# ESMA ISSUES PUBLIC STATEMENT ON THE RECOGNITION OF DEFERRED TAX ASSETS ARISING FROM THE CARRY-FORWARD OF UNUSED TAX LOSSES

## INTERNATIONAL FINANCIAL REPORTING BULLETIN

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# BACKGROUND

**STATUS**
Final

**EFFECTIVE DATE**
Immediate

**ACCOUNTING IMPACT**
Additional expectations concerning the recognition of deferred tax assets that arise from unused tax loss carry-forwards.

IAS 12, Income Taxes establishes criteria that must be satisfied in order for unused tax credits, tax losses and deductible temporary differences to be recognised as deferred tax assets ('DTAs'). The requirements and guidance are primarily contained within IAS 12.34-36, which established:

1. The probability requirements for determining whether future taxable profits are sufficiently likely to conclude that unused tax losses and tax credits may be recognised as DTAs, along with accompanying criteria (IAS 12.34, 36); and
2. What 'convincing other evidence' may be required to support an assertion that sufficient taxable profits will be available to utilise unused tax losses and tax credits in situations where the reporting entity has had a history of recent losses.

ESMA and European enforcement agencies have discussed issues relating to these two aspects of IAS 12 at European Enforcers Coordination Sessions ('EECS'). Several situations were noted where enforcers identified that material DTAs were recognised when significant doubt existed as to whether the applicable recognition criteria in IAS 12 were satisfied.

ESMA has issued a public statement articulating their concerns on this issue, which can be viewed here.

# PROBABILITY CRITERIA FOR RECOGNITION OF DTAs

The concerns expressed by ESMA regarding the two aspects of IAS 12's recognition guidance for DTAs noted above can be summarised as follows:

| Probability Requirements (IAS 12.34, 36) | 'Convincing other evidence' (IAS 12.35) |
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| ESMA's view is that 'probable' indicates a 'more likely than not' (i.e. >50%) threshold for recognition; | Recent losses are objectively verifiable negative evidence against the recognition of DTAs, therefore, evidence in favour of their recognition must be objectively verifiable as well; |
| Positive evidence must outweigh negative evidence for DTAs to be recognised; | Forecasts of future profitability depend on the nature of the entity's operations (e.g. long-term, in-place construction contracts provide stronger evidence than uncommitted, future sales); |
| The longer the estimation or forecast period required to support the recognition of DTAs, the less reliable the forecast is; | Reliance should not be placed on future events the entity cannot control and are highly uncertain (e.g. future market conditions, business combinations or changes in tax laws/rates other than changes that are already enacted or substantively enacted); |
| If sufficient taxable temporary differences do not exist to utilise the tax losses, 'convincing other evidence' must exist (see other section of this table); | Underlying assumptions used should be consistent with other forecasts or projections (e.g. those used in a goodwill impairment test); |
| Tax losses not having a set expiry date or a date that is very long-term in nature is not sufficient to justify the recognition of DTAs; | The risk/uncertainty inherent in the future should be reflected in the forecasts (i.e. if there is more than insignificant probability of an event occurring, that should be factored into how it is weighted in the analysis); and |

| Probability Requirements (IAS 12.34, 36) | 'Convincing other evidence' (IAS 12.35) |
|---|---|
| Management assessing that an entity will be able to continue as a going concern is not sufficient to justify the recognition of DTAs; | When tax-planning opportunities are considered (IAS 12.29(b)), entities must consider the expected incremental deductible costs that will be incurred to affect such strategies (e.g. transaction costs). |
| Positive evidence supporting the recognition of DTAs include: losses occurring due to abnormal/non-recurring events, strong recent history of earnings exclusive of the loss that created the tax loss carried forward (provided the loss is not expected to recur), new business opportunities, restructuring of unprofitable business segments, convincing tax planning strategies, sales backlogs or new contracts, and acquisitions of profitable businesses that will be able to utilise tax losses; and | |
| Negative evidence against the recognition of DTAs include: recent history of losses, the entity being a start-up with little objective business history, history of variances from budgets/plans, losses of major customers and/or significant contracts, going concern uncertainty, past failed restructurings, further losses expected in the near future, history of losses expiring unutilised, and the losses relating to the core activities of the entity (i.e. they are more likely to recur). | |

## DISCLOSURE

ESMA also emphasised the disclosure requirements surrounding the recognition of DTAs, where the extent of such disclosures would be expected to increase as the materiality of the DTAs and the level of uncertainty relating to their recognition increases. Such disclosures might include information about the taxable entity, the applicable tax rules (e.g. the expiry period), the evidence considered (both positive and negative) when evaluating the recognition of DTAs, the period or periods over which they are expected to be used, the critical assumptions and judgments (and related uncertainties) involved, a sensitivity analysis on assumptions (if relevant) and whether there are significant unrecognised DTAs.

## CONCLUSION

ESMA and national authorities will continue to monitor the recognition of DTAs in future examinations.

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