ISSUES PAPER
Recognition of Deferred Tax Assets for Unrealised Losses

Purpose

1 Form tentative views on the IASB proposals in IASB ED/2014/3 *Recognition of Deferred Tax Assets for Unrealised Losses*, decide key comments to be raised in the AASB comment letter to the IASB (subject to feedback received from constituents), and decide on the process for finalising the AASB's comment letter.

2 This paper is structured to correspond to the questions asked by the IASB in ED/2014/3. Due to the timing of the comment period for AASB ED 253 *Recognition of Deferred Tax Assets for Unrealised Losses*, the issues raised in this paper do not incorporate feedback from submissions received by the AASB. Staff will raise at the December 2014 AASB meeting any significant issues included in the submissions received that staff think have not already been adequately dealt with in this issues paper.

Overall preliminary staff views on the proposals

3 Overall, staff agree with the underlying basis for the proposed amendments to IAS 12 and support making amendments to both IAS 12 as well as the non-mandatory guidance accompanying IAS 12. However, staff think that the Board should consider for inclusion in the AASB submission a general comment that various aspects of IAS 12, including those relating to the recognition of deferred tax assets for unrealised losses, would benefit from a limited review focusing on clarifying and improving the principles underpinning IAS 12, rather than piecemeal amendments addressing specific practice issues.

Existence of a deductible temporary difference

4 Question 1 of the ED pertains to the existence of a deductible temporary difference, as follows:

> *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, i.e. 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 proposed amendment? Why or why not? If not, what alternative do you propose?*

Preliminary staff view

5 Staff **agree** with the underlying basis for the proposed amendment, including the example illustrating paragraph 26(d) of IAS 12. However, staff suggest that drafting amendments be made to the example to:

(a) clarify that the debt instrument is measured at fair value in the entity's financial statements;

(b) clarify that the deduction of the tax base is to identify the amounts that are deductible in determining taxable profit, rather than the deduction of the tax base in determining taxable profit; and

(c) to conform the language to that currently employed in IAS 12; e.g. 'through use' rather than 'by use'.

Question to Board Members

Q1 Do Board members agree with the staff views in paragraph 5 above?

Recovering an asset for more than its carrying amount

6 Question 2 of the ED pertains to the accounting when recovering an asset for more than its carrying amount, as follows:

> *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?*

Preliminary staff view

7 Staff **agree** with the inclusion of a paragraph similar to paragraph 29A. However, staff think that the proposed amendment should also address the instrument that is the subject of these amendments (i.e. where recovery of an asset carried at fair value for more than its carrying amount is probable). Further, as previously communicated to IASB staff (as directed by the Board at its April 2014 meeting[1]), staff think that it is not clear whether the intention of the words "for more than its carrying amount" is to capture a 'fair value' or a 'cash flow' notion. Accordingly, staff recommend that an additional sentence be inserted following the proposed first sentence of paragraph 29A, as follows:

"In estimating future taxable profit, an entity considers all expected future cash flows associated with recovering the asset, including an asset to which a deductible temporary difference is related."

Question to Board Members

Q2 Do Board members agree with the staff views in paragraph 7 above?

[1] Minutes of the April 2014 AASB meeting are available at: http://www.aasb.gov.au/admin/file/content102/c3/AASB_Minutes_M137_8-9_April_2014_unsigned.pdf

Probable future taxable profit against which deductible temporary differences are assessed for utilisation

8 Question 3 of the ED pertains to clarifying the amounts included in determining the probable future taxable profit against which deductible temporary differences are assessed for utilisation, as follows:

> *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?*

Preliminary staff view

9 Staff **agree** with the proposed amendment to paragraph 29. Staff note that a similar paragraph was proposed as part of IASB Exposure Draft *Annual Improvements to IFRSs 2010-2012 Cycle* and that the Board at that time did not object to the underlying basis of the amendment. However, staff think that the second sentence in the proposed paragraph 29(a)(i) is unnecessary, given the stem of the paragraph, and should be deleted. Staff note that this view was also previously communicated to IASB staff per the Board direction from the AASB April 2014 meeting.

Question to Board Members

Q3 Do Board members agree with the staff views in paragraph 9 above?

Combined versus separate assessment

10 Question 4 of the ED pertains to whether the tax effect of a deductible temporary difference should be recognised as a deferred tax asset in combination with other deferred tax assets, as follows:

> *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 (e.g. 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?*

Preliminary staff view

11 Staff **agree** with the proposed inclusion of paragraph 27A. Staff note that a similar paragraph was proposed as part of IASB Exposure Draft *Annual Improvements to IFRSs 2010-2012 Cycle* and the Board at that time did not object to the underlying basis of the amendment.

Question to Board Members

Q4 Do Board members agree with the staff view in paragraph 11 above?

Transitional provisions

12 Question 5 of the ED pertains to the proposed transitional provisions, as follows:

> *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?*

Preliminary staff view

13 Staff support requiring limited retrospective application of the proposed amendments for entities already applying IFRSs. However, staff **disagree** with permitting, but not requiring entities, to restate the opening retained earnings (or other component of equity, as appropriate) of the earliest comparative period presented to avoid undue cost and effort. Staff think that this creates diversity as to whether adjustments on adoption of the proposed amendments are reflected as movements in the comparative period results/position, or movements at the start of the comparative period. The staff preference is for the IASB to require only limited retrospective application by requiring prospective application to assets and liabilities existing on the date of initial application of the proposed amendments, including any adjustments within equity on that date.

14 Staff note the IASB view in paragraph BC25 of the ED that, with the exception of the amounts that would have to be restated within equity, the accounting required by the proposed amendments is for amounts and estimates at the end of the reporting periods, and that the changes would be mechanical in nature. Staff are concerned that the effect of proposed paragraph 29(a)(i) may result in the recognition of deferred tax assets arising from deductible temporary differences from sources other than fixed rate debt instruments. Accordingly, staff would also support limited retrospective application in the form described by staff for that reason, and to avoid the use of hindsight.

Question to Board Members

Q5 Do Board members agree with the staff views in paragraphs 13-14 above?

Other comments

15 In relation to the proposed Illustrative Example, staff think that the drafting of:

(a) paragraphs IE5-IE6 could be improved to avoid confusion as to whether earlier versions of IFRS 9 permit such instruments to be measured at fair value through other comprehensive income;

(b) the last sentence of paragraph IE22 could be clarified to reflect that Entity Z will collect only part of the difference of CU28,571 in 20X2; and

(c) paragraph IE34 is confusing as it includes as part of the calculation the taxable profits considered as part of Step 1. Staff think that this is driven by the description of the application of paragraphs 28-29 of IAS 12 as a two-step approach rather than an 'if not, then' approach.

In addition, paragraph IE30 notes that a deferred tax asset would not be recognised in relation to Debt instrument C. Staff are unclear why the application of paragraph 29(a)(i) would not give rise to a deferred tax asset in this instance.

Question to Board Members

Q6 Do Board members agree with the staff views in paragraphs 15 above?

Q7 Are there any other issues in relation to the proposed amendments that the Board wishes to raise to the IASB?