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THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

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The proposal that deferred tax reporting should start from recognition of the 'temporary differences' between the tax basis and the accounting basis for assets and liabilities is sensible. The ED is correspondingly correct that:

28 An entity shall not discount deferred tax assets and liabilities. However, this does not affect the determination of temporary differences, which are calculated by reference to a carrying amount even when the carrying amount is determined on a discounted basis.

However, it is not clear why the 'even when' is necessary. A clearer and more general formulation would be:

28* An entity shall not discount deferred tax assets and liabilities. As temporary differences are calculated by reference to a carrying amount, and the carrying amount of a related asset should not be greater than its recoverable amount, the carrying amount will where appropriate have been determined on a discounted basis so that the corresponding deferred tax liability already reflects the underlying discounting in the valuation of the asset (and similarly for liabilities, *mutatis mutandis*).

There has been much confusion in the literature over 'discounting' of deferred tax. A formulation more like 28* would make clear that, for example in the case of unfunded pension liabilities and life insurance liabilities, the related deferred tax assets are the relevant proportion (i.e. as determined by the effective tax rate) of those discounted liabilities. This logically consistent approach was clearly set out 30 years ago in Watson, P.L (1979), 'Accounting for Deferred Tax on Depreciable Assets', *Accounting and Business Research*, Autumn 1979, pp.338-347, and is consistent with the 'deprival value' arguments set out in the relevant chapter of Baxter, W.T. (1971) *Depreciation*, London: Sweet & Maxwell.

This clarification in the IASB's standard is long overdue. However I agree with the UK's ASB that it is not helped by the ED's proposal that the tax basis of the underlying asset or liability should be determined on the basis of hypothetical immediate sale or settlement at the reporting date, which will not generally be relevant for long-lived assets and liabilities.

{electronically signed}
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