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COVID-19 | Will taxable profits be available to recover deferred tax assets?

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Fred Versteeg
Partner, Department of Professional Practice
KPMG in the Netherlands

COVID-19 may impact projections of future taxable profits that are used to assess the recoverability of deferred tax assets.

What's the issue?

As the COVID-19 coronavirus continues to spread around the world, many companies face unprecedented challenges, which may adversely impact their operations. To help them, many governments are introducing specific measures. Both the current challenges and the government's measures may affect a company's projections of future taxable profits.

Companies need to consider the effect of any changes to the projections and probability of future taxable profits on the recognition of deferred tax assets under IFRS® Standards.

Getting into more detail

Under IAS 12 *Income Taxes*, a deferred tax asset is recognised for deductible temporary differences and unused tax losses (tax credits) carried forward, to the extent that it is probable that future taxable profits will be available. *[IAS 12.24, 34]*

The amount of future taxable profits to be used when assessing the recoverability of a deferred tax asset is not the bottom line of a company's tax return. To determine whether future taxable profits will be available, a company first considers the availability of qualifying taxable temporary differences, and then the probability of other future taxable profits and tax planning opportunities. In other words, if a company is loss-making, it can still recognise a deferred tax asset if it has sufficient qualifying taxable temporary differences to meet the recognition test. *[IAS 12.28–29, IU 05-14]*

In the current circumstances, a company's projections of future taxable profits may be affected by:

- changes in forecast cash flows – e.g. expected decrease in production or sales prices vs increase in costs;
- changes in a company's tax strategies;
- substantively enacted changes to the income tax law introduced as part of a government's measures in response to COVID-19 – e.g. tax reliefs for certain types of income, additional tax deductions, a reduced tax rate or an extended period to use tax losses carried forward; and
- changes in a company's plans to repatriate or distribute profits of a subsidiary that may result in the recognition of a deferred tax liability (i.e. additional taxable temporary differences).

Some of these changes may reduce future taxable profits, while others may potentially increase them. In addition, some of the changes – e.g. government's measures in response to COVID-19 – may impact the timing of the reversal of temporary differences.

When preparing projections of future taxable profits for the purposes of the deferred tax asset recognition test, a company needs to reflect expectations at the reporting date and use assumptions that are consistent with those used for other recoverability assessments – e.g. **impairment of non-financial assets**.

If the recognition threshold is met, then the company recognises a deferred tax asset and measures it using the tax rate expected to apply when the underlying asset is recovered based on rates that are enacted or substantively enacted at the reporting date (similar to deferred tax liabilities and current tax). *[IAS 12.47, 51]*

Actions for management to take now

- Monitor government actions and consider whether any income tax relief is available.
- Determine whether there is a substantively enacted change in the income tax law; if there is, then it may impact the recognition and measurement of deferred tax assets.
- Establish whether there is an intention to repatriate or distribute a subsidiary's profits, because this would trigger recognition of a deferred tax liability.
- Consider how the current economic conditions could affect the company's tax strategies and plans.
- Consider whether there is any uncertainty about income tax treatments.
- Update projections for the reversal of taxable temporary differences and for other future taxable profits, ensuring that the assumptions are consistent with those used for other recoverability assessments.
- Provide clear and transparent disclosure about judgements and estimates made in recognising and measuring deferred tax assets.

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