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IASB proposes amendments to IAS 12 to clarify the recognition of deferred tax assets for unrealised losses related to debt instruments measured at fair value

Why are amendments being proposed to IAS 12?

The IFRS Interpretation Committee (IC) received a request to clarify the application of IAS 12 for the recognition of a deferred tax in the following circumstances:

• an entity holds a debt instrument classified as available for sale with gains and losses being recognised in other comprehensive income;

• changes in market interest rates cause the fair value of the debt instrument to be below its cost;

• the entity expects to recover all the contractual cash flows by holding the instrument until maturity;

• the entity does not consider the debt instrument to be impaired;

• the tax base of the debt instrument remains cost;

• the tax law does not allow a loss to be deducted until it is realised; and

• the entity has insufficient taxable temporary differences and no other probable future taxable profits against which the entity can utilise deductible temporary differences.

The IC noted diversity in practice and identified two prevailing views in the application of IAS 12 in those situations.

One view considers that an entity cannot assume that an asset can be recovered for an amount higher than its carrying amount and consequently no deferred tax arises.

Under this view, the repayment of the principal on maturity does not increase or decrease taxable profits.

The other view, consistent with the IASB proposed amendments, considers that determining temporary differences and estimating future taxable profits are two separate steps and the carrying amount of the asset is only relevant to determining temporary differences. The carrying amount of an asset should not be considered as the limit of the estimated future taxable profits. Paragraphs 20 and 26(d) of IAS 12 specify that a difference between the carrying amount of an asset measured at fair value and its higher tax base gives rise to a deductible temporary difference.

Consequently, the objective of the proposed amendment is to explain the application of the existing principles in IAS 12 to the situation presented.

What are the proposed amendments to IAS 12?

The IASB propose to clarify that unrealised losses resulting from the circumstances described above give rise to a deductible tax difference regardless of whether the holder expects to recover the carrying amount by holding the debt instrument until maturity or by selling the debt instrument.

Observation

The IC concluded that the balance sheet liability method, which focuses on temporary differences, does not require an entity to assume that an asset is recovered only for its carrying amount in estimating probable future taxable profits. The balance sheet method focuses on the difference between the carrying amount of an asset or a liability in the statement of financial position and its tax base at the balance sheet date. By doing so, it determines and limits the tax effects that an entity accounts for. It does not, however, indicate the conditions that will prevail when the temporary differences reverse and what tax consequences these reversals will have.

The IASB propose to add an illustrative example to IAS 12 to illustrate the utilisation of deductible temporary differences for different sources of taxable profits (future reversal of existing taxable temporary differences, future taxable profit and tax planning opportunities) that are available but insufficient to offset existing deductible temporary differences.

In circumstances in which tax law restricts the utilisation of tax losses so that an entity can only deduct the tax losses against income of a specified type, an entity would assess a deferred tax asset in combination with other deferred tax assets of the same type.

The proposed amendments would also clarify that when estimating taxable profit of future periods, an entity can assume that an asset will be recovered for more than its carrying amount if that recovery is probable and the asset is not impaired. All relevant facts and circumstances should be assessed when making this assessment.

The proposed amendments would make clear that, in evaluating whether sufficient future taxable profits are available, an entity should compare the deductible temporary differences with the future taxable profits excluding tax deductions resulting from the reversal of those deductible temporary differences.

Observation

‘There is uncertainty over whether deductible temporary differences should be compared with future taxable profits that exclude or include tax deductions for which those deductible temporary differences exist. The IASB proposes to clarify that the future taxable profits should exclude those tax deductions, to avoid counting them twice.

Effective date, transition requirements and comment period

The ED does not specify an effective date. The IASB will determine the effective date as part of considering the comments they receive on this ED.

The IASB proposes that entities should apply the amendments retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. However, in applying the amendments in the first opening statement of financial position, an entity would not be required to make transfers between retained earnings and other components of equity to restate cumulative amounts previously recognised in profit or loss, other comprehensive income or directly in equity. If an entity does not make such transfers, it would disclose that fact. Full retrospective application would be required for first time adopters.

Comments on the ED are due by 18 December 2014.

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