BANKING METRICS SERIES

DEFERRED TAX ASSETS

The asset that disappears when you need it most.

BANKING METRIC SERIES

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What Is a Deferred Tax Asset?

A DTA appears on a bank's balance sheet when overpaid taxes or accumulated losses will reduce future tax bills. In short: the government owes the bank money in the future.

Timing Differences

Tax authorities recognise expenses at different times than accounting rules, creating a temporary gap.

Loss Carryforward

When a bank runs a loss, it can offset future taxable income, but only if profits return.

How a DTA becomes capital

Bank records a loss today.
Tax law allows that loss to offset future taxable income.
Accountants book a DTA, recognizing the future tax saving.
If the bank returns to profit, the DTA gets used and capital is preserved.
If it does not, the DTA stays on the balance sheet but never converts to cash.

BALANCE SHEET (illustrative)

Loans & Advances	€ 450 bn
Investment Securities	€ 85 bn
Property & Equipment	€ 12 bn
Deferred Tax Assets	**€ 8 bn**
Other Assets	€ 15 bn

KEY TAKEAWAY

A DTA is a real accounting asset, but its value is conditional on the bank generating taxable profit in the future.

Why Regulators Do Not Trust Them

The core problem is a circular dependency. A DTA that relies on future profitability is most valuable when the bank is healthy, and worthless when it is not.

1 Good Times

Bank is profitable.

Future taxable income exists, so the DTA reduces future tax bills.

DTA behaves like a real, bankable asset, no different in spirit from a receivable.

Regulators have no immediate objection.

2 Stress

Bank is loss-making.

No taxable profit to offset, so the DTA cannot be used in the current period.

Its recovery becomes uncertain and the economic value falls sharply.

The asset is still on the balance sheet but starts to look fragile.

3 Crisis

Capital is most critical.

But the DTA is worth nothing: no profit now, no profit in sight.

The asset vanishes precisely when the bank needs it most.

Procyclical weakness, exactly the kind of asset a supervisor cannot rely on.

KEY TAKEAWAY

A DTA that depends on future profitability offers zero protection in a stress scenario, exactly when bank capital is most critical.

The CRR Treatment: Two Buckets

Under the EU Capital Requirements Regulation (CRR Art. 48), the regulatory treatment hinges on one question: does this DTA rely on the bank future profitability?

✓ Does NOT rely on future profitability

Example: timing differences on provisions already tax-deductible regardless of future income. The asset will reduce a tax bill that the bank is going to pay anyway, with or without future profit.

Standard risk weight, no CET1 deduction

Treated like any normal balance sheet asset.

Typical examples: provisions on loans that are already deductible under tax law, differences in depreciation schedules between IFRS and tax accounting.

⚠ DOES rely on future profitability

Example: loss carryforwards, only valuable if the bank returns to profit. Worthless in continued distress. The asset depends on a future that, by definition, may not arrive.

Deduct from CET1 OR **250% risk weight***

** Below 10% individual threshold (Art. 48 CRR).*

Most large EU banks fall into this bucket. Loss carryforwards from the post-2008 cycle are still being absorbed, with material capital impact.

KEY TAKEAWAY

A 250% risk weight means €100m of DTA consumes more capital than most senior corporate loans. It is a severe regulatory penalty.

The Italian DTA Problem

Post-2008, Italian banks accumulated some of Europe largest DTAs, and the regulatory response became a landmark case in capital arbitrage.

2008 – 2012

DTA Accumulation

Italian banks booked massive loan-loss provisions during the recession.

Under Italian tax law, those provisions were deductible over 18 years, creating enormous DTAs on the balance sheet.

By 2012, Italian banks held some of the highest DTA-to-CET1 ratios in the EU.

2011 – 2013

Capital Pressure

EBA stress tests and the phased introduction of Basel III forced banks to confront CET1 deductions.

Banks with large future-profitability DTAs saw capital ratios squeezed exactly when sovereign debt turmoil was impacting earnings.

2013 – 2016

Italy's Response

The Italian government passed legislation converting qualifying DTAs into tax credits.

Tax credits are recoverable even in loss-making years and in insolvency, so they sit outside the CET1 deduction bucket.

The EU Commission scrutinized the measure under state-aid rules. Italian banks kept the relief.

KEY TAKEAWAY

Italy's DTA conversion law was direct regulatory arbitrage, turning a CET1 deduction into a 0%-risk-weighted credit. The EU Commission considered it as a state-aid measure.

THE BOTTOM LINE

Accounting ≠ Regulation

*An asset on the balance sheet can be a **hole in your capital stack** if its value depends on a future that may not arrive.*

This is Episode 7 of the Banking Metrics Series.
Each episode takes one key metric, breaks it down from principles, and illustrates it with real data.