Thematic Review:

Deferred tax assets

September 2022

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1. Executive summary

Introduction

The Covid-19 pandemic has caused many companies to report losses or reduced profits. Losses have often been accompanied by increased recognition of material deferred tax assets.

This has prompted us to revisit the topic of deferred tax asset accounting and disclosure in a thematic review. This review updates the findings on tax disclosures discussed in our October 2016 Corporate Reporting Thematic Review: Tax disclosures ('the 2016 review'). We summarise the findings of the 2016 review, and comment on their continued relevance, in Appendix B.

For a selection of 20 companies, we considered the basis of recognition of deferred tax and the related disclosures under IAS 12, 'Income Taxes'. We also assessed whether the evidence supporting the recognition of deferred tax assets for losses appeared to be sufficiently robust, and consistent with the annual report and accounts as a whole.

In addition to the specific requirements of IAS 12, we considered the guidance set out in the public statement: 'Considerations on recognition of deferred tax assets arising from the carry-forward of unused tax losses', issued in July 2019 by the European Securities and Markets Authority ('the ESMA public statement'). It is our view that this represents best practice, and it is consistent with our expectations. It highlights the need to assess thoroughly the nature and extent of evidence supporting the recognition of a deferred tax asset and, whenever relevant, provide high-quality disclosures.

The opportunities for improvement and better practices are identified in this report as follows:

Represents good quality application that we encourage other companies to consider when preparing their annual reports.

Represents opportunities for improvement by companies to move them towards good practice.

Represents an omission of required disclosure or other issue. We want companies to avoid such issues in their annual reports.

1. Executive summary (continued)

Summary of key observations

We did not identify any obvious issues in relation to the amount of deferred tax recognised, although in some cases it was more difficult to make a full assessment due to the lack of informative disclosure. However, we found two instances where it was not clear why deferred tax assets had not been recognised to the extent of deferred tax liabilities in the same tax jurisdiction and taxable entity.

We found several instances of good practice across most individual aspects of disclosure. We also identified some clear opportunities for improvement in a number of areas. Our principal findings in relation to disclosure were:

Specificity of convincing evidence

- Most loss-making companies gave only boilerplate disclosures about the nature of evidence used to assess the recoverability of net deferred tax assets.
- Better disclosures referred either to specific improvements in profitability expected to occur in the forecast period, or to the loss having been the result of a one-off event.

Judgements and estimates

- We found minimal disclosure of the specific nature of key judgements, and major sources of estimation uncertainty, in relation to deferred tax assets.
- Very few companies disclosed sensitivities to changes in assumptions or the range of possible outcomes within the next financial year.
- A small number of companies specifically disclosed that the potential effect of climate change on the recoverability of deferred tax assets had been considered.

Transparency

- We identified some good examples of informative, transparent tax disclosures, reflecting the requirements of IAS 12 as well as the expectations set out in the ESMA public statement and our 2016 review. Examples included: disclosure of the expected period of recovery of deferred tax assets, and geographical analysis of tax disclosures.
- However, a few companies omitted disclosures required by IAS 12 or disclosed material deferred tax balances, or movements in balances, that were not explained in the accounts.

Consistency

- The underlying assumptions used in companies' estimates of future taxable profit should be consistent with their impairment, viability and going concern forecasts (subject to some specific differences). Some companies noted that this was the case, and we did not identify inconsistencies in assumptions when they did not.
- In a limited number of cases, we identified inconsistencies between the disclosures in relation to deferred tax and other tax disclosures and/or the narrative tax disclosures included in the strategic report.

2. Review scope and selection

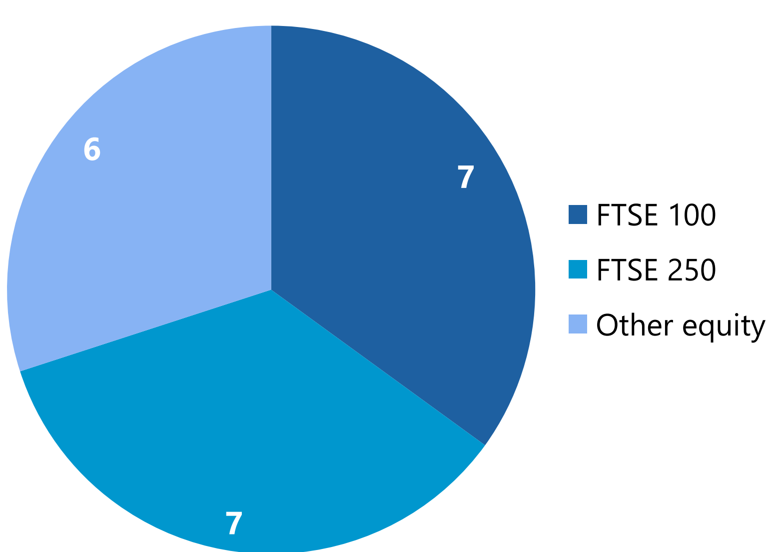
We conducted a limited scope desktop review of the annual reports and accounts of a selection of 20 companies from a cross-section of industries. Period-ends ranged from 31 December 2021 to 2 April 2022. The companies were selected from across the FTSE 100, FTSE 250, and others listed on the Main Market of the London Stock Exchange. No companies were pre-informed of our review.

We selected companies that met at least one of the following criteria:

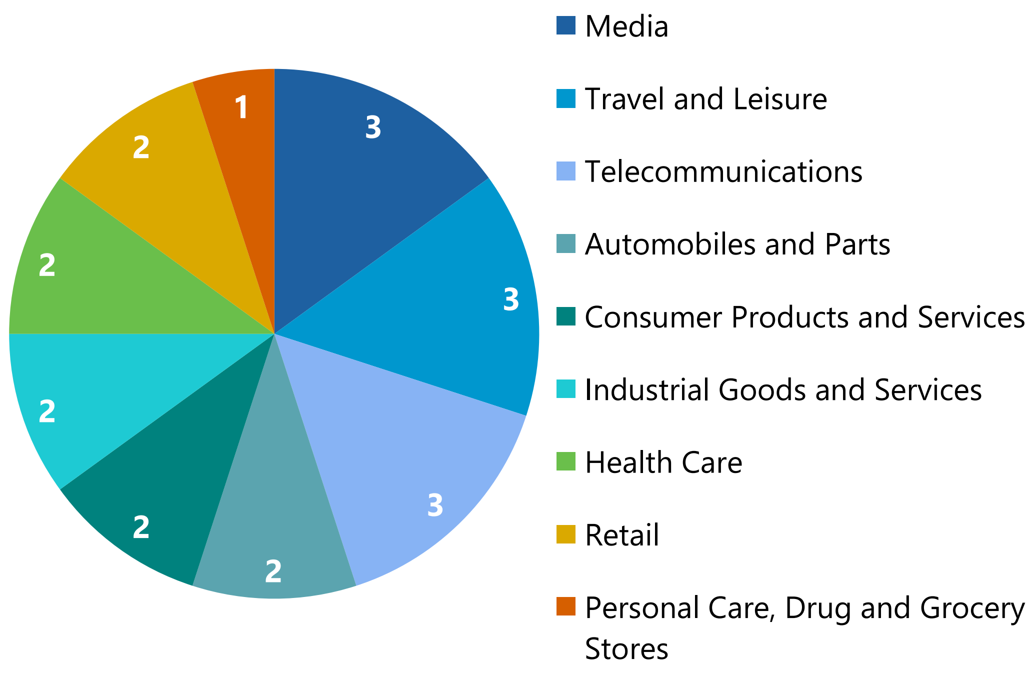
- operate in an industry sector particularly affected by the pandemic;
- disclosed material losses in the current or prior reporting period; or
- disclosed material recognised or unrecognised deferred tax assets.

Our report includes extracts from certain annual reports and accounts included in our selection, and others identified during our routine monitoring. The examples will not be relevant for all companies or all circumstances, but each demonstrates a characteristic of better disclosure. Inclusion of a company's disclosure should not be seen as an evaluation of that company's annual report and accounts as a whole.

Selection by equity market (number of reports)



Industries selected (number of reports)



3. Recognition of deferred tax assets

All of the companies within our selection reported a material deferred tax asset, either on a gross basis or offset against an overall deferred tax liability. In most cases, the deferred tax assets included a material amount relating to trading or capital losses.

Threshold for recognition

Deferred tax assets are required[1] to be recognised to the extent that it is probable (i.e. more likely than not)[2] that sufficient future taxable profit will be available against which the deductible temporary difference or unused tax losses or credits can be recovered or utilised.

In contrast to the requirements of IAS 37, 'Provisions, Contingent Liabilities and Contingent Assets', recognition is not dependent on recovery of the deferred tax asset being virtually certain.

Availability of future taxable profits

In assessing the availability of future taxable profits, companies should consider all available evidence, both negative and positive.[3] Forecasts used for this purpose should be reasonable, realistic and achievable.

Examples of positive and negative evidence relevant to assessing the probability that future taxable profits will be available are set out in Appendix A.

Consistency with going concern conclusions

The conclusion that a company is a going concern does not, in itself, justify recognising a deferred tax asset.[4] Recoverability should always be assessed by reference to forecast taxable profits. Hence, if material uncertainties exist that may cast doubt on the ability of the company to continue as a going concern, the recognition of deferred tax assets based on that forecast should be analysed with heightened scepticism.

Two companies within our selection disclosed the existence of a material uncertainty related to going concern.

One of these companies had not recognised a deferred tax asset in excess of its deferred tax liabilities. The other disclosed the recognition of deferred tax assets as a major source of estimation uncertainty (see section 6 below) and stated that the existence of losses as a result of the effect of Covid-19 resulted in greater uncertainty over the recognition of deferred tax assets.

We consider the consistency between forecasts used for deferred tax and going concern purposes in the following section.

1 IAS 12 paragraphs 24, 27 to 31, and 34 to 36
2 ESMA public statement, paragraph 8
3 ESMA public statement, paragraph 9
4 ESMA public statement, paragraph 13

3. Recognition of deferred tax assets (continued)

Consistency with other forecasts

Forecasts of future taxable profit should use the same underlying assumptions as the company's forecasts of future cash flows used for impairment,[5] going concern and longer-term viability assessment purposes. However, some differences[6] are expected, for example:

- Cash-generating units for IAS 36 impairment purposes may not correspond with taxable companies for IAS 12 purposes;
- Pre-tax cash flows used for IAS 36 may not be the same as taxable profits, as the cash flows will exclude, for example, finance costs;
- While companies should not anticipate or consider highly uncertain[7] future events outside their control when forecasting taxable profit, IAS 12[8] permits the consideration of tax planning opportunities. It may therefore be possible to reflect the benefit of future restructuring plans for IAS 12 purposes that would not be reflected in corresponding IAS 36 value in use forecasts;[9]
- The future cash flows used for impairment purposes are required to be discounted. Discounting is not permitted under IAS 12, although the risk/uncertainty inherent in future events should be reflected in the expected future taxable profits.

Within our selection, we did not identify any apparent inconsistencies between the assumptions underlying the forecasts used for deferred tax asset recognition purposes and those used for impairment, going concern and longer-term viability assessment purposes.

Better disclosures stated helpfully that the assumptions used, and scenarios considered, were consistent with other financial statement forecasts.

5 Under IAS 36, 'Impairment of Assets'
6 ESMA public statement, paragraphs 19, 20
7 ESMA public statement, paragraphs 18, 22
8 IAS 12, paragraphs 29(b), 36(d)
9 IAS 36, paragraph 44

3. Recognition of deferred tax assets (continued)

Period of assessment

There is no prescribed limit to the period of the profit forecast, which should reflect the company's specific circumstances. However, the reliability of forecasts decreases the further into the future they extend. Therefore, companies should exercise caution when the assessment period for deferred tax asset recognition purposes exceeds their normal planning cycle.[10]

Although tax losses with no expiry date may be more likely to be offset by future profits, they alone do not provide evidence that 'sufficient taxable profits are probable'.[11] When tax losses have short expiration periods, the recoverability of deferred tax assets should be subject to a more critical review as there will be less time to generate sufficient profits in order to use the available tax losses.

Our review indicated that the period of assessment of recoverability of deferred tax assets was often longer than the period covered by the company's viability statement. However, it was rare for companies to explicitly discuss the recovery periods and the assumptions behind them.

Better disclosures set out the period of assessment used, and the basis on which this was selected.

Deferred tax assets are reviewed at each reporting date. In considering their recoverability, the Group assesses the likelihood of their being recovered within a reasonably foreseeable timeframe, being typically a minimum of five years, taking into account the future expected profit profile and business model of each relevant company or country, and any potential legislative restrictions on use. Short-term timing differences are generally recognised ahead of losses and other tax attributes as being likely to reverse more quickly.

Smith+Nephew plc
Annual Report and Accounts 2021, p163

Explains the basis for assessment period, which was longer than this company's viability assessment period of three years.

We encourage companies to consider whether, when addressing the recoverability of deferred tax assets, their rationale for the assessment period used should be disclosed as a key judgement (see also section 6 below).

10 ESMA public statement, paragraph 21
11 ESMA public statement, paragraph 12

3. Recognition of deferred tax assets (continued)

Existence of taxable temporary differences

The availability of suitable taxable profit is considered probable[12] when a company has taxable temporary differences (i.e. deferred tax liabilities) relating to the same taxation authority and the same taxable company, that are expected to reverse in the same period as the deductible temporary difference or unused tax losses or credit (or in a period into which the tax losses can be carried back or forward).

In such circumstances, a deferred tax asset in respect of the deductible temporary difference or unused tax loss or credit is recognised to the extent of the relevant deferred tax liability.

Seven of the companies within our selection reported a net deferred tax liability. Of these, six also disclosed, or otherwise appeared to have, material unrecognised deferred tax assets.

Deferred income tax assets have been recognised in respect of all income tax losses and other temporary differences giving rise to deferred income tax assets because it is probable that these assets will be recovered, with the exception of unrecognised capital losses of £194 million (2021: £172 million) following Finance Act 2020 which restricts the amount of chargeable (capital) gains that a company can relieve with its carried-forward capital losses.

J Sainsbury plc
Annual Report and Financial Statements 2022, p130

This company reported a net deferred tax liability and explained the reason for non-recognition of capital losses.

Two companies that reported material deferred tax liabilities, and appeared to have material unrecognised losses in the same taxable entity, relating to the same tax authority, provided no explanation as to why deferred tax assets had not been recognised to the extent of the liabilities.

Better disclosures provided geographical analysis of the deferred tax balance and profits/losses in each jurisdiction, which helped explain why tax assets were not recognised when the company reported net deferred tax liabilities.

We remind companies of the need to reassess the level of recognition of deferred tax assets when material new deferred tax liabilities arise in the same taxable entity, relating to the same tax authority; for example, in relation to non-deductible intangible assets recognised in a business combination.

When a company has material deferred tax liabilities and unrecognised deferred tax assets, an explanation of the reasons for non-recognition of the assets is helpful when these are not apparent from other disclosures in the accounts.

12 IAS 12, paragraph 28

3. Recognition of deferred tax assets (continued)

History of losses – convincing evidence

The existence of unused tax losses is strong evidence that future taxable profit may not be available.[13] Consequently, a deferred tax asset in relation to unused tax losses and credits should be recognised only when there are sufficient taxable temporary differences (i.e. a deferred tax liability), or there is **convincing other evidence** that sufficient taxable profit will be available against which the unused tax loss or credit can be utilised.

It is not sufficient to simply discontinue making losses.[14] While future profit forecasts may be used, caution should be exercised if these require significant judgements to be made about the future. In particular, start-up companies, or companies with a volatile earnings history, may need more extensive convincing evidence than other companies with a history of reliable profit forecasts.

When material losses have occurred as a result of a specific event that is not expected to recur, for example the Covid-19 pandemic, companies need to consider whether and how their business will recover or adapt. **We expect companies to disclose the key assumptions made in this respect.**

12 companies in our selection reported a loss in the current year and/or the prior year at the group level, of which nine had material deferred tax assets in relation to losses. We did not identify any cases where it was obvious that there was insufficient convincing evidence to support the recognition of a deferred tax asset.

We discuss the required disclosure for companies with a recent history of losses in section 4.

13 IAS 12, paragraph 35
14 ESMA public statement, paragraph 12

4. Disclosure – recognised deferred tax assets

Recent history of losses – disclosure of evidence

Nine of the companies that had reported a loss in the current year and/or the prior year, either on a group basis or in a specific jurisdiction, had recognised deferred tax assets in excess of their deferred tax liabilities.

In these circumstances, IAS 12[15] requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.

Where this disclosure was given by the companies within our selection, most only referred to the recoverability of deferred tax assets having been assessed against the company's forecasts.

Better disclosures:

- were specific to the company, rather than using boilerplate language;
- referred to specific improvements in profitability expected to occur in the forecast period;
- referred, when applicable, to the loss for the year having been the result of a one-off event that is not expected to recur;
- stated that the forecasts used were consistent with those used for the purposes of the company's impairment and/or going concern and viability assessments;
- disclosed the period over which the losses would be recovered.

During 2021, there has been a significant improvement in the current copper price (with the copper price reaching record levels in nominal terms during the year) and also the near-term copper price outlook. As a result of this improvement in the copper price environment, Antucoya began to generate taxable profits in 2021. The improved near-term outlook for the copper price also means that Antucoya is now forecast to generate sufficient future taxable profits to fully utilise its remaining tax losses. Current forecasts indicate that the losses will be utilised over approximately the next eight years (compared with the remaining mine life for Antucoya of 22 years).

Antofagasta plc
Annual Report and Financial Statements 2021, p218 (outside thematic selection)

Specific nature of the evidence supporting recognition of a deferred tax asset following recent losses.

Period over which the losses will be recovered.

15 IAS 12, paragraph 82

4. Disclosure – recognised deferred tax assets (continued)

Recent history of losses – disclosure of evidence (continued)

In assessing the probability of recovery, the Directors have reviewed the Group's three-year Plan that has been used for both the Going concern and Viability assessment and the goodwill and fixed asset impairment testing. This plan anticipates continued recovery of membership and robust yields, the successful execution of the accelerated rollout plan and a return to profitability.

The Gym Group plc
Annual Report and Accounts 2021, p141

Confirms consistent assumptions used.

Specific assumptions in relation to the recovery of the business post Covid-19.

A deferred tax asset of £10.5m has been recognised on current year trading losses in the UK which are being carried forward. The utilisation of these losses is dependent on the existence of future taxable profits, which we expect to arise in future years without the one-off current year impact on trading from Covid-19.

Marks and Spencer Group plc
Annual Report & Financial Statements 2021, p176

Explains one-off nature of loss.

We expect disclosure of the nature of evidence supporting the recognition of deferred tax assets by a company with recent losses to be specific to the company's circumstances. The level of detail given should be consistent with the level of judgement and estimation uncertainty involved in assessing the recovery of the deferred tax assets.

5. Disclosure – unrecognised deferred tax assets

Companies are required[16] to disclose the gross amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised.

16 companies in our selection disclosed unrecognised material deferred tax assets. Of these, 13 disclosed the gross value of unrecognised deductible temporary differences, unused tax losses and unused tax credits.

Two companies disclosed only the unrecognised deferred tax assets, rather than gross unrecognised tax losses. Another presented total losses carried forward; it was unclear whether, or how much of, these losses were unrecognised.

One company did not disclose any unrecognised deferred tax assets despite none being recognised for material current year losses. Another company did not disclose unrecognised deferred tax assets in relation to capital losses that had been disclosed in the previous year's annual report and accounts but did not appear to have been utilised in the current year.

While not specifically required by IAS 12, six companies helpfully disclosed the unrecognised deferred tax asset amounts as well as the gross unrecognised deductible temporary differences, losses and credits.

Tax Losses and tax credits carryforwards

Tax losses and tax credits for which no deferred tax asset was recognized

	2021 $000s		2020 $000s	
As of December 31	Gross Amount	Tax Effected	Gross Amount	Tax Effected
Tax losses expiring:				
Within 10 years	19,735	4,343	12,530	2,760
More than 10 years	47,937	11,611	55,312	12,117
Available Indefinitely	147,753	31,028	101,889	21,397
Total	215,425	46,982	169,731	36,273
Tax credits expiring:				
Within 10 years	4	4	13	13
More than 10 years	9,632	9,632	9,107	9,107
Available indefinitely	—	—	—	—
Total	9,636	9,636	9,120	9,120

PureTech Health plc
Annual Report and Accounts 2021, p209

Gross unrecognised amounts, and tax effect, with expiry date time bands and comparatives.

16 IAS 12, paragraph 81(e)

5. Disclosure – unrecognised deferred tax assets (continued)

Expiry dates

Of the 16 companies disclosing material unrecognised deferred tax assets, seven provided no expiry date information. It was not always clear whether this was because the disclosure had been overlooked or because the losses were available indefinitely.

Better disclosures analysed the expiry dates of unused tax losses and credits in time bands, and quantified those losses with no expiry date.

At 31 March 2022, the gross amount and expiry dates of losses available for carry forward are as follows:

	Expiring within 5 years €m	Expiring beyond 6 years €m	Unlimited €m	Total €m
Losses for which a deferred tax asset is recognised	19	259	79,848	80,126
Losses for which no deferred tax is recognised	334	13,162	23,928	37,424
	353	**13,421**	**103,776**	**117,550**

At 31 March 2021, the gross amount and expiry dates of losses available for carry forward were as follows:

	Expiring within 5 years €m	Expiring beyond 6 years €m	Unlimited* €m	Total €m
Losses for which a deferred tax asset is recognised	63	222	86,623	86,908
Losses for which no deferred tax is recognised	245	13,217	26,290	39,752
	308	**13,439**	**112,913**	**126,660**

Vodafone Group Plc
Annual Report 2022, p157

Discloses expiry date time bands for recognised and unrecognised gross losses, including those that do not expire.

6. Disclosure – judgements and estimates

When the recognition of deferred tax assets involves key management judgements in the application of the company's accounting policies, or significant estimates,[17] these are required to be disclosed under IAS 1, 'Presentation of Financial Statements'.[18]

Key judgements in relation to deferred tax asset recognition may include the applicability of relevant tax legislation or tax planning opportunities (see section 3 above). Significant estimation uncertainty is often involved in forecasting future taxable profits.

Four companies in our selection disclosed the recognition of deferred tax assets as an area involving key judgements. A further five clearly disclosed it as a significant estimate. In addition, we identified one instance where it was unclear from the company's disclosures whether the matter was considered to involve key judgements, a significant estimate, or both.

As set out in our July 2022 Thematic Review: Judgements and Estimates: Update, it is important to differentiate between key judgements and significant estimates as the disclosure requirements are different.

Our July 2022 Thematic Review: Judgements and Estimates: Update reported general improvements in the disclosure of judgements and estimates. However, we found very little improvement, since our 2016 review, in the disclosure of specific judgements and estimation uncertainties affecting the recognition of deferred tax assets, and the related sensitivities.

We expect companies to consider carefully whether there are key judgements and estimation uncertainties relating to deferred tax, and to provide company-specific descriptions of these.

Judgements

We found that the disclosure of key judgements was generally boilerplate, referring only to judgement having been applied over the future financial performance of the relevant companies.

One company provided information about the nature of the judgements made in specific jurisdictions in relation to the application of relevant tax legislation and the effect on the availability of future taxable profits.

We have assessed that the current structure continues to be sustainable under the tax law substantively enacted at the balance sheet date and the Group's intentions to keep these activities in Luxembourg remains unchanged.

Vodafone Group Plc
Annual Report 2022, p158

Discloses judgement made in relation to the company's structure in a specific tax jurisdiction.

17 Major sources of estimation uncertainty that have a significant risk of material adjustment to the carrying amount within the next financial year
18 IAS 1, paragraphs 122 and 125

6. Disclosure – judgements and estimates (continued)

Estimates

Disclosure is required[19] of major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities **within the next financial year**.

Four companies did not disclose a significant estimate in relation to the recoverability of deferred tax assets, although their circumstances suggested that there could be a significant level of estimation uncertainty involved. Two of these had disclosed significant estimates in relation to impairment forecasts. The other two implied elsewhere in their accounts that there was a significant level of estimation uncertainty in relation to deferred tax.

Deferred tax assets that are expected to be recovered over an extended period may not have a significant risk of material adjustment within the next financial year.

We do not discourage companies from disclosing other estimates where this provides material, relevant information. For example, disclosures of other uncertainties, such as those carrying lower risk, having smaller impact or crystallising over a longer timeframe. However, **we expect other estimates to be distinguished from significant estimates and the reason for disclosure explained**.

Further details of our expectations in this area are set out in our July 2022 Thematic Review: Judgements and Estimates: Update.[20]

19 IAS 1, paragraph 125
20 Referred to as 'significant estimates' in this report

As discussed elsewhere in the report the Group returned to profits during 2021 despite national lockdowns in the UK affecting trading in the first-half of the year. The return to profit resulted in the use of £8.1m of the deferred tax asset in respect of losses. The use of losses is restricted to 50% of taxable profits over £5m resulting in a spreading of losses across periods where brought forward losses are over £5m. The deferred tax asset on losses remaining at 31 December 2021 is £7.3m. This deferred tax asset on losses has been recognised on the basis that the Group will continue to make profits in the future against which the losses can be used. In order to support the recognition of the £7.3m deferred tax asset on losses, modelling was undertaken to review the recovery period of the deferred tax asset. The modelling was based on management forecasts and showed that the deferred tax asset on losses is expected to be recovered by 2023. A plausible downside case was also modelled which included reduced sales volumes and margins; this downside case modelling showed that the deferred tax asset on losses would be recovered by 2024.

Pendragon PLC
Annual Report 2021, p135

This company did not disclose deferred tax asset recognition as a significant estimate but did separately explain the assumptions made and the sensitivity of the recovery period to a plausible downside scenario.

6. Disclosure – judgements and estimates (continued)

Sensitivity disclosures

Disclosure is also required[21] of information to help users understand the judgements and significant estimates made. Examples include the sensitivity of carrying amounts to changes in underlying assumptions and estimates, or the range of reasonably possible outcomes within the next financial year.

We found minimal disclosure of sensitivities and/or reasonably possible outcomes. Only one company disclosed the amount of reasonably possible adjustment over the next year, although this reflected upside sensitivities only.

Two companies helpfully provided information on the effect of changes in the assumptions on the deferred tax asset recovery period.

Where a significant estimate has been made, we expect companies to disclose any relevant sensitivities and/or the range of reasonably possible outcomes in the next year.

This example of sensitivity disclosures is from outside our thematic selection.

The estimates take account of the inherent uncertainties constraining the expected level of profit as appropriate. Changes in these estimates will affect future profits and therefore the recoverability of the deferred tax assets. The following sensitivities have been modelled to demonstrate the impact of changes in assumptions on the recoverability of deferred tax assets:
– A 5% change in margin in the main Civil Aerospace widebody programmes.
– A 5% change in the number of shop visits driven by EFHs.
– Assumed future cost increases from climate change expected to flow through to customers at 100% are restricted to 90% pass through.

All of these could be driven by a number of factors including the impact of climate change as explained on pages 117 to 119.

A 5% change in margin or shop visits would result in an increase/decrease in the deferred tax asset of around £150m.

If only 90% of assumed future cost increases are passed on to customers, this would result in a decrease in the deferred tax asset of around £40m, and if carbon prices were to double, this would be £110m.

Rolls-Royce Holdings plc
Annual Report 2021, p124 (outside thematic selection)

21 IAS 1, paragraph 129

6. Disclosure – judgements and estimates (continued)

Consideration of climate change risks

A quarter of the companies we reviewed specifically explained that the recognition of deferred tax was affected by significant risks to profitability arising from climate change.

Examples of better disclosure included specific and tailored references to the potential influence of climate change on the key judgements and estimates affecting deferred tax asset recognition.

> [T]he climate-related estimates and assumptions above have also been considered when assessing the recoverability of the deferred tax assets. Recognising the longer term over which these assets will be recovered, the Group has also considered the impact on OE and aftermarket sales if new, more efficient, civil aircraft or new engine options enter the market earlier than assumed in its most likely estimates. Under this scenario some older products would see a reduction in profits but additional opportunities exist for newer products such as the Trent XWB. Whilst carbon pricing illustrates pressure on costs, decarbonisation and new supplier and customer contracts offer the opportunity to receive value for more efficient and sustainable products.
>
> Rolls-Royce Holdings plc
> Annual Report 2021, p118 (outside thematic selection)

Explains the effect of climate risks and opportunities. This company also provided corresponding sensitivity analysis.

> The recovery of the Group's deferred tax assets is dependent on its forecasts of future profitability and the climate related risks identified on page 148 have been considered in the Group's assessment of the recovery of those assets. The Group does not expect the climate related risks to have an impact on the ability of Luxembourg to continue to provide the internal financing, procurement, and roaming activities to other members of the Group.
>
> Vodafone Group Plc
> Annual Report 2022, p158

Explains that climate risks are not expected to affect the basis of recognition of its deferred tax assets in Luxembourg.

As set out in our July 2022 Thematic review of TCFD[22] disclosures and climate in the financial statements, we will continue to monitor disclosures in this area. **We expect the extent of disclosure about how climate change risks have been reflected in deferred tax judgements and estimates to be consistent with the degree of emphasis placed on those risks in the narrative reporting, including TCFD disclosures.**

22 Task Force on Climate-related Financial Disclosures

7. Presentation and other disclosures

Statement of financial position

Non-current presentation

Deferred tax balances are required to be presented as non-current in the statement of financial position,[23] regardless of the expected timing of recovery or settlement of the related deferred tax assets or liabilities.

All companies within our selection presented their deferred tax balances as non-current. However, our routine monitoring occasionally identifies issues in this area.

Better disclosures set out the expected period of recovery of deferred tax assets.

It is expected that €31.9 million of the deferred tax asset will be recovered within the next 12 months and the remaining €38.6 million of the deferred tax asset will be recovered after 12 months.

TI Fluid Systems plc
Annual Report and Accounts 2021, p159

Quantifies amount expected to be recovered within and after 12 months.

Offsetting deferred tax assets and liabilities

Deferred tax assets and liabilities are required[24] to be offset in the statement of financial position if, and only if, the company has a legally enforceable right to set off current tax assets and liabilities, and the deferred tax assets and liabilities relate to taxes levied by the same taxation authority on the same taxable company.

The majority of the companies in our selection had offset deferred tax assets and liabilities in the statement of financial position.

One company that appeared to operate in a single tax jurisdiction had not offset any deferred tax assets and liabilities and did not provide an explanation as to why the offset conditions of IAS 12 were not met.

Where balances were not offset, geographical analysis of the deferred tax assets and liabilities before offset helped to explain why the offset conditions of IAS 12 were not met.

23 IAS 1, paragraph 56
24 IAS 12, paragraph 74

7. Presentation and other disclosures (continued)

Analysis of deferred tax balances and income/expense

For each type of temporary difference, unused tax loss and unused tax credit, disclosure is required[25] of :

- the amount of recognised deferred tax assets and liabilities; and
- the amount of the related deferred tax income or expense recognised in profit or loss, if not apparent from changes in the amounts recognised in the statement of financial position.

All companies within our selection presented an analysis of deferred tax balances by type of temporary difference, and the majority gave the required analysis of deferred tax income/expense recognised in profit or loss.

Deferred tax balances

	Capital allowances £m	Unrealised inventory profit and other inventory provisions £m	Share schemes £m	Derivative Instruments £m	Unused tax losses £m	Leases £m	Other¹ £m	Total £m
As at 28 March 2020	20	72	2	(1)	5	53	20	171
Effect of foreign exchange rate changes	(2)	(5)	–	–	–	(1)	(2)	(10)
(Charged)/credited to the Income Statement	(1)	(5)	1	–	(4)	(17)	–	(26)
Credited to Equity	–	–	1	–	–	–	–	1
As at 27 March 2021	17	62	4	(1)	1	35	18	136
Effect of foreign exchange rate changes	–	4	–	–	–	1	1	6
Credited/(charged) to the Income Statement	2	31	1	–	2	(4)	(1)	31
Credited to Other Comprehensive Income	–	–	–	1	–	–	–	1
As at 2 April 2022	**19**	**97**	**5**	**–**	**3**	**32**	**18**	**174**

1. Deferred balances within 'Other' category in the analysis above include temporary differences arising on other provisions and accruals of £18 million (last year: £18 million)

Burberry Group plc
Annual Report 2021/22, p270

Better disclosures gave this information in a tabular format that also showed the deferred tax income/expense recognised in other comprehensive income and directly in equity.

One company combined material amounts recognised in other comprehensive income with the amounts recognised in profit or loss in their explanation of movements in deferred tax balances.

Two companies disclosed material movements in deferred tax balances labelled 'other' that were not further explained. Another presented a single category for 'other temporary differences' representing two thirds of their total deferred tax asset balance.

We expect the nature of temporary differences giving rise to individually material deferred tax balances, and material movements in balances, to be disaggregated and explained.

Table shows balances and all movements by temporary difference. The footnote explains the nature of the 'other' category.

25 IAS 12, paragraph 81(g)

7. Presentation and other disclosures (continued)

Recognition of deferred tax income and expense

Deferred tax income and expense is required[26] to be recognised in profit or loss (income statement), other comprehensive income, or directly in equity, in a manner consistent with the underlying transaction or event giving rise to the deferred tax balance.

For example, deferred tax related to actuarial movements on defined benefit obligations is recognised in other comprehensive income. Deferred tax on equity-settled share-based payment arrangements in excess of the cumulative share-based payment charge is recognised directly in equity.

The effect of changes in tax rates should be recognised in the same location as the related deferred tax was recognised originally.

The majority of companies within our selection appeared to have recognised the deferred tax income or expense, including that arising from the increase in the UK tax rate from 19% to 25% in May 2021, appropriately across the income statement, other comprehensive income or directly in equity.

One company appeared to have recognised the material effect of the UK tax rate increase on the deferred tax asset on losses directly in equity, rather than in the income statement. The basis on which deferred tax on losses would have been previously recognised in equity was unclear.

Major components of tax expense and ETR reconciliation

Paragraph 79 of IAS 12 requires disclosure of the major components of a company's tax expense for the period, and paragraph 80 gives examples of these. Several of these components will also be reconciling items in the explanation of the relationship between tax expense and accounting profit required under paragraph 81(c) of IAS 12 (the effective tax rate ('ETR') reconciliation).

A number of the example components relate specifically to deferred tax assets and tax losses:

- Deferred tax income/expense relating to changes in tax rates;
- Benefits from previously unrecognised tax losses, tax credits or temporary differences used to reduce current and/or deferred tax expense; and
- Deferred tax expense/income arising from the write-down, or reversal of a previous write-down, of a deferred tax asset.

Of the 16 companies that disclosed the effect of the increase in the UK tax rate, we found a broadly even mix of companies that disclosed the effect solely in the ETR reconciliation and those that also disclosed it in the analysis of the tax charge.

Components of tax expense relating to movements in unrecognised deferred tax assets were disclosed separately in the tax analysis in only two cases. A further 12 companies disclosed these items only in the ETR reconciliation.

26 IAS 12, paragraphs 57, 58, 61A

7. Presentation and other disclosures (continued)

Major components of tax expense and ETR reconciliation (continued)

Only two companies disclosed the benefit of previously unrecognised tax losses on current tax expense. In the majority of other cases it was unclear whether the benefit disclosed related to current or deferred tax expense - this information is required under paragraph 80 of IAS 12.

Several companies presented a single line in the ETR reconciliation labelled 'recognition of losses not previously recognised' that increased, rather than decreased, the tax expense, suggesting that the line item in fact represented current year losses not recognised or write-downs of deferred tax assets previously recognised.

Two companies used vague language, such as 'movements in unprovided deferred tax assets', with no analysis of the amounts related to current year losses not recognised or prior year losses now recognised.

We expect individually material components of the tax expense to be presented separately and appropriately described. There may be opportunities to avoid duplication if this information is presented elsewhere in the accounts.

Tax losses and temporary differences not recognised	**(18.9)**	(24.6)
Utilisation of previously unrecognised tax losses and temporary differences	**1.3**	0.4
Recognition of previously unrecognised tax losses and temporary differences	**1.4**	–
Deferred tax assets written off	**(2.9)**	(2.2)
Deferred tax liabilities written back – impairment of Mandarin Oriental, Geneva	**–**	14.4

Mandarin Oriental International Limited
Annual Report 2021, p45

Separate disclosure of the different movements in unrecognised deferred tax assets.

7. Presentation and other disclosures (continued)

Consistency between tax disclosures

We expect consistency between a company's various tax disclosures.

One company had, for several years, disclosed amounts in the ETR reconciliation for the recognition and utilisation of temporary differences previously not recognised, with no further explanation. While occasional adjustments are to be expected, annual adjustments could indicate that the company had not recognised deferred tax assets for which recovery was probable.

Another reported a loss before tax but did not disclose a deferred tax asset in relation to tax losses, nor any clear explanation of the treatment of the losses for tax purposes in the ETR reconciliation.

Better disclosures explained the reasons for individually material items in the ETR reconciliation or movements in unrecognised deferred tax balances that were not otherwise apparent from the disclosures in the accounts.

Consistency with strategic report

We were pleased to note a broad level of consistency between the narrative discussion of changes in the ETR in the strategic report and the recognition and disclosure of deferred tax assets.

One company disclosed, without further explanation, that the ETR had been materially increased by 'movements in unprovided deferred tax'. The ETR reconciliation disclosed additional material reconciling items, including the derecognition of deferred tax assets, not discussed in the strategic report.

Another stated that the future ETR will be below the headline corporation tax rate 'as tax losses are converted into deferred tax assets'. This could indicate that the company had not recognised deferred tax assets for which recovery was probable, although that was not evident from the disclosures in the accounts.

We expect consistency between the discussion of the current and expected future ETR in the strategic report with the related tax disclosures in the accounts.

[T]he amount of deferred income tax assets not recognised in respect of the UK had a material increase from 2020 to 2021, based on restatement of the deferred tax asset from the UK statutory tax rate of 19% to the increased UK statutory tax rate of 25%.

TI Fluid Systems plc
Annual Report and Accounts 2021, p160

Explains a material movement in unrecognised deferred tax assets not otherwise apparent from the accounts.

7. Presentation and other disclosures (continued)

Accounting policies

All companies in our selection disclosed tax accounting policies that were broadly consistent with the requirements of IAS 12.

However, we identified room for improvement in the following areas:

Several companies provided incomplete, or missing, policy wording in relation to the offset of deferred tax assets and liabilities, referring, for example, simply to a 'right of offset' which does not fully reflect the conditions for offset as discussed earlier in this section.

One company stated that deferred tax liabilities are recognised for all taxable temporary differences but did not make it clear that deferred tax liabilities are not recognised in relation to goodwill arising in a business combination. There was a related material reconciling item in the company's effective tax rate reconciliation.

One company did not explain when tax is recognised in other comprehensive income although this was material to the accounts.

When explaining why a deferred tax asset has, or has not been, recognised, we expect companies to use language that is consistent with IAS 12. Terminology such as 'recovery is uncertain', without further explanation, as used by some companies within our selection, could imply that the recognition threshold applied is inconsistent with that in IAS 12. As discussed in section 3 above, recognition is required when recovery is considered probable.

8. Key expectations

We encourage companies to consider the findings within this report and our expectations when drafting their upcoming annual reports and accounts.

In particular, we expect companies to:

- Disclose company-specific information about the nature of convincing evidence supporting the recognition of deferred tax assets when there is a recent history of losses.
- Base forecasts of future taxable profit on assumptions that are consistent with other forecasts used in the preparation of the annual report and accounts (subject to some specific differences).
- Reassess the level of recognition of deferred tax assets when there are material changes to the deferred tax liabilities in the same taxable entity and tax jurisdiction.
- Disclose company-specific information about deferred tax judgements and estimates, including relevant sensitivities and/or the range of possible outcomes in the next 12 months.
- Explain the extent to which climate change risks have been reflected in deferred tax judgements and estimates, consistent with the degree of emphasis placed on those risks in the narrative reporting.
- Provide disaggregated information about material components of the tax expense and deferred tax balances.
- Provide transparent and informative tax disclosures that are consistent across the annual report and accounts.

Appendix A: Examples of positive and negative evidence relevant to assessing the probability of future taxable profits[27]

Positive evidence	Negative evidence
Losses occurred due to identifiable one-time/non-recurring event	A recent history of operating losses for tax purposes
A strong earnings history exclusive of a non-recurring loss	Start-up business
New business opportunities, e.g. new patents	History of significant variances of actual outcomes against business plans
Restructuring or disposal which clearly eliminates the loss sources	Losses of major customers and/or significant contracts
Convincing tax planning strategies	Uncertainty regarding going concern
Firm sales backlog or new contracts	History of restructuring without returning to profitability, or emerging from a bankruptcy
Business acquisitions generating sustainable profit margins in the relevant taxable entity sufficient to enable the utilisation of tax losses	Losses expected in early future years
	History of unused tax losses and/or credits expiring
	The losses relate to core activities and thus may recur

27 ESMA public statement, paragraphs 14 and 15

Appendix B: 2016 review findings

2016 review	2022 update
Tax in strategic reports	
Good practice included: • providing information on material tax matters likely to be important to investors, including major tax risks and the tax impact of exceptional or non-recurring items; and • discussion of the effective tax rate (ETR), including commentary on variances on prior periods, key influences and the expected future rate.	We continue to encourage informative disclosure in relation to tax in the strategic report. As discussed in section 7 above, we expect consistency between the narrative discussion in the strategic report and the related tax disclosures in the accounts.
ETR reconciliations	
The ETR reconciliation should enable the reader to understand both the relationship between the tax expense and accounting profit, and the significant factors that could affect that relationship in the future. Companies whose reconciliations achieved this objective gave a greater level of disaggregation and detailed descriptions of the reconciling items. Permanent differences, non-taxable income and disallowable expenses were often found to have the most significant effect on the effective tax rate. Good disclosures explained the nature of these items and why they were not tax deductible or chargeable. The applicable rate used to reference the ETR should provide the most meaningful information to users of the financial statements.	Aspects of the ETR reconciliation are considered in section 7 above. Our routine monitoring indicates that the findings of the 2016 review in this area remain relevant. We continue to encourage the presentation of sufficiently informative and transparent ETR reconciliations.

Appendix B: 2016 review findings (continued)

2016 review	2022 update
Key judgements and major sources of estimation uncertainty	
Opportunities were identified for companies to improve the usefulness of their disclosure of significant judgements and estimation uncertainties relating to tax.	Opportunities remain for improvements in this area, as discussed in section 6 above. See also our July 2022 Thematic Review: Judgements and Estimates: Update.
Alternative performance measures	
Informative ETR reconciliations separately identified the tax impact of non-recurring or exceptional items or provided additional information in footnotes.	Section 15 of our October 2021 Thematic Review: Alternative Performance Measures (APMs) discusses the disclosure of the tax effect of adjusting items.
Uncertain tax positions	
The 2016 review identified scope for companies to articulate better how they account for tax uncertainties by explaining the bases for recognition and measurement.	Since the publication of the 2016 review, IFRIC 23, 'Uncertainty over Income Tax Treatments', has been issued. Companies should refer to IFRIC 23 for clarification of the recognition, measurement and disclosure requirements in relation to uncertain tax positions.

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