



## EFRAG DRAFT COMMENT LETTER ON IASB ED/2019/5 DEFERRED TAX RELATED TO ASSETS AND LIABILITIES ARISING FROM A SINGLE TRANSACTION

Issued 4 November 2019

ICAEW welcomes the opportunity to comment on the EFRAG draft comment letter to the IASB's ED/2019/5 *Deferred Tax related to Assets and Liabilities arising from a Single Transaction* published in September 2019, a copy of which is available from this [link](#).

We are currently in the process of finalising our response to the IASB's ED/2019/5 *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*. Although we are not yet able to confirm our final comments, we expect to outline concerns about how the proposals interact with the general principles of IFRS 16 *Leases* and IAS 12 *Income Taxes*, the introduction of further complexity, and the need for further guidance in order to avoid continued diversity in practice.

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## KEY POINTS

### TENTATIVE SUPPORT FOR IASB PROPOSALS, BUT FURTHER GUIDANCE NEEDED

1. We are currently in the process of finalising our response to the IASB's ED/2019/5 *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*. Although we are not yet able to confirm our final comments to the IASB, we expect to broadly agree that the proposal to narrow the scope of the initial recognition exemption (IRE) in IAS 12 *Income Taxes* has the potential to improve the information provided to users of financial statements and to improve comparability between companies. The objective of the IRE is to avoid a profit and loss impact on initial recognition of an asset or liability that arises solely from deferred tax. We understand that the proposed amendments aim to maintain that objective and we support that intention.
2. However, in our draft response, we also outline concerns about how the proposals interact with the general principles of IFRS 16 *Leases* and IAS 12. We also note that the proposals would introduce further complexity in relation to the accounting for leases, decommissioning obligations and deferred tax. We suggest that careful consideration should be given as to whether the expected benefits to users of the proposed amendments would outweigh the potential costs to preparers of applying the requirements, both initially and over time. We also believe that further guidance would be necessary in some areas in order to avoid continued diversity in practice.

### ANSWERS TO SPECIFIC QUESTIONS

#### **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?***

3. No. In our view, the complexity of the matter being addressed in ED/2019/5 is such that it would require standard setting activity. We do not believe it could be effectively addressed with a 'simpler solution', for example, as an IFRS Interpretation Committee Agenda Decision.
4. That said, in our draft response to the IASB we express concerns that the proposals would introduce further complexity in relation to the accounting for leases, decommissioning obligations and deferred tax. We recommend that careful consideration should be given as to whether the expected benefits to users of the proposed amendments would outweigh the potential costs to preparers of applying the requirements, both initially and over time.
5. We also suggest that should the IASB decide to proceed with the proposed amendments, further guidance would be necessary in a number of areas in order to avoid continued diversity in practice.

#### **Question 2**

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

6. In our draft response to the IASB we also raise concerns about the proposal to limit the deferred tax liability (ie, if the deferred tax asset recognised is less than the deferred tax liability, for example, because all/part of it isn't considered recoverable). In our view, this is at odds with the basic principle in IAS 12 that deferred tax liabilities are always recognised. It

also creates a further exception, in addition to the exception outlined in the exposure draft, which arguably creates further unhelpful complexity in IAS 12.

7. We also plan to highlight to the IASB that there is currently very limited guidance in the exposure draft around what happens on subsequent recognition of the deferred tax asset and liability. We believe this leaves some unanswered questions and may, without further guidance, result in continued diversity in practice.

### **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?***

8. In our draft response to the IASB we do not comment directly on the costs and complexity of transition. However, we do comment more generally on the need for additional guidance to support the implementation of the amendments. To give an example, in our draft response we note that BC5 of the exposure draft outlines how on initial recognition of a lease, an entity would need to assess whether temporary differences arise in order to determine whether to recognise deferred tax. To do this an entity must determine whether any tax deductions received on lease payments are attributable to either the lease asset (ie, because the deductions relate to the expenses arising from the lease) or to the lease liability (ie, because the deductions relate to the repayment of the lease liability and interest expense). BC6 states that 'an entity applies judgement in determining whether tax deductions relate to the lease asset or lease liability, having considered the applicable law.'
9. In our view, the decision over whether a tax deduction relates to the lease asset or lease liability will be a challenging area for preparers and further guidance is needed. We suggest that without further specific guidance or examples, preparers may find application of the proposals challenging and could result in continued diversity in practice, limiting the expected benefits of the amendments.

### **Question 4**

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

10. In addition to the points noted above, our draft response to the IASB questions the proposal that the amendments would not apply to any advance lease payments or the payment of initial direct costs.
11. In our view, the division of the leased asset into different components is not consistent with the principle in IFRS 16 *Leases* that considers the 'right of use asset' as one unit of account. It also means that entities would need to keep track of the separate components of the leased asset for the purpose of measuring deferred tax over time, which would introduce further complexity and additional work for entities.
12. In our draft we suggest that a better approach would be to require entities to focus on the liability aspect of the initial transaction ie, either the lease liability or the decommissioning obligation and the resulting corresponding asset ie, the right of use asset or decommissioning component of property, plant and equipment. This might be a more intuitive way of approaching this matter rather than splitting the right of use asset into component parts which, as noted above, is contrary to the principles of IFRS 16.