European Securities and Markets Authority

The Chair

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Mr Hans Hoogervorst
International Accounting
Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Ref: The IASB's Exposure Draft *Recognition of Deferred Tax Assets for Unrealised Losses*: Proposed amendments to IAS 12

Dear Mr ~~Hoogervorst~~, Beste Hans,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to the IASB's due process regarding the Exposure Draft (ED) *Recognition of Deferred Tax Assets for Unrealised Losses*: Proposed amendments to IAS 12. We are pleased to provide you with the following comments with the aim of improving the enforceability of IFRSs and the transparency and decision usefulness of financial statements.

ESMA acknowledges the need for clarification and agrees with the proposals in the ED for the specific case of debt instruments measured at fair value. However, we have concerns regarding their potential broader application and in particular whether the amendment properly delimits the circumstances in which an asset can be recovered for more than its carrying amount. We are concerned that if the amendments are not limited to situations where an entity has both the contractual right and the intention to recover the asset for more than its carrying amount or fair value the proposals could generate unintended consequences.

Finally, ESMA suggests that the IASB undertakes a fundamental review of IAS 12 *Income Taxes* in a timely manner which could address broader issues resulting from its application.

Our detailed comments on the ED are set out in the Appendix I to this letter. Please do not hesitate to contact us should you wish to discuss all or any of the issues we have raised.

Yours sincerely,

Steven Maijoor
Chair
European Securities and Markets Authority

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Appendix I – ESMA's detailed answers to the questions in the ED

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?

1. ESMA agrees with the clarification that the decrease below the cost in the carrying amount of a debt instrument measured at fair value for which the principal is paid at maturity gives rise to a deductible temporary difference.

2. ESMA believes that the conclusion should be the same regardless of whether the fair value of the debt instrument is measured through profit or loss or through other comprehensive income. Although that conclusion could be implied from the draft amendments to Illustrative Examples to IAS 12, ESMA believes that such conclusion should be made explicit in the example that illustrates paragraph 26(d).

3. However, ESMA is concerned that the proposed drafting of paragraph 26 is ambiguous whether the example illustrating paragraph 26(d) relates only to the existence of the deductible temporary difference or it could also be used when estimating future taxable profits. Therefore, we suggest that the IASB clarify in the text of the standard that recognition of a deferred tax asset is a two-step process and that the example in paragraph 26(d) illustrates only the existence of the temporary deductible difference, whereas estimating future taxable profits is the necessary second step before deferred tax assets could be recognised.

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?

4. ESMA acknowledges the need to clarify the extent to which an entity's estimate of future taxable profit includes amounts from recovering assets for a value higher than their carrying amounts.

5. While ESMA agrees with the analysis that if the assessment of the recoverability of deferred tax assets was based only on the assumption that all assets are recovered for their carrying amount, entities could not estimate any future profit and, therefore, deferred tax assets could never be recognised, we have concerns how these arguments could be used in various circumstances. In particular, ESMA is of the view that the proposals are not sufficiently clear about the assessments that have to be made by entities when estimating future taxable profit against which deductible temporary differences are assessed for utilisation, notably in circumstances when probable future taxable profits are insufficient for utilisation of all deductible temporary differences. Consequently, ESMA believes that further clarification is required in paragraph 29A of IAS 12 for circumstances when probable future taxable profits are insufficient for utilisation of all deductible temporary differences.

6. Furthermore, ESMA believes that any clarification should be restricted to situations where an entity has both the contractual right and the intention to recover the asset for more than its carrying amount or its fair value. The example of the debt instrument proposed to illustrate paragraph 26(d) could be referred as an example of these circumstances.

7. In particular, ESMA is concerned that without such limitation to contractual relationship (or other specific circumstances when the deductible temporary difference mechanically reverses over time such as actuarial gains and losses), the proposed amendment could generate unintended consequences. In particular, ESMA questions whether or under which specific circumstances future taxable profits/losses resulting from the estimated sale of a fixed asset/property plant and equipment or an equity instrument in future periods could be considered.

8. Additionally, as deferred taxes are not discounted, recognition of deferred tax assets from future taxable profits resulting from the estimated sales could lead to recognition of deferred tax assets that are inconsistent with the underlying economic position.

9. Finally, ESMA suggests that the IASB undertakes a fundamental review of IAS 12 in a timely manner which could address broader issues resulting from its application.

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?

10. ESMA welcomes the proposed amendment as there is diversity in practice on how entities estimate future taxable profits against which deductible temporary differences are assessed for utilisation.

11. However, ESMA believes that the wording of the proposed paragraph 29(a)(i) is complex and difficult to read.

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?

12. ESMA agrees with the proposed paragraph 27A of IAS 12 as it clarifies how entities have to cluster deductible temporary differences when assessing their utilisation.

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?

13. ESMA disagrees with the limited retrospective application of the proposed amendments for entities already applying IFRS. ESMA believes that it is difficult to understand how to apply the option to restate the opening retained earnings or other components of equity of the earliest comparative period presented. This option also limits comparability of financial statements. Therefore, for the sake of clarity and comparability, ESMA proposes full retrospective application of the proposed amendments for entities already applying IFRS as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.