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

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Exposure Draft ED/2014/3 – Recognition of Deferred Tax Assets for Unrealised Losses

Polish Accounting Standards Committee (PASC) is pleased to respond to the invitation by the IASB to comment on the Exposure Draft, 'Recognition of Deferred Tax Assets for Unrealised Losses' (the 'Exposure Draft').

As discussed in detail in answers to specific questions, members of the PASC were not unanimous whether to support the proposals made by the IASB. This demonstrates that the complexity of remeasuring assets or liabilities through other comprehensive income and related tax effects causes additional difficulties in interpreting the principles of IFRS. We would therefore urge IASB to conclude the discussion around the purpose of other comprehensive income and its interrelation with income tax standard as a part of revised conceptual framework project.

We suggest that the proposed amendments are simplified to focus on whether a deductible temporary difference arises in connection with debt instruments measured at fair value and how the recoverability of the resulting deferred tax assets should be evaluated. The principles applied to address these questions should be explained briefly in IAS 12 and supported by adding a simple illustrative example and illustrative computation to IAS 12. Additional explanation where necessary may be included in the basis for conclusions.

Our detailed suggestions, including answers to the specific questions in the Exposure Draft are included in the appendices to this letter.

Yours faithfully,

Joanna Dadacz
Chairman of the Polish Accounting Standards Committee

e-mail: sekretarz.KSR@mf.gov.pl

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?

Some members of the PASC believe that an entity should not recognize a temporary difference and consequently a deferred tax asset when it holds a fixed-rate debt instrument which is measured at fair value and its carrying amount decreases whereas its tax base remains at historical cost. This should especially apply when:

a) **an entity plans to hold the instrument to its maturity**
b) **an entity expects to recover all the invested amount**
c) **no tax implications arise as the instrument is realised**

In the presented scenario the tax base of the asset equals its carrying amount (see example 5, § 7 IAS 12).

Temporary difference could arise if an entity expected a tax loss on sale / recovery of the instrument.

According to these members of the PASC the proposed amendment is not in line with the general principle of IAS 12 which states that deductible temporary arise when an entity can deduct actual tax losses against future taxable income.

Other members of the PASC agree with the principle confirmed by the proposed amendment that a deductible temporary differences arises when an asset or liability, including a debt instrument, is measured at fair value and its tax base exceeds carrying amount. They further suggest that the basis for conclusions should confirm that the same principle is applied to all deductible and temporary differences. The illustration in paragraph 26(d) is unnecessary and duplicates much of the proposed illustrative computation in paragraphs IE16 to IE24. The principle is clear from paragraph 26(d) and should be illustrated by adding a simple example to the illustrative examples of temporary differences in IAS 12.

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?

Recovering an asset for more than its purchase price or production cost is the essence of running a business and in that sense § 29A adds little which is new, especially given the fact that supporting examples present very straightforward scenarios. Existing § 27 of IAS 12 seems to already emphasize that an entity only recognizes deferred tax assets when there is/will be enough taxable profit, meaning ability to recover assets for more than their purchase price or production cost. The majority of the PASC members is of the opinion that it would be more sensible to point of some circumstances in which an entity estimating its future taxable profit cannot expect to recover more than carrying amounts of its assets. This happens when as per balance sheet date an investment property is revalued to fair value which is above the purchase price or when impairment of an asset takes place due to its destruction.

Some PASC members agree with the principle that the assessment of future taxable profit includes amounts from recovering assets for more than their carrying amounts and believe that this principle is clearly articulated in IAS 12 and is well understood. Paragraph 29A therefore creates unnecessary complexity. They suggest that this paragraph is deleted and that the principle is confirmed by adding a sentence to the basis for conclusions.

Question 3 – Probable future taxable profit against which deductible temporary differences are assessed for utilization
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?

Some PASC members accept the proposed amendment to § 29A, which excludes tax deductions resulting from the reversal of deductible temporary differences when estimating future taxable profit. It should however be emphasized that the proposed amendment has some far reaching consequences, going beyond measuring deferred tax assets for unutilized losses. For this reason we would request the IASB to analyze the proposal in this wider context. Given the complexity of estimating future taxable profit it seems reasonable to illustrate 29A with an example and computations.

Other PASC members also agree with the principle that the estimate of future taxable profit excludes tax deductions arising from the reversal of deductible temporary differences. They stressed that the consequence of including tax deductions resulting from the reversal of deductible temporary differences is to 'double count' the deduction and inappropriately reduce the estimate of future taxable profit. However, they believe that this is obvious from the existing guidance in IAS 12 and does not need to be stated specifically in a separate paragraph. This paragraph should be deleted and instead a simplified illustrative computation could be provided.

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 tax 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?

The amendment of § 27A states that the tax law can identify specific types (groups) of taxable profits or losses which need to be reported separately (for example capital gains/ losses). In that case within one specific tax type there may be taxable profit big enough to recognize deferred tax asset but only up to deductible temporary differences of this type. The tax loss simultaneously arising on another type of transactions should not entitle an entity to recognize deferred tax asset on this second type of transactions. This approach appears to be correct as an entity is effectively subject to two different corporate income taxes which are paid (or not) irrespective of each other and should therefore separately consider deferred tax asset recognition for the two types. On the other hand this would imply that unless the tax rules are strict about it, deductible temporary differences for unrealized gains (which we object to) are not to be assessed separately but together with other temporary differences leading to increase in future taxable profit and more deferred tax assets to be recognized (see question 3).

Other PASC members agree with the principle that deferred tax assets are assessed in combination with other deferred tax assets of an appropriate type, however, they suggest that the amendment might be simplified and that the detailed explanation in paragraph 27A is moved to the basis for conclusions.

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 accept the concept of limited retrospective application of the proposed amendments for entities applying IFRS. This should reduce the cost and effort necessary to implement the amendments.