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N°40

M. Hans HOOGERVORST
Chairman
I.A.S.B.
30, Cannon Street
LONDON EC4M 6XH
United Kingdom

Re : Exposure Draft ED/2014/3 : recognition of Deferred Tax Assets for Unrealised Losses (Proposed amendments to IAS 12).

Dear Mr Hoogervorst,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned draft. These views result from the ANC's due process, involving all interested stakeholders. More precisely, the due process includes work by a diversified experts task force, a full fledged discussion of its assessment by its Commission for all International Standards and then a global and strategic discussion in the Collège (Board) before signing this letter.

The ANC agrees with the proposals in the ED as it helps clarifying the recognition of a deferred asset related to a debt instrument measured at fair value, when the carrying amount of the instrument is lower than its tax base.

The ANC welcomes the addition of a detailed illustrative example dealing with this issue.

Nevertheless, we believe that some of the wording needs clarification to avoid misinterpretations and we suggest these be amended :

- The examples illustrating the probability of recovering (or not) an asset for more than its carrying amount should not be included in paragraph 29A of the Standard, but rather in the Basis for Conclusions ;
- To be comprehensive, paragraph 29 (a) (i) of the Standard should specify that the entity must also exclude the reversal of taxable temporary differences when comparing the deductible temporary differences with future taxable profits ;
- Transition requirements need clarification of the "limited retrospective application" to avoid misunderstanding and diversity of practices ;

- Finally, we believe that paragraphs IE41 and IE43 of the Illustrated Example, if absolutely necessary to maintain, should be amended to avoid misinterpretations of the allocation of changes in deferred taxes to profit and loss or other comprehensive income, as stated by the paragraph 63 of IAS 12.

Our detailed answers to the questions in the ED are in the Appendix.

If you have any questions concerning our comments, we would be pleased to discuss them.

Yours sincerely,

A handwritten signature in blue ink, consisting of a long horizontal stroke followed by a vertical stroke and a small loop at the top.

Gérard Gil
ANC Board Member
ANC IFRS Commission Chair

Appendix – Invitation to comment

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?

Answer

The ANC agrees with the proposed amendment as it helps clarify that the decrease of the carrying amount of a debt instrument measured at fair value gives rise to a deductible temporary difference, irrespective of the holder's intention, when the tax value of the asset remains the same, whatever the manner of recovering the asset may be (by sale or by use).

It will help reduce diversity in practice, because, in such circumstances, some entities fail to identify the tax benefits embodied in the resulting difference between the carrying amount of the debt instrument and its tax base. Indeed, some entities who expect to recover the carrying amount of the asset by holding the instrument until maturity do not recognise deferred tax assets, because they consider that they will not benefit from any tax savings.

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?

Answer

The ANC agrees with the IASB's proposed amendment as it would reduce diversity in practice on how entities estimate future taxable profits against which deductible temporary differences are assessed for utilisation.

The ANC agrees that determining temporary differences and estimating probable taxable profits are two separate steps and that the carrying amount of an asset does not theoretically limit the estimation of probable future taxable profits obtained from this asset. But we also believe that the assessment of future taxable profits should require assessing whether it is probable that the liabilities of the entity will be settled for less than their carrying amount. As a result, we think that the IASB should address the expected treatment for liabilities (and not only for assets) and consequently amend paragraph.

Moreover, we think that the rationale, which is clearly explained in paragraphs BC12 and BC13 of the Basis for Conclusions, should be included in the body of the Standard.

Conversely, we believe that the examples illustrating the probability of recovering (or not) an asset for more than its carrying amount should not be included in paragraph 29A of the Standard, but rather in

the Basis for Conclusions. Indeed, the assessment of the recoverability of an asset depends on several assumptions and cannot be reduced to only two opposite situations. Inclusion in the standard could mislead entities as to the fact that there are only two main situations to consider, which would result in limitation of judgment.

By the way, we consider that paragraph BC9 of the Basis for Conclusions should benefit from further clarification. This BC states: *“Future taxable profit has to be probable to justify the recognition of deferred tax assets. Consequently, only the conditions that will probably prevail when the deductible temporary differences are utilised determine the estimate of future taxable profit”*.

It is not clear as to what “the conditions that will probably prevail” refer to. Do they include both tax and economic conditions? As paragraph 47 of IAS 12 states that *“Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (an tax laws) that have been enacted or substantively enacted by the end of the reporting period”*, some wonder whether the assessment that the tax legislation will probably change in the future is a “condition” that should be taken into consideration in the assessment of probable future taxable profit. If so, it should be stated.

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?

Answer

The ANC welcomes the proposal as we are aware that there may be some confusion as to how entities interpret future taxable profit against which deductible temporary differences are assessed for utilisation. Some entities believe that probable taxable profits calculated for assessment of the utilisation of deductible temporary differences must exclude any deduction resulting from the reversal of deductible temporary differences. Conversely, others take the actual definition of income tax in IAS 12, without any exclusion.

Nevertheless, to be comprehensive, the Standard should also specify that the entity must also exclude the reversal of taxable temporary differences as mentioned in paragraph IE34 of the illustrative example that accompanies the Standard (figure (78,571) excluded as taxable profits already considered as part of Step 1).

In addition, we believe the illustrative example paragraph IE 34 “Step 2” would gain in clarity if it were stated (by a footnote for instance) which principles the figures (78,571) and 487,143 refer to, with cross-references to the paragraphs of the body of the Standard (29 (a) (i)) and of the Basis of Conclusions (BC17 and BC18).

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?

Answer

The ANC is supportive of the proposed amendment to paragraph 27A of IAS 12 as it helps clarify how entities have to assess the utilisation of deductible temporary differences - that is together with other deferred tax assets - and how they have to assess them when tax laws limit the ability to offset sources of losses against sources of taxable profits.

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?

Answer

The ANC is generally supportive of limited retrospective application when the full retrospective application could result in undue costs and efforts which could outweigh the benefits of comprehensive information.

Nevertheless, we believe that the consequences of limited retrospective application are not precisely described in the Basis for Conclusions, and we would like the IASB to confirm that the understanding hereafter is correct.

If we consider year N as the first application period and financial statements with one comparative period, we understand that:

- Full retrospective application of the amendments regarding the recognition of deferred tax assets is required for N and N-1;
- The restatement of the opening retained earnings or other components of equity is mandatory at 1/01/N;
- On the other hand, the restatement of the opening retained earnings or other components of equity at 1/01/N-1 is not required.

Should this understanding be correct, we are supportive of the proposed limited retrospective application.

In addition, we consider that paragraph 98G of the Standard and paragraphs BC24 to BC26 of the Basis for Conclusions should be more precise to avoid uncertainties in their application.

Other comments

Amendments to the illustrative computations and presentation on IAS 12 *Income Taxes*.

1° General (paragraphs IE11 to IE15)

To enhance clarity and to be consistent with the utilisation of deductible temporary differences described below, the general scope of the example should mention that the entity is expecting no other sources of future temporary differences (either deductible or taxable) at the end of 31 December 20x1.

2° Allocation of changes in deferred tax assets between profit and loss and other comprehensive income (paragraphs IE41 to IE43)

We wonder about the usefulness and the relevance of these paragraphs.

According to the Basis for Conclusions, the specific issue of the allocation of changes in deferred tax assets between profit and loss and other comprehensive income was not raised by the IFRS-IC.

The IASB has not issued any related amendment nor specific issue is addressed in the Basis for Conclusions.

Moreover, whereas paragraph 63 of IAS 12 requires entities to recognise current and deferred tax related to items that are recognised outside profit or loss based on a reasonable prorata allocation, **or other method that achieves a more appropriate allocation in the circumstances**, paragraph IE43 states that the changes in deferred taxes are allocated to profit and loss or other comprehensive income based on a reasonable prorata allocation.

Such a presentation could be misleading and drive entities to allocate systematically deferred tax assets and liabilities based on a prorata basis allocation, without exercising judgment and looking for a more appropriate allocation, if any.

We believe that these paragraphs do not illustrate the application of the principles of paragraph 63 of IAS 12 in an appropriate way, and we would recommend:

- Either to remove paragraphs IE41 to IE43;
- Or to change the wording of paragraph IE43 as follows : *“For such situations, entities allocate the changes in deferred taxes to profit or loss and other comprehensive income, as required by paragraph 63 of IAS 12”*.