

STAFF PAPER

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Project	Annual Improvements to IFRSs—2010-2012 Cycle (ED/2012/1) comment letter analysis		
Paper topic	IAS 12 <i>Income Taxes</i> —Recognition of deferred tax assets for unrealised losses		
CONTACT	Thomas Harzheim	tharzheim@ifrs.org	+44 (0)20 7246 0552

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 *Annual Improvements to IFRSs 2010-2012 Cycle* (ED/2012/1) published in May 2012 (ED) includes the IASB's proposal to amend paragraphs 29 and 30 of IAS 12 *Income Taxes*, add paragraphs 27A, 30A and examples after paragraphs 29 and 30A to IAS 12.
2. This amendment proposes 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. If tax law restricts the utilisation of tax losses so that an entity can only deduct the tax losses against income of a specified type (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;
 - (b) taxable profit against which an entity assesses a deferred tax asset for recognition is the amount before any reversal of deductible temporary differences; and

- (c) an action that results only in the reversal of existing deductible temporary differences is not a tax planning opportunity. To qualify as a tax planning opportunity, the action needs to create or increase taxable profit.

Objective of this paper

- 3. The objective of this paper is to:
 - (a) provide an analysis of the comments received on the proposal to amend IAS 12; and
 - (b) obtain a recommendation from the IFRS Interpretations Committee (the Interpretations Committee) for the IASB on the question of whether or not to finalise the proposed amendment.

Structure of this paper

- 4. This agenda paper:
 - (a) provides background information on the issue;
 - (b) analyses the comments received as part of the Exposure Draft process; and
 - (c) asks the Interpretations Committee to confirm whether they agree with the staff recommendation not to proceed with the proposed amendment to IAS 12 as part of the 2010-2012 cycle of the annual improvements project.

Background

5. In March 2010, the Interpretations Committee was asked to provide guidance on how an entity determines, in accordance with IAS 12, whether to recognise a deferred tax asset when the entity:
 - (a) has deductible temporary differences relating to unrealised losses on debt instruments that are classified as available-for-sale financial assets in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* and measured at fair value;
 - (b) has the ability and intention to hold the instruments until the loss reverses (which may be at their maturity); and
 - (c) has insufficient taxable temporary differences and no other probable taxable profits against which the entity can utilise those deductible temporary differences.
6. The Interpretations Committee reported to the IASB that practice differed because of divergent views on the following questions:
 - (a) Does an entity assess whether a deferred tax asset is recognised for each deductible temporary difference separately, or in combination with other deductible temporary differences?
 - (b) If an entity has the ability and intention to hold an available-for-sale debt instrument until an unrealised loss reverses, does that create a source of taxable profits; for example, because it is a tax planning opportunity or akin to a tax planning opportunity?
 - (c) When an entity assesses whether it can utilise a deductible temporary difference against probable future taxable profits, do those probable future taxable profits include the effects of reversing deductible temporary differences?
7. In order to resolve the significant diversity in practice, the IASB proposed the clarifications presented in paragraph 2 above in its ED.

Comment letter analysis

8. In this section, we summarise the comments on the ED.
9. The ED asked two general questions that were answered individually for each proposed amendment:
 - (a) **Question 1:** *Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?*
 - (b) **Question 2:** *Do you agree with the proposed transitional provisions and effective date for the issue described in the exposure draft? If not, why and what alternative do you propose?*
10. The IASB received 84 comment letters on the ED in total.
11. 75 respondents (89 per cent of all the respondents) expressed their views on the proposed amendment to IAS 12.
12. A majority of these respondents (61 per cent) agreed with all of the IASB's proposals for an amendment to IAS 12.
13. About 28 (37 per cent) of those respondents disagreed with the IASB's proposals. However, 14 (50 per cent) of them only disagreed or primarily disagreed with the proposed clarification that an action that does not create or increase taxable profit does not qualify as a tax planning opportunity and they also disagreed with the illustration of the proposed clarifications in example following draft paragraph 30A. They agreed instead with the proposed clarifications in draft paragraphs 27A and 29(a)(i) and the example following paragraph 29 that:
 - (a) deferred tax assets are, subject to limitations by tax law, assessed on a combined basis; and
 - (b) taxable profit against which an entity assesses a deferred tax asset for recognition is the amount before any reversal of deductible temporary differences.

14. The table below analyses the comment letters received on this topic by type of respondent:

Type of respondent	Number of comment letters
Preparer	25
Standard-setter	21
Accountancy body	14
Accounting firm	7
Users	3
Regulator	2
Other	3
Total number of respondents	75

15. There is considerable variety in the responses given: they range from strong support, to flat rejection, to the recommendation that further questions need to be addressed before a final conclusion can be reached on the issue:

- (a) Chris Barnard notes, for example, “I agree with these common sense and reasonable clarifications”.
- (b) IACVA notes instead: “we strongly disagree with the amendments to the text of paragraphs 29 and 30, the addition of paragraphs 27A, 30A and 98C, as well as the examples added after paragraphs 29 and 30A (...)”.
- (c) EY finally notes: “we do not support the proposed amendments to IAS 12 and we recommend these amendments are not pursued as part of the Annual Improvements process. The proposed amendments to IAS 12 have, for us, highlighted a broader more fundamental issue with IAS 12, which we believe should be addressed before we can comment on the clarifying amendments proposed in the ED.”

16. We discuss and analyse in the following chapters the main concerns that were raised on the proposed amendment in the ED.

Illustrative example

17. EFRAG notes in its comment letter that it “has in its due process collected evidence that different understandings of the basic mechanics of IAS 12 [exist that] may lead to different interpretations of the current requirements. ...”

18. After taking into consideration all the comments that we received on the proposal to amend IAS 12, we agree with this observation.
19. To illustrate the main concerns raised in the comment letters on the basis of these different interpretations, we will explain the impact of the main concerns and the different views on the mechanics of IAS 12 by the following example:

Fact pattern:

Entity A invests at the beginning of Year 1 CU1,000¹ in an available-for-sale debt instrument with a nominal value of CU1,000 payable on maturity in 5 years.

Interest is paid at the end of each year at a rate of 2 per cent, taxable when received. The market interest rate is 5 per cent at the end of Year 2, which results in a fair value of the debt instrument at the end of Year 2 of CU918. The shortfall is due solely to the difference between market interest rate and the nominal interest rate of the debt instrument, ie it does not consider the debt instrument to be impaired.

Management's intention is to hold the available-for-sale debt instrument until maturity and expects to collect the contractual cash flows.

Tax law does not allow Entity A to deduct the loss until it is realised, ie by selling the debt instrument or by failure of the issuer to repay the principal.

Entity A has no other transactions in Years 1 to 5 than the ones related to the available-for-sale debt instrument.

¹ In this staff paper, currency amounts are denominated in 'currency units' (CU).

20. Accordingly, Entity A records the following in- and outflows of economic benefits in Years 1 to 5:

Period	Transaction	CU
Year 1	Investment in available-for-sale debt instrument at the beginning of Year 1	-1,000
Year 1	Interest income received at the end of Year 1	20
Year 2	Interest income received at the end of Year 2	20
Year 3	Interest income received at the end of Year 3	20
Year 4	Interest income received at the end of Year 4	20
Year 5	Interest income and repayment of principal received at the end of Year 5	1,020

Future taxable profits before deducting the amounts resulting from the reversal of deductible temporary differences

Concern raised

21. Several respondents (eg EY, KPMG, PwC) assert that it is not clear what exactly is meant by the words “future taxable profit before deducting the amounts resulting from the reversal of those deductible temporary differences” in draft paragraph 29(a)(i) of IAS 12 in the ED.
22. In particular, it is not clear for these respondents whether the “future taxable profits before deducting the amounts resulting from the reversal of deductible temporary differences” include the non-taxable gain from the reversal of the unrealised loss on the available-for-sale debt instrument (CU82 in the example above).
23. KPMG explains that draft paragraph 29(a)(i) of IAS 12 in the ED might be interpreted in two different ways:
- (a) On the one hand, it may be interpreted that “amounts resulting from the reversal of deductible temporary differences” are only added back to taxable profits (tax losses) as defined in paragraph 5 of IAS 12 (taxable

profits (tax losses) if they will give rise to an actual tax deduction that will result in lower tax payments (**Interpretation 1—Actual tax deduction**).

- (b) Alternatively, it may be interpreted that “amounts resulting from the reversal of deductible temporary differences” are “mechanically” added back to taxable profits (tax losses) in assessing whether deductible temporary differences can be utilised as set out in paragraph 24 of IAS 12 and the paragraphs that follow it (**Interpretation 2—Mechanical reversal**). This is because “amounts resulting from the reversal of the deductible temporary differences” are not only actual tax deductions resulting in lower tax payments but also adjustments made in the reconciliation between accounting profit and taxable profit.

24. KPMG demonstrates the different consequences of each interpretation by Example 2 following paragraph 8 of IAS 12.
25. In that example, current liabilities include interest revenue received in advance, with a carrying amount of CU100. The related interest revenue was taxed on a cash basis. It is concluded in the example that the tax base of the interest received in advance is nil.
26. If it is not probable that the entity will have other sources of future taxable profit, KPMG concludes that the application of:
- (a) Interpretation 1 (*Actual tax deduction*) leads to not recognising a deferred tax asset. Future taxable profits before deducting the amounts resulting from the reversal of the deductible temporary difference will be nil, because there are no future taxable profits against which the deduction can be taken and so reduce future tax payments.

- (b) Interpretation 2 (*Mechanical reversal*) results instead in recognising the deferred tax asset. Future taxable profit before deducting the amounts resulting from the reversal of the deductible temporary difference will be CU100:
- (i) First of all, the entity will have a future accounting profit of CU100 in the period when it recognises the interest revenue in profit or loss.
 - (ii) In a second step, this gain is deducted from future accounting profit to determine future taxable profit, because the accounting gain of CU100 from the interest revenue is not taxable in this period (ie reconciliation between accounting profit and taxable profit).
 - (iii) Finally, CU100 is added back to taxable profit because “amounts resulting from the reversal of deductible temporary differences” are always (“mechanically”) added to taxable profits. In the period when the interest revenue is recognised in profit or loss, the deductible temporary difference that arose in the period when the interest revenue was received in advance (see paragraph 25 above) reverses.

Staff response

27. The purpose for determining future taxable profits before deducting the amounts resulting from the reversal of deductible temporary differences is to assess whether it is probable that taxable profits will be available against which deductible temporary differences can be utilised (see paragraph 24 of IAS 12). Deferred tax assets are only recognised if they pass this test.
28. When assessing whether deferred assets can be recognised according to paragraphs 24 of IAS 12 and following, we think that IAS 12 requires to add back all tax deductions resulting from the reversal of deductible temporary differences to taxable profit (tax loss) as defined in paragraph 5 of IAS 12 (taxable profit (tax loss)).

29. Tax deductions resulting from the reversal of deductible temporary differences are added back to taxable profit (tax loss) because taxable profit is taxable income less tax deductions.
30. We think this view aligns with the aim of the proposed amendment to paragraph 29 of IAS 12 to avoid ‘double counting’ (see draft paragraph BC11 of IAS 12 in the ED):
- (a) Paragraph 24 of IAS 12 requires to assess the utilisation of deductible temporary differences against probable future **taxable profits**.
 - (b) Paragraph 5 of IAS 12 defines **taxable profit** (tax loss) as the **profit (loss)** for a period, determined in accordance with the rules established by the taxation authorities, **upon which income taxes are payable (recoverable)**.
 - (c) The **taxable profit (tax loss)** for a period, **upon which income taxes are payable** considers **tax deductions** and **tax deductions** may be the result of the **reversal of a deductible temporary difference** when the carrying amount of an asset or a liability is recovered or settled (see the definition of a deductible temporary difference in paragraph 5(a) in IAS 12).
31. Consequently, all tax deductions that will result from the reversal of a deductible temporary difference must be excluded from taxable profit when assessing whether deductible temporary differences can be utilised.
32. Otherwise, the result may be that an entity does not recognise deferred tax assets for all deductible temporary differences that are probable to be utilised in the future.
33. This may be illustrated by example 1 following paragraph 8 of IAS 12.
34. In that example, current liabilities include accrued expenses with a carrying amount of CU100. The related expense will be deducted for tax purposes on a cash basis. It is concluded in the example that the tax base of the accrued is nil.
35. Without excluding the tax deduction resulting from the reversal of the deductible temporary difference from taxable profit (tax loss) (ie adding this tax deduction

back to taxable profit (tax loss)), the entity would need taxable income of CU200 to offset a tax deduction of CU100.

Analysis of the divergent interpretations

36. Consequently, we think that neither Interpretation 1 (*Actual tax deduction*) nor Interpretation 2 (*Mechanical reversal*) entirely reflect the concept of the current IAS 12:

Actual tax deduction

37. We disagree with Interpretation 1 (*Actual tax deduction*) because it sets up an additional condition for adding back tax deductions resulting from the reversal of deductible temporary differences.
38. This additional condition is a lower tax payment resulting from the reversal of the deductible temporary difference.
39. We think this additional condition transposes ‘cause’ and ‘effect’ and leads to inappropriate results:
- (a) We think all tax deductions resulting from the reversal of deductible temporary differences are added back taxable profit (tax loss) in order to assess whether they lead to reductions in tax payments (see paragraphs 27-35 above).
 - (b) Someone applying Interpretation 1 (*Actual tax deduction*) adds only tax deductions resulting from the reversal of deductible temporary differences back to taxable profit (tax loss) *if they will result in lower tax payments* in order to assess *whether they lead to reductions in tax payments*.
40. This may be illustrated by the example of an entity that expects in a future period a tax loss of CU1,300. Suppose that this tax loss results from tax deductions of CU2,000 resulting from the reversal of deductible temporary differences being offset against taxable income of CU700.

41. We would add back the total tax deductions of CU2,000 to the tax loss of CU1,300 to determine that only tax deductions of CU700 lead to a reduction in tax payment (provided tax losses cannot be carried forward or backwards).
42. Someone applying Interpretation 1 (*Actual tax deduction*) adds tax deductions of only CU700 back to the tax loss of CU1,300 to assess whether deductible temporary differences can be utilised. Only tax deductions of CU700 reduce the tax payment for this period to nil.
43. This calculation results in a tax loss before deductions amount resulting from the reversal of deductible temporary differences of CU600. Consequently, no deferred tax assets could be recognised (provided tax losses cannot be carried forward or backwards) although the entity expects to pay no taxes on taxable profits of CU700 because of the reversal of the deductible temporary differences.

Mechanical reversal

44. We agree with Interpretation 2 (*Mechanical reversal*) that all tax deductions resulting from the reversal of deductible temporary differences are added back to taxable profit (tax loss) to assess whether the deductible temporary differences can be utilised (see paragraph 28 above).
45. We do, however, disagree with the conceptual basis of the approach. We think recognising deferred tax assets on the basis of adjustments made to accounting profits in order to determine taxable profits (*reconciliation between accounting profit and taxable profit*) is not in line with IAS 12 because:
- (a) We understand adjustments made to accounting profits in order to determine taxable profits in the reconciliation between **accounting** profit and **taxable** profit reflect differences between tax law and financial accounting standards.
 - (b) Paragraph 24 of IAS 12, however, requires to assess the utilisation of deductible temporary differences on the basis of **taxable** profits and paragraph 5 of IAS 12 defines **taxable** profit as number solely determined on the basis of tax law.

46. Consequently, we think that **accounting** profits and the reconciliation between **accounting** profit and **taxable** profit is not the basis for recognising deferred tax assets.
47. In other words, an entity cannot offset a tax deduction resulting from the reversal of a deductible temporary difference against income that doesn't exist in the specific period according to law tax (ie the profit exists in a specific period only according to financial accounting standards).
48. However, the distinction between accounting profit (loss) and taxable profit (tax loss) might be irrelevant, if tax law of a jurisdiction requires to determine taxable profit (tax loss) on the basis of accounting profit (loss). We think such a reference makes accounting income also taxable income.
49. We are not convinced that it requires the reconciliation between accounting profit to recognise a deferred tax asset for the interest revenue received and taxed in advance (see example 2 following paragraph 8 of IAS 12), if the entity will not have any other sources of taxable profit.
50. Paragraph 18 of the preliminary staff draft of IAS 12 *Income Taxes* as of 6 July 1995 presented at the July 1995 Steering Committee Meeting explained:

The temporary difference associated with deferred income is the amount of that income that will not be taxable when the deferred income is included in accounting profit (loss) in future years. In substance, the enterprise settles the deferred income when it recognises it as income, but for tax purposes the enterprise is entitled to a deduction equal to the amount of deferred income that will not be taxable. Deferred income will give rise to a temporary difference where either:

- (a) part or all of the deferred income has already been included in taxable profit in the current or earlier periods, for example where the deferred income is taxed on a cash basis; or
- (b) the deferred income is not subject to tax at all.

51. The Steering Committee was a Committee established by the International Accounting Standards Committee (IASC) (the predecessor of the IASB) for developing a revised Standard on accounting for income taxes.
52. We understand that the conceptual basis of paragraph 18 of that preliminary staff draft of IAS 12 of July 1995 is the view that there is both:
- (a) a tax deduction in the period when the deferred income is recognised in accounting profit or loss and that this tax deduction results from paying taxes in a previous period; and
 - (b) a taxable income consisting of the deferred income in the same period as the tax deduction.
53. Consequently, by assuming that there is a tax deduction and a taxable income of the same amount in the period when the interest revenue received in advance is recognised the in accounting period the reference to accounting profit and the reconciliation to taxable profits is not necessary to assess the recognition of the deferred tax asset.
54. It must be noted, though, that several significant changes were made to the draft before the revised IAS 12 *Income Taxes* was issued in October 1996 and we think, it cannot be said what view the IASC and the Steering Committee finally took with respect to the taxable profit in period when the interest revenue received in advance is recognised in accounting profit or loss.
55. Nonetheless, we think the view presented in paragraph 50 above is supported by the following requirements in IAS 12:
- (a) Interest revenue received and taxed in advance gives rise to a deductible temporary difference between the carrying amount of the current liability of CU100 and its tax base of nil (see example 2 following paragraph 8 of IAS 12).
 - (b) Deductible temporary differences are amounts that will result in tax deductions in determining taxable profit (tax loss) of future periods (see the definition of a deductible temporary difference in paragraph 5(b) of IAS 12).

- (c) Deductible temporary differences are utilised by offsetting the tax deductions against taxable profits (see paragraph 27 of IAS 12).
 - (d) Taxable profits are amounts solely determined by tax law (see the definition of taxable profit (tax loss) in paragraph 5 of IAS 12).
56. This conclusion is based on the assumption that deductible temporary differences are only amounts that result in future tax deductions. Without a future tax deduction, there is no deductible temporary difference.
57. Accordingly, without a future tax deduction that can be utilised by offsetting it against future taxable profits, no deferred tax asset is recognised (see paragraph 24 of IAS 12).
58. We think this conclusion is supported by:
- (a) paragraphs of IAS 12 given in paragraph 55 above; and
 - (b) the fact that we don't see any exception from the principle that deferred tax assets are only recognised for future tax deductions that can be utilised against probable future taxable profits in current IAS 12.
59. In addition, some comment letters support this conclusion as well. PwC and the Swedish Financial Reporting Board explicitly state that a deferred tax asset is recognised only when it will result in lower tax payments in the future, not merely because a deductible temporary difference reverses over time.
60. Consequently, we think that the view of ACTEO, AFEP, MEDEF, the European Insurance CFO Forum, ACLI and Sun Life Financial that deferred tax assets for unrealised losses on available-for-sale debt instrument are unique, and that they can be recognised without a future tax deduction, is not in line with the current IAS 12.

Conclusion on the concern raised

61. Summarising our analysis, we think that our view, ie future taxable profits before deducting the amounts resulting from the reversal of deductible temporary differences is taxable profit (tax loss) after adding back all tax deductions

resulting from the reversal of deductible temporary differences, should not be changed.

62. This view was also the basis for proposed amendment to IAS 12.
63. However, we agree with respondents that the wording of paragraph 29 of IAS 12 and the examples might be amended to explain more clearly, what we mean by “taxable profit before deducting amounts resulting from the reversal of deductible temporary differences”, and in particular with respect to deductible temporary difference resulting from unrealised losses on debt instruments.

Is there a deductible temporary difference, if Entity A expects to recover the carrying amount of the debt instrument by holding it to maturity?

Concern raised

64. As explained above, we think that all tax deductions resulting from the reversal of deductible temporary differences are added back to taxable profit (tax loss) to assess the recognition of deferred tax assets (see paragraph 27 and following above).
65. Consequently, the taxable profit (tax loss) is only increased by the amount of the unrealised loss on the available-for-sale debt instrument, if this unrealised loss gives rise to a deductible temporary difference.
66. The comment letters from EY, PwC, the Swedish Financial Reporting Board, ACLI, Sun Life Financial and ASCG, for example, indicate that there are divergent views in the case of an unrealised loss on an available-for-sale debt instrument if the entity expects to recover the carrying amount of debt instrument by holding it to maturity and collecting all the contractual cash flows.
67. These views can be summarised as follows:
 - (a) **View 1 (DTD also when holding):** the difference between the carrying amount of the available-for-sale debt instrument and its higher tax base gives rise to a deductible temporary difference, because the tax base of the available-sale debt instrument can be offset against the taxable economic benefit flowing to the entity from the repayment of the

principal. Consequently, the temporary difference will result in an amount that is deductible in determining taxable profit (or tax loss) of future periods when the carrying amount of the asset is recovered (see the definition of ‘deductible temporary differences’ in paragraph 5 of IAS 12).

- (b) **View 2 (DTD only on sale):** the difference between the carrying amount of the available-for-sale debt instrument and its higher tax base does **not** give rise to a deductible temporary difference, because the reversal of the temporary difference will not give rise to amounts that are deductible in determining taxable profits (or tax losses). The reversal of the unrealised loss is a non-tax event.

68. The divergent views are illustrated below using the example given in paragraphs 19 and 20 above.

No impairment on available-for-sale debt instrument held to maturity

Entity A holds the available-for-sale debt instruments to maturity. At the end of Year 2, Entity expects that for Year 5 the issuer of the debt instrument will pay interest and repay the total principal of CU1,000.

69. This would have the following tax effect in Year 5:

	CU
Economic benefit that will flow to Entity A in Year 5 (Repayment of principal + interest for Year 5)	1,020
Less tax base	-1,000
Future taxable profit in Year 5	20

70. In this case, proponents of View 1 (DTD also when holding) and View 2 (DTD only on sale) come to different conclusions:

- (a) Proponents of View 1 (DTD also when holding) conclude that there is a deductible temporary difference of CU88 (carrying amount (fair value) CU 912 less tax base of CU1,000) because there is a tax deduction of CU1,000 and, if this is Entity A’s only transaction in Year 5, it receives

taxable economic benefits of CU1,020. Because of the tax deduction of CU1,000, however, taxable profit is only CU20.

- (b) Proponents of View 2 (DTD only on sale) instead consider the repayment of the principal to be a non-tax event, because there is no reduction in future tax payments/on future taxable profits from recovering the principal. Accordingly, they do not think that there is a deductible temporary difference at the end of Year 2.

Staff response

- 71. We agree with View 1 (DTD also when holding) because we think that it better aligns with the concept of IAS 12. In determining taxable profits (tax losses), the entity:
 - (a) deducts the tax base of an asset
 - (b) against any taxable economic benefits that flow to the entity
 - (c) when it recovers the carrying amount of the asset (see paragraphs 7 and 16 of IAS 12).
- 72. The fact that the repayment of the principal of the available-for-sale debt instrument in the example above does not decrease or increase tax payment results from the fact that the tax base equals the economic benefits from the repayment of the principal. This is because tax law does not aim to raise taxes or give a tax deduction on the repayment of the principal.
- 73. This should not, however, in our opinion be a reason for concluding that there will be no tax deduction beyond the carrying amount of the asset on the reversal of the deductible temporary difference.
- 74. In addition, by testing the approach against different scenarios of recovery of the carrying amount of the debt instrument, we think that it can be shown that View 1 (DTD also when holding) aligns with the concept of IAS 12 and leads to appropriate results. It has to be noted however that we do not see that View 2 (DTD also on sale) would come to a different conclusion for these scenarios.

Sale of the available-for-sale debt instrument

Entity A plans to sell the available-for-sale debt instrument at the beginning of Year 3 for its carrying amount at the end of Year 2 of CU918 and to collect the interest for Year 2 of CU20.

75. This would have the following tax effect in Year 3:

	CU
Economic benefit that will flow to Entity A in Year 3 (sale proceeds)	918
Less tax base	-1,000
Future tax loss in Year 3	-82

76. The proponents of both View 1 (DTD also when holding) and View 2 (DTD only on sale) would determine that there is a deductible temporary difference of CU82 (carrying amount CU918 (fair value at the end of Year 2) less tax base CU1,000) at the end of Year 2, whose reversal would give rise to a tax loss of CU82 in Year 3.
77. Entity A would, however, not recognise a deferred tax asset for the deductible temporary difference of CU82 unless other sources of taxable profit would be available against which the deductible temporary difference can be utilised.

Partial impairment on available-for-sale debt instrument

Entity A holds the available-for-sale debt instrument to maturity. At the end of Year 2, Entity A expects that issuer of the debt instrument will pay the interest for Years 3 to 5 but can only repay CU918 of the total principal of CU1,000 at the end of Year 5.

78. This would have the following tax effect in Year 5:

	CU
Economic benefit that will flow to Entity A in Year 5 (Partial repayment of principal + interest for Year 5)	938
Less tax base	-1,000
	-62
Future tax loss in Year 5	-62

79. The proponents of both View 1 (DTD also when holding) and View 2 (DTD only on sale) would determine that there is a deductible temporary difference of CU158 (carrying amount (fair value at the end of Year 2) CU842 less tax base of CU1,000), whose reversal would give rise to a tax loss of CU62 in Year 5.

80. Entity A would, however, not recognise a deferred tax asset for the deductible temporary difference of CU158 unless other sources of taxable profit would be available against which the deductible temporary difference can be utilised.

Full impairment on available-for-sale debt instrument

Entity A holds the available-for-sale debt instrument to maturity. At the end of Year 2, Entity A expects that for Year 5 the issuer of the debt instrument can neither repay the total principal of CU1,000 nor the interest for the Years 3 to 5.

81. This would have the following tax effect in Year 5:

	CU
Economic benefit that will flow to Entity A in Year 5	0
Less tax base	-1,000
	-1,000
Future tax loss in Year 5	-1,000

82. The proponents of both View 1 (DTD also when holding) and View 2 (DTD only on sale) would determine that there is a deductible temporary difference of CU1,000 (carrying amount (fair value at the end of Year 2) (CU0 less tax base of CU1,000), whose reversal would give rise to a tax loss of CU1,000 in Year 5.

83. Entity A would, however, not recognise a deferred tax asset for the deductible temporary difference of CU1,000 unless other sources of taxable profit would be available against which the deductible temporary difference can be utilised.

Conclusion on the concern raised

84. Having completed the analysis presented above, we think that the conclusions drawn in the example following draft paragraph 30A of IAS 12 in the ED that there is a deductible temporary difference related to the debt instrument was appropriate and consistent with the requirements of IAS 12.
85. However, we note the comments received on this matter in response to the ED and think that clearer explanation is needed to communicate why there is a deductible temporary difference.

Recovery for more than the carrying amount

86. The example following draft paragraph 30A in the ED concluded that the deferred tax asset cannot be recognised, because there are no probable future taxable profits against which the deductible temporary difference can be utilised.
87. The conclusion was based on the following assumptions:
- (a) Entity A expects no other source of taxable profits from elsewhere that would be available to offset the tax deduction from the debt instrument; and
 - (b) the debt instrument cannot be recovered for more than its carrying amount (implicit assumption). In other words, Entity A in the example following draft paragraph 30A in the ED must assume when estimating future taxable profits that it recovers the debt instrument for its carrying amount of CU80. In this context it cannot assume that it will recover the debt instrument at CU100.

Concern raised

88. EY notes in its comment letter that there is significant diversity in practice in general on this question, ie not only when the utilisation of deductible temporary difference for unrealised losses on available-for-sale debt instruments is assessed. The respondent notes that there is significant diversity on both:
- (a) whether an entity can assume that it will recover an asset for more than its carrying amount in estimating future taxable profits against which deductible temporary differences can be utilised; and
 - (b) (depending on the view that is taken on the previous question) on the basis of what specific facts and circumstances can an entity assume that it will recover an asset for more than its carrying amount.
89. We understand that the latter question is relevant for assessing when future taxable profits are probable, and that giving guidance on the probability criterion in paragraph 24 of IAS 12 is outside the scope of this project.
90. The first question instead is relevant to understand the basic mechanics of IAS 12 when assessing deferred tax assets for unrealised losses and therefore directly relevant to the proposed amendment.
91. The question is relevant for understanding the basic mechanics of IAS 12 because on the basis of the discussions in the previous sections of this staff paper, Entity A in the particular fact pattern of the example in paragraphs 19 and 20 above could only recognise the deferred tax asset for the unrealised loss of the available-for-sale debt instrument if it can assume that it will recover this asset for CU1,000, ie for more than its carrying amount. This is because no other source of taxable profit is available in the fact pattern given in the example.
92. If Entity A instead had to assume that it recovers the available-for-sale debt instrument only for its carrying amount of CU918, Entity A's future taxable profit before deducting amounts resulting from the reversal of the deductible temporary difference in Year 5 would not be sufficient to offset the entire tax base and so the deferred tax asset could not be recognised.

93. EY explains in its comment letter that both views are applied in practice:

- (a) **View A** (temporary difference only): proponents of this view think that determining temporary differences and estimating probable future taxable profits are two separate issues and the inherent assumption of recovering an asset for its carrying amount in the Objective of IAS 12 and paragraphs 16 and 51 of IAS 12 only applies when determining temporary differences. For estimating future taxable profits against which deductible temporary differences can be utilised, it is instead the probability criterion that drives the relevant assumptions. Consequently under this view, it may be possible to determine that the asset will be recovered for more than its carrying amount and thus a deferred tax asset may be recognised for up to the full amount of the deductible temporary difference.
- (b) **View B** (consistent assumptions): proponents of this view think instead that the assumption of recovering an asset for its carrying amount is relevant for both:
 - (i) determining temporary differences; and
 - (ii) estimating future taxable profits against which deductible temporary differences can be utilised.

Under view B, accounting for deferred taxes must be based on consistent assumptions. Consequently, under this view the amount of the deferred tax asset recognised in respect of the deductible temporary difference will be limited, and potentially no deferred tax asset will be recognised if there are no other sources of taxable income against which to assess the utilisation of the deductible temporary difference.

Staff response

94. Taking into consideration the comments from EY, we support View A (temporary difference only) for the following reasons:

Utilisation concept for deferred tax assets

95. We think that View A (temporary difference only), ie assuming to recover an asset for more than its carrying amount at balance sheet when estimating future taxable profits, aligns with the concept given in paragraph 24 of IAS 12, provided such a gain is probable.
96. Paragraph 24 of IAS 12 requires to assess the recognition of deferred tax assets on the basis of probable future taxable profits.
97. Estimating probable future taxable profits, however, implies to consider events that take place after balance sheet date, including the realisation of profits from recovering the carrying amount of an asset.
98. We don't think that the balance sheet liability method, which focuses on temporary differences, requires to assume that an asset is recovered for its carrying amount in estimating probable future taxable profits.
99. This is the method required by current IAS 12 (see paragraph IN2 of IAS 12) and the cause for the inherent assumption of recovering an asset for its carrying amount. This method focuses on the difference between the carrying amount of an asset and a liability in the statement of financial position and its tax base at balance sheet date. By doing so, it determines and limits the tax effects that an entity accounts for. It does however not indicate the conditions that will prevail when the temporary differences reverse and which tax consequences these reversals will have.
100. The conditions that will prevail when the temporary difference reverses and the tax consequences these reversal will have is either determined by tax law or other principles in IAS 12 like the principle in paragraph 51 of IAS 12 that the measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at

the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Appropriate results

101. In addition, we think that only View A (temporary difference only) leads to appropriate results in accounting for deferred tax assets in many cases.
102. This may be illustrated by a profitable manufacturing entity that applies IAS 12 in accounting for its deferred tax assets and deferred tax liabilities.
103. A significant part of the assets of manufacturing entities is usually property, plant and equipment and inventories and the assumption of recovering these assets for their carrying amount conflicts with the assumption that these entities are profitable.
104. This is because a significant part of their probable future taxable profits shortly after the balance sheet date result from recovering these assets for more than their carrying amount.
105. Accordingly, only View A (temporary difference only) would allow such manufacturing entities, in many cases, to recognise deferred tax assets.
106. We think that this is an appropriate result, because such profitable entities would be able to utilise the tax deductions resulting from the reversal of deductible temporary differences, ie they would be able to realise a tax reduction of future tax payments from the reversal of the deductible temporary difference.
107. View B (consistent assumptions) instead requires basing the entire accounting for deferred taxes on the assumption that all assets are recovered for their carrying amount.
108. For consistency, we think the assumption underlying View B (consistent assumptions) would have to apply not only to the asset that gave rise to deductible temporary difference, but also to all the assets of the manufacturing entity.

109. However, this would mean that a profitable manufacturing entity would not be allowed to:
- (a) assume that it would achieve taxable profits by recovering property, plant and equipment and inventories, although this assumption would in many cases pass the probability criterion in paragraph 24 of IAS 12; and
 - (b) recognise the deferred tax assets that it expects will reduce future tax payments.

Conclusion on the concern raised

110. Summarising the analysis on the concern raised, we think that:
- (a) an entity should assume that it will recover an asset for more than the carrying amount when estimating future taxable profits against which deductible temporary differences can be utilised, provided that the recovery for more than the carrying amount is probable; and
 - (b) the conclusion on this issue is relevant in assessing whether deferred tax assets can be recognised for unrealised losses on available-for-sale debt instruments, if the entity expects to recover the carrying amount of the available-for-sale debt instrument by holding it to maturity and collecting the contractual cash flows.
111. We are however not aware that this issue of whether an entity can assume to recover an asset for more than its carrying amount when estimating probable future taxable profits:
- (a) is addressed in current IAS 12; or
 - (b) that it has been discussed by the IASC or its Steering Committee in developing IAS 12 (revised 1996).
112. Consequently, we think the issue is about understanding what the principles are in IAS 12, and for that reason we think the issue does not qualify for annual improvements.

113. We think that reaching a conclusion on this point is achievable by the Interpretations Committee within the confines of IAS 12.
114. We also note the significant diversity in practice on this issue and recommend therefore that the issue should be addressed in a narrow scope amendment to IAS 12 that should be exposed separately from annual improvements.

Expected manner of recovery

Concern raised

115. Many respondents (TELUS, SEAG, EY, BUSINESSEUROPE, PwC, Swedish Financial Reporting Board, ACTEO, AFEP, MEDEF, British American Tobacco and ESMA) made the criticism that the example following draft paragraph 30A in the ED does not reflect that holding the debt instrument to maturity and collecting all the contractual cash flows, is a recovery by ‘use’ and not by ‘sale’.
116. Furthermore, several respondents (SEAG, BUSINESSEUROPE, ACTEO, AFEP, MEDEF and British American Tobacco) noted that the available-for-sale category in IAS 39 is a default classification for accounting purposes. It does not mean that such an instrument would not be held to maturity and, in practice, current shortfalls in carrying value will often mean that they are held for the longer term to obtain recovery of value.

Staff response

117. We agree with respondents that:
- (a) holding an available-for-sale debt instrument until maturity and collecting the contractual cash flows is recovering the carrying amount of the available-for-sale debt instrument by ‘use’ and not by ‘sale’; and
 - (b) the classification of the debt instrument as available-for-sale does not require the assumption that the carrying amount of the debt instrument is recovered by sale.

118. Paragraph 9 of IAS 39 *Financial Instruments: Recognition and Measurement* defines available-for-sale financial assets as a default category that does not necessarily require the intention to sell the asset.
119. The same conclusion applies to a financial asset that is classified at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* (eg the classification of the debt instrument in the example following draft paragraph 30A in the ED). Paragraphs 4.1.1-4.1.5 of IFRS 9 allow the classification of many debt instruments as financial assets at fair value through profit or loss even if the entity does not intend to sell the debt instrument but instead to hold it to maturity and to collect the contractual cash flows.

Conclusion on the concern raised

120. Consequently, we agree with respondents that the example following draft paragraph 30A of IAS 12 in the ED should be amended to reflect that holding the debt instrument to maturity with the intention to collect all contractual cash flows is a recovery by ‘use’.
121. The example should thereby explain that such a recovery by ‘use’ leads to a classification of gains and losses arising while holding the debt instrument and collecting the contractual cash flows as ordinary profits and losses by tax law.
122. We think the better reflects the tax situation in many jurisdictions.
123. Furthermore, the example following draft paragraph 30A of IAS 12 in the ED should also be amended to reflect the assumption that probable future taxable profits against which deductible temporary differences can be utilised will include taxable economic benefits that result from recovering an asset for more than its carrying amount (see paragraph 110(a) above).
124. The example in the ED instead was based on the counterview that an entity has to assume that it recovers an asset only for its carrying amount when estimating probable future taxable profits.

Tax planning opportunity

Concern raised

125. Half of the respondents that disagree with the proposed amendment to IAS 12 in the ED disagree only or primarily because of the proposed clarification in draft paragraph 30A that an action that results only in the reversal of an existing deductible temporary difference, without creating or increasing taxable profit, is not a tax planning opportunity.
126. They give various reasons for whether and when holding an available-for-sale debt instrument to maturity, and collecting the contractual cash flows, qualifies as a tax planning opportunity, or is at least akin to a tax planning opportunity and that it should therefore be considered a source of taxable profits against which deductible temporary differences can be utilised (see for example DTT, GLASS, CINIF, FACPCE, ASCG, Sun Life Financial, ACLI, ACTEO, AFEP, MEDEF, European Insurance CFO Forum and GDV).

Staff response

127. We conclude from the analysis in paragraphs 27-124 above that the question of whether holding an available-for-sale debt instrument to maturity and collecting the contractual cash flows qualifies as a tax planning opportunity, or is at least akin to a tax planning opportunity, is irrelevant for recognising deferred tax assets for unrealised losses on available-for-sale debt instruments:
- (a) If an entity applies the view that there is only a deductible temporary difference when the entity expects to recover the value of the available-for-sale debt instrument by sale (see paragraph 67(b) above), there is no deferred tax asset that would need to be assessed for recognition if the entity expects to recover that asset by use.
 - (b) If the entity applies instead the contrary view that there is also a deductible temporary difference when the entity expects to recover the carrying amount of the asset by holding it and collecting the contractual

cash flow (see paragraph 67(a) above), it can recognise the deferred tax asset provided that:

- (i) it also applies that view that future taxable profits against which deductible temporary differences can be utilised may include taxable benefits that will result from recovering an asset for more than its carrying amount (see paragraph 93(a) above);
 - (ii) such a recovery of the asset for more than its carrying is probable, and
 - (iii) the entity is not in a tax loss position that excludes the recognition of deferred tax assets.
- (c) Otherwise, no deferred tax asset is recognised for the unrealised losses on the available-for-sale debt instruments.

128. Whichever of these two views an entity applies, the question of whether holding an available-for-sale debt instrument to maturity and collecting the contractual cash flows qualifies as a tax planning opportunity, or is at least akin to a tax planning opportunity, is in our opinion irrelevant to the analysis:

- (a) Either there is no deductible temporary difference for which a deferred tax asset could be recognised;
- (b) Or the assessment of whether probable future taxable profits as specified in paragraph 29(a) of IAS 12 will be available is sufficient to determine whether a deferred tax assets for unrealised losses on debt instruments is recognised.

129. This conclusion is supported by TELUS. The respondent thinks that the issue is not relevant, because if the entity sells the available-for-sale debt instrument and thereby realises the loss, it needs profits from elsewhere to utilise the deductible temporary difference. If it instead holds the available-for-sale debt instrument until maturity, it has the ‘accounting profit’ from the reversal of the unrealised loss, against which it can offset the deductible temporary difference.

Conclusion on the concern raised

130. On the basis of the conclusion that tax planning opportunities are irrelevant for the recognition of deferred tax assets for unrealised losses on debt instruments, we think that the draft paragraph 30A should not be included in the final amendment.
131. Considering however the importance that this issue had in discussion so far and in order to ensure a consistent application, we think that the irrelevance of this question for recognising deferred tax assets on unrealised losses should be explained in the final amendment to IAS 12. The explanation may be in the example following draft paragraph 30A of IAS 12 in the ED and in the Basis for Conclusions.

Staff recommendation

132. On the basis of the comment letter analysis, we propose that the issue of whether and when deferred tax assets for unrealised losses on debt instruments are recognised should be addressed in a separate project to amend IAS 12.
133. We think the issue cannot be clarified as part of this annual improvements cycle because it requires answering the question whether an entity can assume to recover an asset for more than its carrying amount when estimating probable future taxable profits (see paragraphs 111-113 above) and such guidance cannot be finalised without exposing a draft amendment to IAS 12.
134. This Exposure Draft should also propose to clarify (further):
- (a) what “future taxable profit before deducting the amounts resulting from the reversal of deductible temporary differences” is (see paragraphs 61-63 above);
 - (b) why the unrealised loss on a debt instrument give rise to deductible temporary difference when the entity expects to recover the carrying amount of debt instrument by holding it to maturity and collecting the contractual cash flows (see paragraphs 84 and 85 above);

- (c) that holding a debt instrument to maturity and collecting the contractual cash flows is recovery of the asset by ‘use’ (see paragraphs 120-124 above); and
 - (d) that the question of whether holding an available-for-sale debt instrument to maturity and collecting the contractual cash flows qualifies as a tax planning opportunity, or is at least akin to a tax planning opportunity, is irrelevant to recognising deferred tax assets for unrealised losses on available-for-sale debt instruments (see paragraphs 130 and 131 above).
135. In addition, we also noted uncertainty during our discussion with interested parties during the comment period on whether and when the proposed amendments to IAS 12 in the ED would result in the recognition of deferred tax assets for unrealised losses on debt instruments.
136. Considering this uncertainty, we think that the ED should also explicitly explain whether and when the proposed amendment results in the recognition of deferred tax assets for unrealised losses on debt instruments if the entity expects to recover the carrying amount of the debt instrument by holding it to maturity and collecting the contractual cash flows.
137. On the basis of our analysis, we think that such deferred tax assets are always recognised unless the entity is in a loss position, ie insofar taxable profit before deducting amounts resulting from reversal of deductible temporary difference is not a profit but a loss (less than nil).
138. We think that recognising such deferred tax assets meet the basic mechanics and is also appropriate in economic terms. An entity with such an unrealised loss is in a better tax position than an entity acquiring the debt instrument for its fair value at balance sheet date.
139. This may be illustrated by the example presented in paragraphs 19 and 20 above:
- (a) Entity A offsets a tax deduction of CU1,000 in Year 5 against its taxable economic benefits of CU1,020.

- (b) Entity B instead acquired the available-for-sale debt instrument at the end of Year 2 for its then carrying amount of CU918. Consequently, it can only deduct the tax base of CU918 against the economic benefits of CU1,020 in Year 5.
140. In other words, Entity A may, unlike Entity B, receive additional taxable economic benefits of CU82 without paying taxes.
141. Consequently, we think that the Interpretations Committee should recommend to the IASB that it should not pursue this issue in the Annual Improvements Project but that the IASB should instead address it in a separate project to amend IAS 12.
142. If the Interpretations Committee agrees with our recommendation, we would present at a future meeting a proposed amendment to IAS 12 that would be presented to the IASB as a proposed amendment to IAS 12.
143. Such an analysis would also consider the results from the FASB meeting on 3 October 2012. At this meeting, the FASB discussed the need for a valuation allowance on a deferred tax asset related to debt instruments that are classified and measured at fair value through other comprehensive income (see Board Meeting Handout—Accounting for Financial Instruments: Classification and Measurement²).

Question to the IFRS Interpretations Committee

Question to the IFRS Interpretations Committee

Does the Interpretations Committee agree to recommend to the IASB that it should proceed with the issue in a separate project to amend IAS 12?

² http://www.fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176160397639

Appendix A—ED

A1. The proposed amendment to IAS 12 that was presented in the ED is reproduced below:

Proposed amendment to IAS 12 *Income Taxes*

The Board proposes to amend IAS 12 by amending paragraphs 29 and 30, adding paragraphs 27A, 30A and 98C and adding examples after paragraphs 29 and 30A.

The proposed amendment is marked up in the text of IAS 12 (new text is underlined and deleted text is struck through). Paragraphs 24 and 27 are not proposed for amendment but are included here for ease of reference.

The following Basis for Conclusions accompanies, but is not part of, the proposed amendment. It sets out the reasons why the Board proposes the amendment. If the amendment is approved, this basis will be included in the Basis for Conclusions on IAS 12 *Income Taxes*, which is not part of the IFRS.

Deductible temporary differences

24 A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

- (a) is not a business combination; and
- (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44.

...

27 The reversal of deductible temporary differences results in deductions in determining taxable profits of future periods. However, economic benefits in the form of reductions in tax payments will flow to the entity only if it earns sufficient taxable profits against which the deductions can be offset. Therefore, an entity recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised.

27A 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 profit 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 its other deductible temporary differences. However, if tax law restricts the utilisation of losses to deduction against income of a specified type, a deductible temporary difference is assessed in combination only with other deductible temporary differences of the appropriate type.

...

29 When there are insufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, the deferred tax asset is recognised to the extent that:

- (a) it is probable that the entity will have sufficient taxable profit relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference (or in the periods into which a tax loss arising from the deferred tax asset can be carried

back or forward). In evaluating whether it will have sufficient taxable profit in future periods, an entity:

- (i) compares the deductible temporary differences with those future taxable profits before deducting the amounts resulting from the reversal of those deductible temporary differences. This comparison shows the extent to which the future taxable profits are sufficient that the entity will be able to deduct the amounts resulting from the reversal of those deductible temporary differences; and
 - (ii) ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from these deductible temporary differences will itself require future taxable profit in order to be utilised; or
- (b) tax planning opportunities are available to the entity that will create taxable profit in appropriate periods.

Example

Entity A has an asset with a carrying amount of 100 and a tax base of 170. Entity A has no other deductible temporary differences, no unused tax losses and no unused tax credits. Tax law offsets all deductions against taxable income from all sources. Entity A concludes that it is probable that, after deducting the amount resulting from the reversal of the deductible temporary difference, it will file a tax return showing a taxable profit of nil and tax losses of nil in the period in which it recovers the carrying amount of the asset.

At the end of the reporting period a deductible temporary difference of 70 (170 less 100) is associated with the asset and needs to be assessed for recoverability. Entity A recognises a deferred tax asset because it is probable that it will have taxable profit of 70 relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference of 70. For assessing the recognition of the deferred tax asset, Entity A compares the deductible temporary difference of 70 with its probable future taxable profit of 70 (nil plus 70) before deducting the amount resulting from the reversal of the deductible temporary difference of 70.

- 30 Tax planning opportunities are actions that the entity would take in order to create or increase taxable profit ~~income~~ in a particular period before the expiry of a tax loss or tax credit carryforward. For example, in some jurisdictions, taxable profit may be created or increased by:
- (a) electing to have interest income taxed on either a received or receivable basis;
 - (b) deferring the claim for certain deductions from taxable profit;
 - (c) selling, and perhaps leasing back, assets that have appreciated but for which the tax base has not been adjusted to reflect such appreciation; and
 - (d) selling an asset that generates non-taxable income (such as, in some jurisdictions, a government bond) in order to purchase another investment that generates taxable income.

Where tax planning opportunities advance taxable profit from a later period to an earlier period, the utilisation of a tax loss or tax credit carryforward still depends on the existence of future taxable profit from sources other than future originating temporary differences.

- 30A An action does not qualify as a tax planning opportunity if the action does not create or increase taxable profit. Consequently, if an action results only in the reversal of existing deductible temporary differences, that action is not a tax planning opportunity because that reversal does not create or increase taxable profit.

Example

Entity A has only two deductible temporary differences and no taxable temporary differences:

- (a) Entity A purchased a debt instrument for 100 and classified it as a financial asset at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments*. At the end of the reporting period, the debt instrument has a fair value of 80. Consequently, Entity A recognises an unrealised loss of 20 in profit or loss. It expects to receive all future contractual cash flows and hence expects that the loss of 20 will reverse (no later than by maturity of the debt instrument). Tax law does not allow unrealised losses on debt instruments to be deducted from taxable profit, ie the tax base remains 100 until the loss is considered realised for tax purposes. Entity A does not generally plan to hold debt instruments until their maturity but may choose to do so, for example, to avoid realising a loss.
- (b) Entity A also has an item of property, plant and equipment with a carrying amount of 50 and a tax base of 80.

Tax law classifies gains and losses on debt instruments as capital gains and losses, and capital losses can only be offset against capital gains. Tax law classifies gains and losses on property, plant and equipment as ordinary gains and losses, and ordinary losses can only be offset against ordinary gains or losses.

Entity A considers it probable that its taxable profits relating to ordinary gains and losses will be more than 1,000 in each of the periods over which the carrying amount of the item of property, plant and equipment will be recovered and over which the unrealised loss on the debt instrument will reverse.

Entity A has historically had no taxable profits that tax law classifies as capital gains, nor does it expect any such taxable profits in the future.

Entity A assesses separately for each deductible temporary difference whether sufficient taxable profits will be available against which that deductible temporary difference can be utilised because tax law does not offset capital losses against ordinary gains, nor does it offset ordinary losses against capital gains.

Entity A recognises a deferred tax asset arising from the deductible temporary difference of 30 associated with the item of property, plant and equipment because it is probable that it will have sufficient taxable profits in periods in which the deductible temporary difference reverses.

Recognising a deferred tax asset arising from the deductible temporary difference associated with the debt instrument would require sufficient probable taxable profits of appropriate type (ie profits that applicable tax law classifies as capital gains).

Entity A does not have sufficient taxable temporary differences of the appropriate type (ie capital gains) reversing in the same periods as the reversal of the deductible temporary difference associated with the debt instrument (or in the periods into which a tax loss arising from that reversal could be carried back or forward). In addition, it is not probable that Entity A will have sufficient future taxable profits of appropriate type (ie capital gains) against which the deductible temporary difference associated with the debt instrument can be utilised.

Thus, Entity A does not recognise a deferred tax asset arising from the deductible temporary difference of 20 associated with the debt instrument unless a tax planning opportunity is available to create sufficient taxable capital gains in the future. Holding the debt instrument until it matures does not qualify as a tax planning opportunity because that action will not create taxable profits. Instead, it only prevents a capital loss from being realised.

Effective date

...

- 98C *Annual Improvements to IFRSs 2010–2012 Cycle* issued in [date] amended paragraphs 29 and 30, added paragraph 27A and 30A and added examples after paragraphs 29 and 30A. An entity shall apply that amendment for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Basis for Conclusions on the proposed amendment to IAS 12 *Income Taxes*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Recognition of deferred tax assets for unrealised losses

- BC1 The IFRS Interpretations Committee (the Committee) was asked to provide guidance on how an entity determines, in accordance with IAS 12 *Income Taxes*, whether to recognise a deferred tax asset when the entity:
- has a deductible temporary difference relating to an unrealised loss on debt instruments that are classified as available-for-sale financial assets in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* and measured at fair value;
 - has the ability and intention to hold the instruments until the loss reverses (which may be at their maturity); and
 - has insufficient taxable temporary differences and no other probable taxable profits against which the entity can utilise that deductible temporary difference.
- BC2 The Committee reported to the Board that practice differed because of divergent views on the following questions:
- Does an entity assess whether a deferred tax asset is recognised for each deductible temporary difference separately, or in combination with other deductible temporary differences (see paragraphs BC3–BC5)? This question is particularly relevant where tax law distinguishes capital gain and loss from other taxable gains and losses and capital losses can only be offset against capital gains.
 - If an entity has the ability and intention to hold an available-for-sale debt instrument until an unrealised loss reverses, does that create a source of taxable profits, for example because it is a tax planning opportunity or akin to a tax planning opportunity (see paragraphs BC6–BC9)?
 - When an entity assesses whether it can utilise a deductible temporary difference against probable future taxable profits, do those probable future taxable profits include the effects of reversing deductible temporary differences (see paragraphs BC10–BC11)?

Combined versus separate assessment

- BC3 The Board considered the guidance in IAS 12 on the recognition of deferred tax assets. Paragraph 24 requires that a deferred tax asset is recognised only to the extent of probable future taxable profit against which the deductible temporary difference can be utilised. Paragraph 27 elaborates on these requirements and explains that:
- the deductible temporary difference is utilised when its reversal results in deductions that are offset against taxable profits of future periods; and
 - economic benefits in the form of reductions in tax payments will flow to the entity only if it earns sufficient taxable profits against which the deductions are offset.
- BC4 The Board noted that:
- tax law determines which deductions are offset in determining taxable profits, because paragraph 5 defines taxable profit as the profit of a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable; and
 - no deferred tax asset is recognised if the reversal of the deductible temporary difference will not lead to reductions in tax payments. To achieve this outcome, if tax law offsets different types of expense against the same type of taxable income, an entity will need to assess in combination all temporary differences that, when they reverse, will give rise to deductions against the same type of taxable income. Only such a combined assessment determines whether taxable profits are sufficient to utilise deductible temporary differences.
- BC5 Consequently, if tax law, as is often the case, offsets a deduction against taxable income on an entity basis, without segregating deductions from different sources, an entity carries out a combined assessment of all its deferred tax assets relating to the same taxation authority and same taxable entity. However, if tax law offsets specific types of loss (eg capital losses) only against the same types of income (eg capital gains), an entity assesses a deferred tax asset in combination with other deferred tax assets of the same type, but separately from all other deferred tax assets. The Board proposes to add paragraph 27A and an example after paragraph 30A to clarify this.

Tax planning opportunities

- BC6 The Board noted that paragraphs 28 and 29 identify three sources of taxable profits against which an entity can utilise deductible temporary differences. They are:
- future reversal of existing taxable temporary differences;

- (b) future taxable profits; and
- (c) tax planning opportunities.

A deferred tax asset arising from a deductible temporary difference is recognised only to the extent that it is probable that at least one of these sources of taxable profits is available. Otherwise, no deferred tax asset is recognised.

- BC7 The Board also noted that an action that results in a reversal of existing deductible temporary differences without creating or increasing taxable profit in the future is not a tax planning opportunity, as described in paragraph 30. The Board proposes to add paragraph 30A and an example after paragraph 30A to clarify this.
- BC8 However, some think that the action of holding available-for-sale debt instruments until the unrealised loss reverses is akin to a tax planning opportunity and they believe that this justifies recognising the deferred tax asset by analogy to paragraph 29(b). They argue that if an entity can deduct unrealised losses for tax purposes, it could subsequently create taxable profits by holding available-for-sale debt instruments until the losses reverse. Consequently, they think that the ability to hold those instruments until the losses reverse is a tax planning opportunity, as described in paragraph 30, if the entity has already deducted unrealised losses on those instruments for tax purposes. By analogy, if an entity cannot deduct unrealised losses for tax purposes, they argue that the entity must be in an equivalent deferred tax position. They reach this conclusion because there is an inherent assumption in IAS 12 that an entity will recover the carrying amount of an asset. In their view, applying this assumption leads to a notional tax loss, and holding the asset until the loss reverses should therefore be considered an action that creates a notional taxable profit against which the notional tax loss can be offset.
- BC9 However, the Board noted that paragraphs 29 and 30 do not permit an entity to recognise a deferred tax asset based on an action that does not qualify as a tax planning opportunity even if such an action is akin to a tax planning opportunity. Moreover, such action does not give rise to a source of taxable profits (see paragraph BC6) and so the availability of such an action does not permit an entity to recognise a deferred tax asset. The Board proposes to add an example after paragraph 30A to clarify this.

Deductible temporary differences

- BC10 During its work on the issue, the Committee observed uncertainty about how to define the cases when probable future taxable profits are insufficient for the recognition of a deferred tax asset. The uncertainty related to whether a deductible temporary difference should be compared with probable future taxable profits before the reversal of deductible temporary differences, or after their reversal.
- BC11 The Board noted that a deductible temporary difference is utilised by deduction against the amount of taxable profit determined before deducting the amounts resulting from the reversal of the deductible temporary difference. If not, the deduction would be counted twice. The Board proposes to amend paragraph 29(a) and to add an example after paragraph 29 to clarify this.