AAT RESPONSE TO THE IASB EXPOSURE DRAFT RECOGNITION OF DEFERRED TAX ASSETS FOR UNREALISED LOSSES (PROPOSED AMENDMENTS TO IAS 12)

1 INTRODUCTION

1.1. AAT welcomes the opportunity to respond to the IASB Exposure Draft on "Recognition of Deferred Tax Assets for Unrealised Losses (Proposed amendments to IAS 12)" published in August 2014.

1.2. We have over 49,600 full and fellow members and 74,000 student and affiliate members worldwide. Of the full and fellow members, there are 4,000 Members in Practice (MIPs) who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.

1.3. AAT is a registered charity whose objects are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

1.4. In pursuance of those objects AAT provides a membership body. We are participating in this consultation not only on behalf of our membership but also from the wider public benefit.

1.5. AAT notes that IAS 12 addresses the accounting for income taxes, including deferred tax assets and that the amendments published today propose guidance that clarifies how to account for deferred tax assets related to debt instruments measured at fair value. Whereby, the draft amendments are proposed in response to diversity in practice and are relevant in circumstances in which the entity reports tax losses.

1.6. AAT would recommend that it would be helpful to users if IAS 12 included an executive summary which incorporates this clarification in the final document.

2 OVERVIEW

2.1 AAT recognises that this Exposure Draft comprises a clarification of the current IAS 12 as a result of differences of interpretation which have arisen in practice. As such, certain basic accounting principles in respect of the treatment of deferred tax assets for unrealised losses arising from decreases in the carrying amounts of fixed-rate debt instruments have already been established by IAS12. However, AAT would firstly comment on the basic principles as a background to the responses to the five questions which follow.

2.2 Where there is a fair valuation applied to a fixed-rate debt instrument which results in a temporary revaluation loss being reflected in financial statements, AAT accepts that it is appropriate to recognise the related deferred tax asset on the basis of applying matching principles in the treatment of the notional tax benefit attaching to the revaluation loss, but also considers that a prudent approach must be adopted in evaluating the amount of the deferred tax asset.

2.3 As a basic concept, AAT believes that the ED should clarify the requirement for differing accounting treatments of deferred tax assets which arise from revaluation losses which probably will not crystallise as compared to those relating to other revaluation losses. The latter should be subject to consideration in conjunction with and grouped with other deferred tax liabilities and assets while the former should be considered separately on the basis that the temporary decrease in the carrying amount of a debt instrument arises from the application of a fair value which it is probable will be reversed either on maturity or disposal, so as to reflect a timing difference in the amount of tax charges appearing in each accounting period's financial statements and does not represent an asset which is realisable and will not result in a tangible tax benefit at any time.

2.4 The unrealised loss should be considered in relation to the related debt instrument in isolation as regards the probability of the loss not crystallising in the future and should not be grouped with other debt instruments, and the related deferred tax asset should not be set against other deferred tax liabilities.

2.5 In taking a prudent and realistic approach, no deferred tax asset should be created if tax law would not recognise such a benefit if the loss were to be crystallised at the reporting date.

2.6 AAT's concerns are that the provisions of IAS 12 permit a deferred tax asset to be created on the basis of predictions of future taxable profits, future tax rates and an expectation of no future changes in tax legislation, for which purpose it is difficult for preparers of financial statements to take an objective or prudent view.

2.7 With regard to the format of the published amended IAS 12, as these amendments are intended to provide clarification of interpretation, AAT would suggest that it would be helpful to users if the final document includes an executive summary which incorporates this clarification.

3 RESPONSES TO QUESTIONS

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, i.e. by holding it to maturity, or whether it is probable that the issuer will pay all the contractual cash flows. Do you agree with the proposed amendment? Why or why not? If not, what alternative do you propose?

3.1 AAT agrees that decreases in the carrying amount of a fixed-rate debt instrument in which the principal is paid on maturity give rise to a deductible temporary difference if this debt instrument is measured at fair value and its tax base remains at cost, but, to take a prudent approach, the amount of the deductible temporary difference must be based on the loss which would be allowable by the tax authorities and usable if the debt instrument were to be realised at the fair value carrying amount at the reporting date.

3.2 The assessment of the allowable loss also requires a prediction of the future date of realisation, the likely amount to be realised and the availability of taxable profits for offset of the loss at that time, as well as a prediction of the future rate which will be relieved by the allowable crystallised losses. Consequently AAT believes that it is important to stress the need to take a prudent view with these predictions.

3.3 Where the debt instrument is expected to be fully recovered on maturity or realisation, there is a difficulty in determining the appropriate tax rate to be applied to unrealised losses and it is considered that the appropriate tax rate at the time of creation should be applied to the losses, representing the timing difference and subsequent releases of that asset should be at that same tax rate applied to the losses released in each accounting period. The creation of a deferred tax asset is only a representation of matching the amount of a tax benefit attaching to a revaluation loss were it to crystallise at the reporting date, but which in practice will be released over the life of the debt instrument as the related revaluation loss is released until it is fully eliminated.

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

3.4 AAT agrees that the proposed clarification of the extent to which an entity's estimate of future taxable profit includes amounts from recurring assets for more than their carrying amounts is desirable and is logical. For example, in this extreme situation where the anticipated profits are represented only by the surplus on realisation of the debt instrument, it is appropriate to match the release of a deferred tax asset against that surplus.

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?

3.5 Applying the same principles as set out in the response to question 2 above, AAT agrees with the proposed clarification that an entity's estimate of future taxable profits excludes tax deductions resulting from the reversal of deductible temporary differences.

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 (e.g. if it can deduct capital losses only against capital gains), the entity must still assess a deferred tax asset in combination

with other deferred tax assets, but only with deferred tax assets of the appropriate type.

Do you agree with the proposed amendment? Why or Why not? If not, what alternative do your propose?

3.6 AAT considers that the assessment of a deferred tax asset should be applied on an item by item basis initially and not automatically combined with other different tax assets.

3.7 Where the creation of a deferred tax asset in respect of unrealised losses arises in a situation where a loss is not expected to crystallise and consequently having no effect on actual tax payable at any time, and the rate of tax applied in the calculation of the deferred tax asset and therefore has no relevance to fiscal rates at any time, the nature of the asset is purely one of disclosing the tax benefits of a timing difference of revaluation losses spread over a number of accounting periods. Consequently, the nature of the asset is significantly different to deferred tax liabilities or other deferred tax assets, which are expected to have an impact on future fiscal tax payable, and so should not be combined with such in financial statements.

3.8 One of the benefits of accounting at fair values where unrealised losses arise is to reflect a prudent view of the relevant debt instruments even if it is probable that full cost value will be achieved on maturity or disposal and it is considered valid to also recognise the potential tax benefit attaching to that temporary loss in value.

3.9 There should be a requirement for the notes in financial statements to disclose details of deferred tax assets relating to unrealised losses on debt instruments should be disclosed separately in financial statements so as to be recognised as an asset which will probably not crystallise and the effective rate of tax applied to the unrealised losses should also be disclosed.

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 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?

3.10 In practice, it appears that, while the ED proposes amendments to the wording of IAS 12 in respect of the accounting treatment of deferred tax assets for unrealised losses, they are in the nature of clarification only. AAT considers that these amendments will not impose a burden on preparers of financial statements so that it is considered that there is no need for a transitional period and the revised IAS can be introduced on the earliest practicable date.

4 CONCLUSIONS/SUMMARY

These amendments are intended to provide clarification of interpretation. As previously mentioned, AAT would suggest that it would be helpful to users if IAS 12 included an executive summary which incorporates this clarification in the final document.

5. FURTHER ENGAGEMENT

If you have any questions or would like to consult further on this issue then please contact the AAT at:

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