AFRAC
AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

C/O KAMMER DER WIRTSCHAFTSTREUHÄNDER
SCHOENBRUNNER STRASSE 222–228/1/6
A-1120 VIENNA
AUSTRIA

TEL	+43 (1) 81173 228
FAX	+43 (1) 81173 100
E-MAIL	office@afrac.at
WEB	http://www.afrac.at

Mr Hans Hoogervorst, Chairman
International Accounting Standards Board (IASB)
30 Cannon Street
London EC4M 6XH
United Kingdom

16 December 2014

Dear Mr Hoogervorst,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on the Exposure Draft ED/2014/3 *Recognition of Deferred Tax Assets for Unrealised Losses*.

Principal authors of this comment letter were Josef Arminger, Eva Eberhartinger, Max Eibensteiner, Peter Geyer, Klaus Hirschler, Christian Höllerschmid, Monika Kals, Erich Kandler, Johannes Lahninger, Aslan Milla, and Otto Nowotny. In order to assure a balanced Austrian view on the ED, the professional background of these authors is diverse.

General remarks

Overall, we think the Board's proposed amendments to IAS 12 are useful: we think they will lead to less diversity in the practical application of fundamental principles of the standard. But we also think that most of the amendments are not necessary, because the issues are already adequately covered by the current version of IAS 12.

In particular, we appreciate the efforts made to clarify the meaning of the phrase "probable future taxable profit", as there have been different views on this issue in theory and in practice. However, the proposed amendments combined with the principles set out in IAS 12 could mean that the assessment of recoverability could result in different probable future taxable profits with respect to deductible temporary differences and to tax-losses carried forward. Our concerns are that the amendment only refers to the recoverability assessment of deductible temporary differences and not to the recoverability assessment of tax losses carried forward.

As we understand from the Annual Improvements Cycle 2010-2012, the purpose of the proposed amendments in the ED is to avoid double counting of deductible temporary differences from now on. We do not think, however, that amending the standard is essential, particularly because the amendment increases complexity in this area, and the double counting of deductible amounts has no economic substance to begin with.

Our specific remarks on the questions discussed in the ED are set out below.

SPECIFIC REMARKS

<u>Question 1—Existence of a deductible temporary difference</u>

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 instruments 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?

We agree with the Board's view.

We particularly agree with the Board's view in BC6 of the proposed ED, which states: "[…] decreases below cost in the carrying amount of a fixed-rate debt instrument for which principal is paid on maturity give rise to a deductible temporary difference if the debt instrument is measured at fair value and if its tax base remains at cost."

In general, we think that one core principle of IAS 12 is the determination of differences as at the balance sheet date. This is clearly explained in IAS 12.16 and IAS 12.25. The manner of recovery should only affect measurement of a deferred tax asset or liability as stated in IAS 12.51. We think that, based on these principles, it should be clear that the difference is a deductible temporary difference at the balance sheet date. Otherwise, to provide a consistent approach, every temporary difference would have to be assessed in the light of the expectation of recovery, and this is not what IAS 12 says.

Although some may have problems in identifying the economic benefit because the payment of the principal does not increase or decrease taxable profit, we also appreciate the Board's explanation that the economic benefit of the deferred tax asset resulting from this deductible temporary difference relates to the ability of the holder of the debt instrument to achieve future taxable gains in the amount of the deductible temporary difference without paying taxes on those gains.

We think that the example provided in the body of the proposed amended standard to explain IAS 12.26(d) is excessive: Example 7 of the proposed amendments to the illustrative computations and presentation section of the ED also covers all the aspects needed for clarification, so the example in the standard should be excluded.

<u>Question 2—Recovering an asset for more than its carrying amount</u>

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?

We agree.

We agree with the proposed amendment, as it is likely to reduce diversity in practice. We agree with the Board's view in BC12 of the ED that determining temporary differences and estimating probable future taxable profit against which deductible temporary differences are assessed for utilisation are two different steps.

Were recoverability to be limited by the carrying amount of assets, this would lead to inappropriate results, as entities would not be able to generate future taxable profits and therefore no deferred tax asset could be recognised. Limiting the attributable future taxable profit to the (IFRS) carrying amount is arbitrary and does not reflect the underlying economic reality.

Given the wording "probable future taxable profit", judgment will always be required in assessing the recoverability, so we are convinced that neither further guidance nor additional examples complementing the proposed amendment of IAS 12.29A will result in less diversity in practice.

<u>Question 3—Probable future taxable profit against which deductible temporary differences are assessed for utilisation</u>
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?

We appreciate the clarification effort but have some concerns.

Based on IAS 12.35, the criteria for recognising deferred tax assets arising from tax losses carried forward are the same as the criteria for recognising deferred tax assets arising from deductible temporary differences.

We think that especially the amended IAS 12.29(a) is difficult to understand in connection with IAS 12.34 and IAS 12.35, and that the assessment of recoverability of both a deductible temporary difference and a tax-loss carried forward could lead to different approaches.

We understand that in countries where utilisation of tax losses carried forward is not limited in time or as a percentage of taxable profit, the mechanics of adding back deductible temporary differences (as in the newly proposed IAS 12.29(a)(i)) and ignoring taxable amounts arising from deductible temporary differences that are expected to originate in future periods (as in the newly proposed IAS 12.29(a)(ii)) results in taxable income that represents the maximum amount that can be recognised as a deferred tax asset regardless of whether it is a deductible temporary difference or a tax-loss carried forward.

In countries such as Austria, where there is a limitation on the utilisation of tax losses carried forward (the utilisation is limited to 75% of taxable profits in each year), applying the steps mentioned under ED IAS 12.29(a) would lead to inappropriate results, as 100% of deductible temporary differences would be deducted from the relevant taxable income, while tax losses carried forward can only be utilised subject to the 75% limitation of taxable profits in each year. Some may therefore argue that the guidance provided in the newly proposed IAS 12.29(a) is not applicable in connection with the recoverability assessment of tax losses carried forward, and that in countries with utilisation limits on tax loss carryforwards a two-step approach would lead to more appropriate results.

The first criterion for the recognition of deferred tax assets resulting from deductible temporary differences, i.e., the assessment whether sufficient taxable profits will be available in future fiscal periods, is covered by IAS 12.29(a). A second, similar criterion for the recognition of deferred tax assets resulting from tax losses carried forward is provided by IAS 12.34, which states that a deferred tax asset shall be recognised for tax losses to the extent that it is probable that future taxable profit will be available against which the unused tax losses can be utilised.

As there is no further guidance concerning taxable profits and IAS 12.29(a) is not applicable, some may argue that the taxable profits are the ones defined under IAS 12.5, as these are the taxable profits that will be available for the future utilisation of tax losses carried forward. These taxable profits include the deductions resulting from the reversal of the deductible temporary differences expected to originate in future periods, together with the taxable amounts arising from deductible temporary differences. As a result, the two recognition criteria described above will result in different taxable profits.

For these reasons we encourage the Board to remove the proposed amendment of IAS 12.29(a), as it will increase complexity in several situations. We think that the standard in its current version is clear enough with respect to recoverability of deductible temporary differences and tax losses carried forward. We think that it is clear that double counting of deductible temporary differences has no economic substance, and that therefore "sufficient future taxable profit" in the current version of IAS 12.29, can only be understood as the taxable profit that is available for deduction of temporary differences that reverse in the same period.

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?

We agree with the Board's view.

Where certain types of losses can only be deducted from income of a specific type we fully agree with the Board´s view that this deductible amount should be assessed in combination with other similar deductible temporary differences. The rationale for the assessment of appropriate groups of deductible temporary differences is that only if aggregated will these differences result in deferred tax assets that reflect the economic benefits expected to be derived from deductible temporary differences. Thus, we do not think that it is necessary to amend the standard on that issue.

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?

We agree.

As explained above, we do not think that amendments for most of the questions addressed in the ED are necessary. If the Board nonetheless decides to amend IAS 12, we agree with the proposed application requirements.

Kind regards,

Romuald Bertl,

Chairman