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Amendments to IAS 12 Deferred Tax related to Assets and Liabilities arising from a Single Transaction

We are pleased to have the opportunity to share our view on EFRAG's comment on the proposed amendment to IAS 12. From the point of view of a preparer of financial statements under IAS/IFRS, we welcome the amendment to IAS 12 proposed by IASB.

In our view, the initial recognition exemption laid out in IAS 12.22 (c) should be limited to cases where the recognition of deferred tax would distort the value of assets or liabilities and, hence, make financial statements less transparent. We agree with the argumentation of the board that this premise is not met in the case of initial recognition of assets and liabilities in the same amount. The resulting deferred tax would be equal and offsetting and, hence, would not result in a distortion of the value of the underlying assets and liabilities.

Applying the initial recognition exemption always has the drawback that, in subsequent periods, tax expense deviates from the expected value derived by multiplying accounting profit with the statutory tax rate. This requires explanatory line items in the income tax rate reconciliation. Such explanatory items are typically the result of permanent differences between taxable and accounting profit due to specific tax regulations. In the case of initial recognition of assets and liabilities in the same amount due to a lease or decommissioning obligation, there is not generally a substantial basis for such explanatory items. The reason is because in many countries income or expense related to leases or decommissioning obligations are not permanently tax-free or non-tax deductible, respectively. Hence, applying the initial recognition exemption to leases or decommissioning obligations would make financial statements, in particular tax expense in the income statement, less transparent.

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Preparers of financial statements typically calculate deferred tax not in a transactions-related way but rather by comparing closing balances of account positions in IFRS financial statements with local GAAP / tax accounts. This is particularly true for large companies and groups of several companies. In that case, it would be extremely difficult to identify in an asset account position those amounts that are related to lease transactions and are subject to the initial recognition exemption and to separate those amounts from other assets. Asset account positions such as property, plant and equipment would typically be viewed as an item where all differences to tax bases are temporary differences (taxable or deductible). Therefore, it would not be practical to apply the initial recognition exemption to leases. Instead, application of the initial exemption method should be as narrow as possible and limited to cases where its purpose is met.

We, therefore, support IASB's proposed amendment to IAS 12 to the extent that the application of the initial recognition exemption is narrowed. We view this merely as a clarification as it conforms to our practice in previous cases of similar nature. However, in our point of view, it would neither add transparency to financial statements nor would it be practical to be obliged to trace back particular deferred tax liabilities in cases where corresponding deferred tax assets could not be recognised. Additionally, the proposed recognition 'cap' for deferred tax liabilities would not be effective in practice as deferred tax liabilities generally allow the recognition of deferred tax assets in the same amount. Therefore, we agree with EFRAG's recommendation that the recognition 'cap' for a deferred tax liability set out in IAS 12.22 A (b) should be removed.

Yours sincerely
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