Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

DRSC

DRSC e. V. • Zimmerstr. 30 • 10969 Berlin

78. Sitzung IFRS-FA am 24.10.2019
78_03b_IFRS-FA_ED IAS12_DRSC-SN an EFRAG

Jean-Paul Gauzès
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Berlin, 8 October 2019

Dear Jean-Paul,

EFRAG Draft Comment letter on IASB ED/2019/5 *Deferred Tax related to Assets and Liabilities arising from a Single Transaction – Proposed Amendments to IAS 12*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to contribute to EFRAG's Draft Comment Letter (herein referred to as 'DCL') on the IASB ED/2019/5 *Deferred Tax related to Assets and Liabilities arising from a Single Transaction – Proposed Amendments to IAS 12.* We appreciate the opportunity to comment on this DCL.

Our answers to the EFRAG's questions to constituents are laid out in the appendix 1 to this letter. Our detailed comments to the IASB on the questions raised in the ED are set out in the appendix 2.

If you would like to discuss our comments further, please do not hesitate to contact Olga Bultmann (bultmann@drsc.de) or me.

Yours sincerely,

Andreas Barckow
President

Appendix 1 – Answers to the EFRAG's questions to constituents

Question 1
EFRAG observes that the issue could have been addressed more simply on, for example, an IFRS Interpretation Committee Agenda Decision. This could avoid the complexity introduced by the ED. Do you agree with EFRAG that a simpler solution could have been developed?

We don't agree with the EFRAG's observation. We acknowledge that there is an accounting diversity with respect to the accounting for deferred taxes related to transactions that give rise to equal amounts of taxable and deductible temporary differences. We also confirm that this diversity becomes more prevalent under IFRS 16. Hence, we fully support the IASB's action to clarify this issue through narrow scope amendments to IAS 12. Otherwise, an entity would have to apply the initial recognition exemption in situations in which it is neither needed nor appropriate. As a result, the accounting outcome will remain to be not aligned with the general principles of IAS 12 in this case.

Question 2
If the IASB continues standard setting activity, do you agree with EFRAG's recommendation that the 'cap' should be removed?

We share EFRAG's concerns about the proposed requirements in para. 22A of the ED, which EFRAG sets out in paras. 21 to 23 of its DCL. For this reason, and without having a solution in mind, we recommend the IASB reconsidering the provisions of para. 22A.

Question 3
If you are not using a similar approach to that proposed in the ED, do you expect significant complexity in transitioning to the approach proposed in the ED?

We do not share the EFRAG's concerns about the complexity of the gross approach under which the unit of account is the separate asset and liability arising from the single transaction. From our experience, tracking the deferred tax assets and liabilities separately from each other is the most common method in accounting practice. Furthermore, the gross approach is consistent with the general principles of IAS 12.

Question 4
Do you have other concerns with the application of the proposed amendments?

Please refer to our comments to the IASB in the appendix 2, containing our detailed comments on the questions raised in the ED.

Appendix 2 – Answers to the question of the ED and related proposals

Question
Do you agree with the Board's proposal to amend IAS 12 in the manner described in the Exposure Draft? If not, why not, and what do you recommend instead?

We are aware of the diversity in practice with respect to the accounting for deferred taxes related to transactions that give rise to equal amounts of taxable and deductible temporary differences. We also confirm that this diversity becomes more prevalent under IFRS 16. Hence, we fully support the IASB's action to clarify this issue through narrow scope amendments to IAS 12.

Overall, we support the solution proposed by the IASB to require an entity to recognise deferred taxes for temporary differences that arise on the transactions that give rise to equal and offsetting amounts of taxable and deductible temporary differences on initial recognition. We fully agree with the Board's conclusion that the recognition exemption is not needed on initial recognition of an asset or a liability to the extent that an entity would recognise equal and offsetting amounts of deferred tax assets and liabilities related to this asset or liability. This is because an entity would typically offset these deferred tax assets and liabilities in the statement of financial position and therefore, would not be required to adjust the carrying amounts of the related asset or liability. Thus, we agree with the proposed solution to narrow the application of the recognition exemption so that it would not apply to the transactions addressed in the ED because it would reduce diversity in practice for such transactions. Further, we agree with the proposed transition requirements.

However, we don't think the way the Board suggests amending the standard is principle-based and preparer-friendly.

In addition, we have some concerns about the proposed requirements in para. 22A which we explain below.

<u>Ability to recognise deferred tax assets</u>

The proposed para. 22A(b) requires an entity to cap the deferred tax liability to the amount of the deferred tax asset arising from the same transaction on initial recognition. In other words, the amount of the recognised deferred tax asset determines the amount of the deferred tax liability arising from the same transaction.

- We think that this approach contradicts the general principle in IAS 12, according to which deferred tax liabilities in the balance sheet generally justify the recognition of deferred tax assets and not vice versa.

- We note that the proposed amendments are based on the gross approach that considers the unit of account being the separate asset and liability arising from the single transaction. Under this approach, an entity considers the asset and liability recognised in its statement of financial position at the contract independently of each other for the purposes of recognising deferred taxes. While we fully agree that the gross approach is consistent with the principles of IAS 12, we wonder whether the proposed linkage of the amount of the recognised deferred tax liability to the amount of the deferred tax asset from the same transaction according to para. 22A is consistent with the gross approach from a conceptual point of view. Further, we consider that the proposed linkage may be too complex from the preparers' point of view: On the one hand, an entity would have to separately track the reversal of the taxable and deductible temporary differences in subsequent periods. On the other hand, the entity would be required to assess the deferred tax liability together with the deferred tax asset for measurement purposes.
- As correctly stated in para. BC19, equal taxable and deductible temporary differences might result in an entity recognising unequal amounts of deferred tax assets and liabilities on initial recognition. However, we think the Board considers only one cause of this situation - the recoverability requirement according to para. 24 of IAS 12. If an entity does not meet the recoverability requirement and, therefore, does not recognise or partly recognises the deferred tax asset, the amount of the deferred tax asset would be lower than the amount of the deferred tax liability. Thus, applying the proposed para. 24A(b), an entity would cap the amount of the deferred tax liability to the amount of the recognised deferred tax asset. Other reasons for having unequal amounts of deferred tax assets and liabilities are, however, not addressed in the ED, for example, when tax rates are expected to change in the future. The amount of the deferred tax asset can even exceed the amount of the deferred tax liability. Therefore, we urge the Board to clarify in the main body of the standard how an entity shall apply the initial recognition exemption to any portion of the deferred tax liability that exceeds the deferred tax asset and vice versa regardless of the reason for that situation.

<u>Reassessment of unrecognised deferred tax assets</u>

Paras. BC25 and BC 26 of the ED explain the reasons why the proposed amendments do not address the reassessment of unrecognised deferred tax assets. While we agree with these explanations, we fail to see how an entity has to account for the portion of the deferred tax liability that it did not recognise applying the proposed requirement in para. 22A(b), if it subsequently reassesses the unrecognised deferred tax asset from the same transaction in accordance with para. 37 of IAS 12.

For these reasons, we recommend the Board to reconsider the provisions of para. 22A.