achieves a more appropriate allocation in the circumstances’ to paragraph IE43 to be consistent with paragraph 63.

---

<sup>13</sup> For example, BusinessEurope and the European Financial Reporting Advisory Group (EFRAG).

**Staff recommendation**

114. On the basis of the analysis in the previous section of the paper, we think that the Interpretations Committee should recommend to the IASB that it should proceed with the proposed amendments to IAS 12.
115. We also propose to the Interpretations Committee that it should recommend to the IASB that it should make some changes to clarify the proposed amendments to IAS 12.
116. The staff draft of the wording for the proposed amendments to IAS 12 is presented in Agenda Paper 3A. These amendments are summarised below:
- (a) revise the example illustrating paragraph 26(d) to:
    - (i) clarify that the debt instrument is measured at fair value;  
and
    - (ii) remove information that is superfluous to the objective of the example such as impairment, tax law and taxable profit.
  - (b) delete the last two sentences of paragraph 29A and the examples in the last sentence of paragraph BC15;
  - (c) add one sentence in paragraph BC18 to clarify that taxable profit excluding tax deductions used for assessing the utilisation of deductible temporary differences is different from taxable profit on which income taxes are payable, as defined in paragraph 5;
  - (d) clarify in paragraph BC24 that the difference in a limited retrospective application from a retrospective application is that any changes in opening equity of the earliest comparative period presented that arise upon adoption of the amendment may be recognised in any component of equity, without the need to allocate those changes between opening retained earnings and other components of equity; and

- (e) shorten Illustrative Example 7 to simplify it and amend it to be consistent with paragraph 63.

## Questions to the Interpretations Committee

### Questions to the IFRS Interpretations Committee

1. Does the Interpretations Committee agree to recommend to the IASB that it should proceed with the amendments to IAS 12 and add further changes that would make the proposed amendments clearer?
2. Does the Interpretations Committee have any comments on the proposed amendments to IAS 12, as presented in Agenda Paper 3A?