

Mr
Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
Großbritannien

Ref
F 2

Phone extension
5430

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**Recognition of Deferred Tax Assets for Unrealised Losses,
Proposed amendments to IAS 12 (Exposure Draft ED/2014/3)**

Dear Mr Hoogervorst

The German Insurance Association (GDV) welcomes the opportunity to comment on the Exposure Draft "Recognition of Deferred Tax Assets for Unrealised Losses, Proposed amendments to IAS 12" (ED/2014/3) as issued by the IASB on the 20 August 2014 for public consultation. We understand that the proposed amendments to IAS 12 "Income Taxes" are intended to provide clarity how to account for deferred tax assets related to debt instruments measured at fair value.

We are fully supportive of the efforts undertaken by the IASB to ensure a globally consistent application of requirements and principles of IAS 12 and hence to safeguard a level playing field. In general, we support the clarifications suggested in the ED as they are suitable to remove the existing unnecessary uncertainty with regard to the interpretation of IAS 12 in case of the unrealised losses on debt securities caused by temporary negative fair value movements. Especially, we strongly welcome the clarification with regard to the existence of a deductible temporary difference in such a case (i.e. example illustrating paragraph 26(d) of IAS 12).

However, we doubt if the proposed Illustrative Example 7 is really necessary in the suggested extensive length and if it effectively provides the intended clarity. At least, the Illustrative Example 7 as drafted is not complete. In particular, it does not demonstrate in an explicit manner that in the final consequence the outcome of the ED for the debt securities measured at fair value through other comprehensive income would be by a significantly constrained recognition of the corresponding deferred tax asset positions. We recommend removing the Illustrative Example 7.

**Gesamtverband der Deutschen
Versicherungswirtschaft e. V.**

German Insurance Association

Wilhelmstraße 43 / 43 G, D-10117 Berlin
Phone: +49 30 2020-5000
Fax: +49 30 2020-6000

51, rue Montoyer
B - 1000 Brussels
Phone: +32 2 28247-30
Fax: +32 2 28247-39
ID-Nummer 6437280268-55

E-Mail: h.saeglitz@gdv.de

www.gdv.de

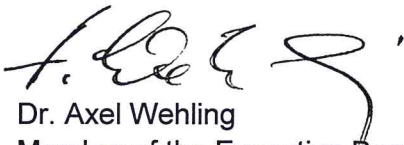


Alternatively we suggest amending it to provide greater clarity about the outcome of the suggested "clarification".

As a conclusion, we believe that the preliminary decisions taken by the IASB for the ED are only partly addressing the essential concerns raised by insurance industry in the past with regard to the recognition of deferred tax assets on debt securities being accounting at fair value through other comprehensive income. We refer to the previous GDV's response from the 10 September 2012 to the Exposure Draft ED/2012/1 "Annual Improvements to IFRSs 2010-2012 Cycle".

For our comments and our rationale in more detail we kindly refer to our responses to specific questions in the annex. If you would like to discuss our comments further, we would be delighted.

With best regards



Dr. Axel Wehling
Member of the Executive Board
German Insurance Association



Hans-Juergen Saeglitz
Head of Accounting
German Insurance Association

Annex

General remarks

We believe that the conclusions taken by the IASB in the ED are a step in the right direction. However, they are only partly addressing the essential concerns raised by insurance industry in the past with regard to the recognition of deferred tax assets on debt securities being accounting at fair value through other comprehensive income. In particular, we continue to question the need for precondition of probable future taxable profit in case of FVOCI securities held by insurers as the fair value changes due to fluctuations of market interest rates in general reverse over time without affecting profit or loss and also the related changes in an amount of deferred tax assets recognised are presented in other comprehensive income only.

In case of disposal effects on profit or loss would occur, but then the existing special regime for deferred tax asset on unused tax losses would provide a sufficient safeguard to prevent recognition of deferred tax assets when considered inappropriate. A substantially constrained recognition of deferred tax positions in case of debt instruments measured at fair value will cause increased volatility in equity and also significant distortion in performance reporting. That's why we continue to believe that a full recognition of deferred tax assets on unrealised losses on debt instruments measured at fair value is conceptually more appropriate.

For our rationale in detail we refer to our additional comments in our response to Question 4. We also refer to the previous GDV's response from the 10 September 2012 to the Exposure Draft ED/2012/1 "Annual Improvements to IFRSs 2010-2012 Cycle".

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?

Yes. We fully support the suggested clarification that a deductible temporary difference exists in cases described here, irrespective of the holder's intention. We strongly believe that the proposed amendment is appropriate and the suggested confirmation necessary, especially in case of debt instruments (e.g. bonds) which are held until maturity and measured at fair value with fair value changes caused mainly by market interest rate changes and presented in other comprehensive income. Hence we are fully supportive of the proposed example illustrating paragraph 26(d) of IAS 12.

Nevertheless, we believe that the wording of the suggested amendment needs to be further improved as we have the strong impression that the suggested example mostly refers to the classification approach of the IAS 39. We recommend that the example should also consider the application of IFRS 9 and should make explicitly clear that it also applies irrespective whether the fair value changes are presented in other comprehensive income (FVOCI category) or in profit or loss (FVPL category).

In addition, the ED at large seems to be mostly oriented on the use of IAS 39. We recommend adjusting the wording of the proposed amendments to be also consistently aligned with the business model oriented classification approach of recently published IFRS 9.

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?

We support the proposed amendment as we agree with the underlying rationale for it.

Nevertheless, we believe the most significant case for the issue under consideration would be the decrease in the fair value due to the increase in interest rates and not due to the uncertainty about where or not all contractual cash flows will be received. Therefore, we suggest removing the example/sentence referring to the instrument measured at amortised cost (i.e. last sentence of paragraph 29A) as inappropriate with regard to the objective of the suggested amendment and, in addition, as not in line with the ED in general which is to deal with debt instruments measured at fair value (both through profit or loss or through other comprehensive income).

Furthermore, we are not sure how the reference to 'impairment' in the next-to-last sentence of paragraph 29A relates to the application of IFRS 9. IFRS 9 requires recognition of expected credit losses (as a 12-month or full (remaining) lifetime consideration) and does not refer to classical 'impairment' on incurred losses bases. We have the strong view, that in general the recognition of loss allowances for expected credit losses in accordance with requirements of IFRS 9 for FVOCI securities does not automatically exclude the assumption that the financial asset can be recovered for more than its carrying amount. Therefore, to avoid confusion we also recommend removing the next-to-last sentence of paragraph 29A. Alternatively, we urge an appropriate clarification with regard to the relevance of the recognition of loss allowances for expected credit losses. Otherwise, we would be concerned that the unintended situation might occur that outdated impairment trigger events of IAS 39 might be interpreted and required to be used as implicitly required for application of IAS 12.

For all these reasons noted above and also taking into account our response to Question 1 we recommend that a thorough review of the proposed amendments to IAS 12 should be undertaken with the objective to carefully verify their full consistency with the application of IFRS 9 as issued by the IASB on the 24 July 2014.

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?

We agree with the proposed amendment in paragraph 29(a) (i) of IAS 12 as suggested by the IASB.

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?

Although we agree with the rationale for the suggested amendment (as outlined in the second sentence of Question 4), we do not believe that this extensive clarification as proposed for the new paragraph 27A of IAS 12 is necessary.

From our point of view, the suggested amendment is clarifying the matter of fact that potentially different tax treatment of capital losses (gains) and e.g. operating expenses (income) needs to be taken into account when calculating deferred tax positions.

Should the explicit clarification however be considered by the Board as absolutely indispensable, we would recommend extending the existing paragraph 27 of IAS 12 by a sentence that the potentially different treatment of different sources of taxable profit by particular tax law must be appropriately considered instead of including the new paragraph 27A.

Additional comments: another level of separate assessment necessary

We refer to our general concerns as expressed in the cover note with regard to the danger of an **inappropriately limited recognition of deferred tax assets** when treated as implicitly suggested by the “clarifying” Illustrative Example 7 of the ED. We continue to believe that a separate regime should be explicitly acknowledged by the IASB to safeguard a more suitable treatment of deferred tax positions **on unrealised losses on debt instruments measured at fair value** (for both the FVPL category and FVOCI category). In this respect the Illustrative Example 7 is not reflecting the objective we are arguing for as it applies the general rules of IAS 12 for deferred tax assets without taking into consideration the specific characteristics of debt instruments, especially when held until maturity. A potentially substantially constrained recognition of deferred tax positions in case of debt instruments measured at fair value is conceptually not appropriate; it will cause increased volatility in equity and also lead to a significant distortion in performance reporting. For example, in the Illustrative Example 7 in the ED about 41,05% of the potential deferred tax asset is prohibited to be recognised. We continue to believe that a **full recognition would be conceptually more appropriate** and a better reflection of the underlying economics. In particular, we disagree with the precondition of the need for assessment of probable future taxable profit in case of FVOCI securities. That’s why a clarification regarding the separate assessment in case of debt instruments measured at fair value is necessary.

To avoid any potential misunderstanding regarding our view: In the case of disposal of debt instruments effects on profit or loss would obviously occur, but then the especially defined regime for deferred tax asset on unused tax losses (IAS 12, paragraph 34) would provide a sufficient safeguard to prevent recognition of deferred tax assets when considered inappropriate. We believe that this internal interaction of rules of IAS 12 has not been sufficiently considered in the discussion so far.

Finally, we also note that the similar issue (i.e. regarding the appropriate recognition of deferred tax asset position on deductible temporary differences) will need to be solved for the final standard for insurance contracts which will provide the accounting policy choice for presentation of effects of discount rate changes which reverse fully over time in other comprehensive income. Hence a proper conceptual approach for deferred tax assets in relation to the use of other comprehensive income for changes which reverses over time appears to be necessary. A combined assessment and application of general rules of IAS 12 also does not seem to provide the appropriate outcome in this case: an only limited recognition of deferred tax position does not seem to be convincing in such cases.

Our conclusion:

We acknowledge that the proposed amendments might be seen as in line with the existing wording of IAS 12. However, for all the reasons above we believe that the recognition of deferred tax assets on debt instruments measured at fair value might require a more general revision than foreseen for the scope of the ED/2014/3. We believe that the recognition of deferred tax assets in case of FVOCI securities should be reconsidered in a more principle-based way, especially after the insurance contracts project (IFRS 4 Phase II) has become finalised and its interconnections with e.g. IFRS 9 clearer.

Therefore, we believe that at this stage it should be at least ensured that the proposed Illustrative Example 7 is not contradicting the conceptually superior outcome as explained above. We recommend delating it. In our view the amendment introducing the example illustrating paragraph 26(d) of IAS 12 (Question 1) is adequate and enough.

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 appreciate that the full retrospective application should be allowed but not required by the final amendment to IAS 12.

We believe however that further clarification should be provided with regard to the intended relief via the difference between the suggested “limited retrospective application” and a full retrospective application of the proposed amendments to IAS 12 for entities already applying IFRS.