ED253 sub 3

Submission ED 2014/3 Recognition of Deferred Tax Assets for Unrealised Losses (Proposed Amendments to IAS 12)

December 2014

IPA INSTITUTE OF PUBLIC ACCOUNTANTS

Partnership beyond numbers

17 December, 2014

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

By email: standard@aasb.gov.au

Dear Madam

Exposure Draft ED 2014/3 Recognition of Deferred Tax Assets for Unrealised Losses (Proposed Amendments to IAS 12)

Introduction

The Institute of Public Accountants (IPA) welcomes the opportunity to comment on ED/2014/3 'Recognition of Deferred Tax Assets for Unrealised Losses (Proposed Amendments to IAS 12)'. We support the proposed amendments as they seek to clarify and provide consistency of treatment in relation to the specific issue, debt instruments measured at fair value.

The IPA is a professional organisation for accountants recognised for their practical, hands-on skills and a broad understanding of the total business environment. Representing more than 35,000 members in Australia and in over 65 countries, the IPA represents members and students working in industry, commerce, government, academia and private practice. Through representation on special interest groups, the IPA ensures the views of its members are voiced with government and key industry sectors and makes representations to Government including the Australian Tax Office (ATO), Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) on issues affecting our members, the profession and the public interest. The IPA recently merged with the Institute of Financial Accountants of the UK, making the new IPA Group the largest accounting body in the SMP/SME sector in the world.

Executive summary

1. On 20 August 2014, the International Accounting Standards Board (IASB) published Exposure Draft ED 2014/3 *Recognition of Deferred Tax Assets for Unrealised Losses* (Proposed amendments to IAS 12) which proposes to clarify the accounting for deferred tax assets related to debt instruments measured at fair value.

2. The proposed amendments clarify that deductible temporary differences arising from unrealised losses on debt instruments arise regardless of whether the instrument is recovered through sale or by holding it to maturity or whether the issuer will pay all contractual cash flows.

3. Provided the recognition criteria for deferred tax assets are met, an entity is required to recognise deferred taxes for temporary differences from unrealised losses of debt instruments measured at fair value.

4. The proposed amendment provides clarification to what extent an entity's estimate of future taxable profit includes amounts from recovering assets for more than their carrying amounts. It also makes it clear that the carrying amount of an asset does not limit the estimate of

probable future taxable profits. The estimate of future probable profits includes the probable inflow of taxable economic benefits that results from recovering the asset.

We have provided comments to specific questions raised in the exposure draft, included in Appendix A

If you would like to discuss our comments, please contact me or our technical advisers Sonya Sinclair (sonya@ecorac.com.au) or Colin Parker (colin@gaap.com.au), GAAP Consulting.

Yours faithfully

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Appendix A

Exposure Draft 2014/3 Recognition of Deferred Tax Assets for Unrealised Losses

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 proposed amendment? Why or why not? If not, what alternative do you propose?

1. It is common for differences to arise between the financial reporting basis and the tax basis of debt instruments as a debt instrument is measured at fair value whilst the tax basis remains at cost. The difference must be assessed to determine whether a temporary difference exists for which a deferred tax balance should be recognised.

2. The proposed amendment to include paragraph 26(d) of IAS 12 seeks to clarify how to determine the deductible temporary difference by addressing how to determine the tax base of the debt instrument and whether a deductible temporary difference exists.

3. As specified in paragraph 26(d) of IAS 12 a deductible temporary difference arises where the tax base of the debt instrument exceeds the carrying value of the debt instrument measured at fair value. We agree with the IASB's proposal to add an example to illustrate the concept outlined in paragraph 26(d) of IAS 12. The proposed amendment to IAS 12, clarifies that a deductible difference still arises even though the entity may not expect to deduct the loss for income tax purposes.

4. The proposed illustrative example provides clear guidance that it is irrelevant whether the entity expects to recover the carrying amount of the debt instrument by sale or holding it until maturity and collecting contractual cash flows, that is, no loss is expected at maturity. Under these circumstances, the entity deducts the tax base of the asset in determining taxable profit (tax loss). That is, the tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits to the entity when it recovers the carrying amount of the asset.

5. We recommend that the example that illustrates paragraph 26(d) also explains other circumstances that may impact on an entities understanding for determining whether a temporary difference arises. For example, where there is an option for the debt instrument to convert into equity, would there be an alternative treatment. And secondly, where tax law does not explicitly specify any tax consequences resulting from the full repayment of the principal.

6. Under various circumstances, the treatment should be made clear that where a fixed rate debt instrument tax base (which remains at cost) and exceeds the financial reporting base measured at fair value, a deductible temporary difference will arise.

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?

7. The proposed amendment to add paragraph 29A of IAS 12 is to provide clarification to what extent an entity's estimate of future taxable profit includes amounts from recovering assets for more than their carrying amounts.

8. We agree with the IASB's proposal to add paragraph 29A of IAS 12 to provide clarification to what extent an entity's estimate of future taxable profit includes amounts from recovering assets for more than their carrying amounts. The proposed amendment provides examples of when to include or exclude the recovery of an asset for more than its carrying amount.

9. The recovery of an asset for more than its carrying amount is not included in estimating future taxable profit if it is unlikely to be probable, where for example it was recently impaired. However, if it is likely to be probable that the recovery of an asset is more than its carrying amount, it is included in the estimate of future taxable profit and measured at cost.

10. Recovering assets for more than their carrying amounts may arise under a number of circumstances including where the entity expects that the principal amount of the debt instrument is to be recovered on maturity even though the fair value of the instrument is less than the tax base, provided the instrument is not impaired.

11. Other instances may include where only part of the principal is recovered and the probability of receiving all contractual cash inflows may be difficult to determine. We recommend further guidance be provided for determining whether it is probable to recover an asset for more than its carrying amount especially under volatile circumstances or where maturity of a debt instrument is over a significant time period. Under these circumstances, there is a high degree of estimation and judgment required to determine whether a debt instrument will be realised for more than their carrying value.

12. More complex scenarios for various assets should be provided by way of example in the proposed amendment to IAS 12 to clarify and address cases that involve a high degree of judgment.

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?

13. The proposed paragraph 29(a)(i) of IAS 12 has the intention to provide further clarification to address the issue of how to determine future taxable profit for the recognition test under IAS 12. Whilst not the intention of IAS 12, future taxable profit would assume the meaning of the amount on which income taxes are paid.

14. Under the proposed amendment, an entity's estimate of future taxable profit excludes tax deductions for which those deductible temporary differences exist. That is, future taxable profit for the recognition test under IAS 12 would exclude both taxable and deductible temporary differences.

15. We recommend further guidance be provided to show where an entity expecting a tax loss may still result in a taxable profit for the recognition test due to the reversing of a taxable temporary difference and deductible temporary differences. Further, a distinction should be made between actual taxable profit and estimate of future taxable profit used for assessment as required under IAS 12, in particular, paragraph 29 as distinct from the actual amount on which income taxes are paid.

16. The proposed amendment will provide consistent treatment of estimating future taxable profit.

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?

17. We agree with the proposed amendments in paragraph 27A of IAS 12 to provide a clear understanding on when deductible temporary differences of a particular type are assessed in combination with other deductible temporary differences.

18. If tax law imposes no restriction to the source of taxable profits against which a deductible temporary difference can be utilised, then the entity would assess a deductible temporary difference in combination with all its other deductible temporary differences.

19. If tax law restricts the utilisation of losses such that the entity can only deduct against income of a specific type, then a deductible temporary difference would be assessed in combination only with other deductible temporary differences of the same type.

20. Under the proposed amendments, the treatment of the unrealised losses on the debt instrument does not result in separate assessment even though the debt instrument reverses on maturity. We have no further recommendations.

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?

21. The proposed amendment provides relief to those entities already applying IFRS and is therefore not required to restate opening balances of retained earnings of the earliest comparative period.

22. We agree with the transitional arrangement as it is consistent with the requirements of IFRS 1 First-time Adoption of International Financial Reporting Standards required for first-time adopters of IFRS.