Federation of European Accountants
Fédération des Experts comptables Européens

28 July 2009

Sir David Tweedie
Chairman International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

E-mail: commentletters@iasb.org

Ref.: ACC/HvD/SS/SR

Dear Sir David,

Re: FEE Comments on IASB Exposure Draft *Income Tax*

(1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the IASB Exposure Draft *Income Tax* (the “ED”).

(2) As a founding organisation of EFRAG we have also contributed to the EFRAG consultation process by submitting the FEE comments on EFRAG’s Draft Comment Letter issued on 5 June 2009. EFRAG has not yet issued its final comment letter. We have considered the EFRAG Draft Comment Letter in our response and made reference to the EFRAG draft comments where relevant.

(3) Like EFRAG, we support having a single global accounting language but we do not support the proposals in the ED, because in our opinion these proposals would not represent an improvement to the existing requirements in IAS 12 and are likely to cause significant effort and expense on behalf of preparers to comply with the new requirements. The ED does not involve a fundamental rethink of accounting for income taxes. Therefore, we agree with EFRAG that the ED should not be used as a basis for a revised standard on income taxes.

(4) Regarding the objective of achieving convergence, we would like to reiterate FEE’s views that only genuine improvements to financial reporting should be considered and although a level playing field between IFRS and US GAAP is important, this also risks to drive global financial reporting towards the lowest common denominator. FEE supports the principle of seeking convergence, provided that this leads to higher quality accounting solutions and goes where needed beyond existing standards. Our views in this respect are consistent with EFRAG’s comments on convergence or rather a universal development towards high level global standards.

(5) As indicated in paragraph IN5 the FASB has deferred its decision about whether to undertake projects that would eliminate differences in the accounting for tax. Therefore the convergence aim will not be achieved. The FASB withdrawal from the project reduces the urgency around the preparation of a final standard. This may afford the Board time to reflect more fundamentally on the issues raised.

(6) In particular, we share EFRAG's concerns expressed in its draft comment letter that the proposals do not include sufficient explanations in the Basis for Conclusions to demonstrate a conclusion that the proposed changes are an improvement to financial reporting.

(7) In addition, we agree with EFRAG that some of the proposals are very rules-based and complex, and lack underlying conceptual rationale. We would recommend a more principles-based approach if the standard on income tax were to be amended, with clearly articulated principles that can be applied in practice in the various tax jurisdictions in order to provide the maximum level of decision useful information that considers the particular tax circumstances. In this respect we also wish to refer to the project on accounting for corporate income tax that the German standard setter (GASB) and the UK standard setter (ASB) are undertaking as part of the EFRAG Pro-active Accounting Activities in Europe (PAAinE) initiative, which looks at the issue of tax accounting from a principles-based approach.

(8) We also question the priority of the income tax project within the IASB agenda. As previously indicated on several occasions to the IASCF and IASB, FEE is concerned about the IASB agenda setting and priorities in its work plan. We believe that the IASCF should submit the IASB work plan to an annual public consultation process. Completion of such a public consultation would also assist in getting the priorities right and may help to address the problem of heaviness of the current agenda. Finally, before issues are added to the agenda, a needs analysis, including an initial cost/benefit analysis, should be carried out to demonstrate that there is a genuine need for a new or revised standard in areas already covered by an existing standard or interpretation. The current financial and economic crises require a reconsideration of priorities and timing of current and already planned projects, such as the project on income tax.

(9) FEE is concerned that the IASB addresses the notion of management intent differently in different standards. In addition, as also signalled by EFRAG in its draft comment letter, the ED looks at the notion of management expectations in a way that is internally inconsistent with other aspects of the ED. For example, the ED requires management expectations to be taken into account to determine the tax rate but rejects the consideration of management intent in relation to the tax basis. In our opinion the way the business is run is relevant in determining the tax basis. This illustrates, in our view, the need for a more fundamental rethinking of issues addressed in the ED.

(10) We suggest to consider real life examples that illustrate the possible consequences of the proposals, in particular the impact of the proposed tax basis not being based on management's expectations, the implications of the different tax rates under a "sale" and an "in use" strategy and the different types of tax deductions.

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(11) In summary, our main technical concerns are:

a. We agree with EFRAG's draft comments that requiring the tax basis of an asset to be determined on the basis that the asset is sold or on the basis that the liability is settled might not be the correct approach from a conceptual point of view. Hence, these proposals will not always result in a faithful reflection of the reporting entity's deferred tax situation.

b. We agree with EFRAG's draft comments that in general it would be preferable to eliminate the initial recognition exception in IAS 12 since it will result in a more principles-based standard. At the same time we believe that the current proposals are not a clear improvement on IAS 12.

c. We agree with EFRAG's overall conclusion that the existing exceptions to the temporary difference approach for some investments in subsidiaries branches, associates and joint ventures in IAS 12 should be retained and hence we do not support the proposals to remove the existing exception for temporary differences related to domestic subsidiaries. We agree with EFRAG's draft comments that there should not be a distinction between domestic and foreign entities.

d. Like EFRAG in its draft comments, we do not support the proposals regarding the tax allocation requirements, whether it is adopting the requirements in SFAS 109 on the allocation of tax to components of comprehensive income and equity or an approach based on the IAS 12 requirements with some amendments. In our view, the proposals regarding the tax allocation requirements do not appear to represent an improvement to IAS 12 since they add undue complexity. We favour a more principles-based approach if the standard were to be amended.

e. Regarding the proposals for recognising and measuring tax assets we support EFRAG's call for a more principles-based approach.

(12) On balance, we are concerned about continuing developing the income tax standard on the basis of this ED. We suggest postponing the project to a future date at which time a more fundamental rethinking of accounting for income tax can be carried out rather than developing short-term solutions to improve IAS 12 for the following reasons:

a. As indicated above we are sceptical about achieving convergence in particular now that the FASB has deferred its decision on eliminating differences in the accounting for tax;
b. We question whether the project is a priority given the other more urgent projects on the agenda of the IASB;

c. We have serious concerns with the contents of the ED.

Our responses to the questions in the Invitation to comment of the ED are included as an Appendix to this letter.

For further information on this letter, please contact Ms. Saskia Slomp, Technical Director.

Yours sincerely,

Hans van Damme
President

Appendix - Comments on the EFRAG draft comment letter including the responses to the questions in the Invitation to comment of the IASB Exposure Draft *Income Tax*

Question 1 - Definitions of tax basis and temporary difference

The exposure draft proposes changes to the definition of tax basis so that the tax basis does not depend on management's intentions relating to the recovery or settlement of an asset or liability. It also proposes changes to the definition of a temporary difference to exclude differences that are not expected to affect taxable profit. (See paragraphs BC17–BC23 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

Tax basis of an asset and a liability

(13) We agree with EFRAG's draft comments that the proposal to change the definition of tax basis is simple and would involve a lower degree of judgement since the proposed tax basis would not depend on management's expectations. But like EFRAG, we have significant concerns with the proposed definition as explained in paragraphs 14 to 17 below.

(14) Regarding the tax basis of an asset, the Board proposes to require the tax basis of an asset to be determined by tax deductions that are available if the asset is sold at the reporting date. From a conceptual point of view, we agree with EFRAG's draft comments that requiring the tax basis of an asset to be determined based on the tax effects of selling the asset at the reporting date is unlikely to resolve the problems arising in practice in determining the tax basis of an asset in situations where there are different tax consequences between selling the asset and using the asset.

(15) The proposed definition appears to include an understandable principle that an entity shall determine the tax basis of an asset, liability or other item in accordance with substantively enacted law. However, the appropriateness of the proposed definition is less convincing when it specifies how this principle should apply. In particular, we agree with EFRAG that an approach based on sale at the reporting date might not always lead to appropriate, meaningful and decision useful information in all tax jurisdictions.

(16) We find the arguments in paragraphs 9 and 10 of the EFRAG draft comment letter convincing to support the view that determining the tax basis of assets based on single "sale" notion might not be the right conclusion, because this could lead to very significant differences between the actual cash flows and the deferred tax effects recognised in the financial statements, when entities acquire assets for use or consumption and recover their operational assets through use as opposed through sale. In addition, we agree that the existing differences across tax jurisdictions regarding the determination of the tax basis would not be taken into account if the proposal requires the tax basis to be determined only on sale.

(17) Regarding the tax basis of a liability, like EFRAG's draft comments we disagree with the proposal to require the tax basis of a liability to be determined based on how the liability is settled at the reporting date. Indeed, there might be circumstances where the tax basis of a liability depends on whether the liability is transferred as opposed to settled or is transferred/settled on a date other than the reporting date. The differences between the actual cash flows and the deferred tax effects recognised in the financial statements could be significant if the only consideration in the determination of the liability is the settlement at the reporting date.

Management expectations

(18) We agree with EFRAG's draft comments that the ED looks at the notion of management expectations in a way that is internally inconsistent with other aspects of the ED. For example, the ED requires management expectations to be taken into account to determine the tax rate but rejects the consideration of management intent in relation to the tax basis. In our opinion the way the business is run is relevant for the determination of the tax basis. Depending on the tax strategy in place, management may make different decisions with related implications for the tax basis. Therefore, we disagree with the ED proposal to establish the tax basis without consideration of management's expectations. We support the arguments set out by EFRAG in paragraphs 14 and 15 of its draft comment letter.

Recognition core principle and the definition of a temporary difference

(19) FEE shares the concerns expressed in paragraphs 17 and 18 of the EFRAG draft comment letter about whether the revised core principle is sufficiently clear, particularly when read together with the definition of a temporary difference and with paragraph 10 of the ED.

Overall conclusion

(20) We agree with EFRAG's draft comments that requiring the tax basis of an asset to be determined on the basis that the asset is sold, or requiring the tax basis of a liability to be determined on the basis that the liability is settled, might not be the correct approach from a conceptual point of view and hence that these proposals will not always result in a faithful reflection of the reporting entities' deferred tax consequences.

(21) We support the comments detailed in paragraph 20 of the EFRAG draft comment letter, in particular that it would be preferable for the IASB to develop a principles-based approach with clearly articulated principles that can be applied in practice in the various tax jurisdictions in order to provide the maximum level of decision useful information that reflects the particular tax circumstances.

(22) We suggest to consider real life examples where the possible consequences of the proposals could be illustrated: in particular the impact of the proposed tax basis not depending on management's expectations, the implications of the different tax rates under a "sale" and under an "in use" strategy, and the different types of tax deductions.

(23) We agree with EFRAG's draft comments that the linkage between the recognition of deferred taxes in the ED and the proposed definition of a temporary difference needs to be clearer in the ED and support EFRAG's call on the IASB to review the drafting.

Question 2 – Definitions of tax credit and investment tax credit

The exposure draft would introduce definitions of tax credit and investment tax credit. (See paragraph BC24 of the Basis for Conclusions.)

Do you agree with the proposed definitions? Why or why not?

(24) In principle, we believe that having clear definitions of what constitutes an (investment) tax credit would be useful, in particular as there is no existing guidance in this area under IFRS. However, we acknowledge that (investment) tax credits have different meaning in different jurisdictions. Therefore, it will be difficult to find a meaningful definition. Moreover, it is difficult - at least in some countries - to draw a dividing line between tax credits, investment credits and grants.

(25) We find the proposals confusing in the sense that they do not appear to provide a clear indication of how (investment) tax credits should be treated. In our opinion, investment tax credits should have the same accounting treatment as tax credits. The accounting treatment should also be aligned with the (future) accounting treatment for grants.

(26) Therefore, we are not convinced that a distinction between tax credits and investment tax credits is required (and hence having two definitions). In our view, a clear distinction between these two terms would only be necessary if a different accounting treatment is expected for each. In practice, the accounting treatment of tax credits and investment tax credits depends on the way the tax authorities provide economic benefits.

(27) The Basis for Conclusion indicates that the Board concluded that it was beyond the scope of the project to include a comprehensive reconsideration of the accounting for tax credits and tax deductions. This is another indication that the project would benefit from a more fundamental rethinking as explained in the cover letter.

(28) On this basis, we agree with EFRAG's draft comments that having a specific definition of a tax credit and investment tax credit in a standard may be misleading if in fact the accounting treatment of such incentives varies depending on the tax jurisdictions concerned.

(29) We agree with EFRAG's draft comments that it is difficult to differentiate between a simple tax credit and an investment tax credit but in our opinion IAS 12 should not remain silent in this respect. We encourage the IASB to define and set the accounting for (investment) tax credits in the new standard. We think that it would be helpful having a principles-based definition – as opposed to having two rules-based definitions - setting the underlying concept under which the accounting treatment can be applied and reflects the varying considerations by the different tax authorities. However, we agree that, should the IASB decide not to address the accounting treatment, it would be better that the future standard remains silent on the issue of (investment) tax credits.

Question 3 – Initial recognition exception

The exposure draft proposes eliminating the initial recognition exception in IAS 12. Instead, it introduces proposals for the initial measurement of assets and liabilities that have tax bases different from their initial carrying amounts. Such assets and liabilities are disaggregated into (a) an asset or liability excluding entity-specific tax effects and (b) any entity-specific tax advantage or disadvantage. The former is recognised in accordance with applicable standards and a deferred tax asset or liability is recognised for any temporary difference between the resulting carrying amount and the tax basis. Outside a business combination or a transaction that affects accounting or taxable profit, any difference between the consideration paid or received and the total amount of the acquired assets and liabilities (including deferred tax) would be classified as an allowance or premium and recognised in comprehensive income in proportion to changes in the related deferred tax asset or liability. In a business combination, any such difference would affect goodwill. (See paragraphs BC25–BC35 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

(30) We agree with the comments by EFRAG in paragraphs 36 and 37 of its draft comment letter that, in general, it would be preferable to eliminate the initial recognition exception in IAS 12 on the basis of having a more principles-based standard. However, we do not consider the current proposals are a clear improvement to IAS 12 since they add undue complexity.

Entity-specific tax effects and recognition under IFRSs (steps 1-2)

(31) We share EFRAG's concern about the rules-based nature of the proposal. Moreover the rules proposed are not clear in particular in relation to entity-specific impacts. We also share EFRAG's concerns as to whether the requirements in the ED are consistent with the way assets and liabilities are recognised in other IFRS.

Net-off approach on deferred tax effects (step 4)

(32) We agree with EFRAG's draft comments that the ED's proposals will not fundamentally change the different treatment that arises for assets acquired individually or in a business combination. The proposed complex changes to the requirements will often have no practical effect in comparison with the existing practice. Therefore, we agree with EFRAG that the outcome of the proposal in the ED will, in most cases, result in the same end result on initial recognition as the current exception in IAS 12 – a zero deferred tax balance in the financial statements.

Overall conclusion

(33) We support EFRAG's overall conclusion in its draft comment letter that the proposals in this area do not appear to represent a clear improvement to IAS 12. Accordingly, it might be appropriate for the IASB to consider maintaining the existing requirements until a more principles-based approach is developed.

Question 4 – Investments in subsidiaries, branches, associates and joint ventures

IAS 12 includes an exception to the temporary difference approach for some investments in subsidiaries, branches, associates and joint ventures based on whether an entity controls the timing of the reversal of the temporary difference and the probability of it reversing in the foreseeable future. The exposure draft would replace these requirements with the requirements in SFAS 109 and APB Opinion 23 *Accounting for Income Taxes—Special Areas* pertaining to the difference between the tax basis and the financial reporting carrying amount for an investment in a foreign subsidiary or joint venture that is essentially permanent in duration. Deferred tax assets and liabilities for temporary differences related to such investments are not recognised. Temporary differences associated with branches would be treated in the same way as temporary differences associated with investments in subsidiaries. The exception in IAS 12 relating to investments in associates would be removed.

The Board proposes this exception from the temporary difference approach because the Board understands that it would often not be possible to measure reliably the deferred tax asset or liability arising from such temporary differences. (See paragraphs BC39–BC44 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not? Do you agree that it is often not possible to measure reliably the deferred tax asset or liability arising from temporary differences relating to an investment in a foreign subsidiary or joint venture that is essentially permanent in duration? Should the Board select a different way to define the type of investments for which this is the case? If so, how should it define them?

(34) We fail to see the logic in drawing a distinction between foreign and non-foreign investments in subsidiaries, joint ventures and associates. We agree with EFRAG's draft comments that developing an accounting model on where the geographic location is of an entity is not principles-based and is an inappropriate way of developing global accounting standards.

(35) We are not certain whether the conditions spelled out in B5 differ in substance from the current requirements in IAS12.39 and would appreciate clarification in this respect.

(36) We are concerned about the use of US GAAP terminology in B5 such as "permanent in duration" and "apparent". Generally, IFRS users are not familiar with this kind of terminology. We suggest that these terms are reworded using IFRS terminology or further detailed to explain what these terms mean and whether they are different from the existing terminology, for example is "apparent" different from "probable".

Overall conclusion

(37) We agree with EFRAG's overall conclusion in paragraph 49 of its draft comment letter that the existing exceptions in IAS 12 should be retained and hence we do not support the proposals.

Question 5 – Valuation allowances

The exposure draft proposes a change to the approach to the recognition of deferred tax assets. IAS 12 requires a one-step recognition approach of recognising a deferred tax asset to the extent that its realisation is probable. The exposure draft proposes instead that deferred tax assets should be recognised in full and an offsetting valuation allowance recognised so that the net carrying amount equals the highest amount that is more likely than not to be realisable against taxable profit. (See paragraphs BC52–BC55 of the Basis for Conclusions.)

Question 5A

Do you agree with the recognition of a deferred tax asset in full and an offsetting valuation allowance? Why or why not?

(38) We agree with EFRAG's draft comments and support the proposed recognition of a deferred tax asset in full and with an offsetting valuation allowance, when necessary. However, in our view, the proposal could be further improved if the link between the uncertainties that are considered in the valuation allowance and the uncertainties which are not taken into account for the offsetting was made clearer. We also refer to our response to Question 7.

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(39) In addition, we believe that it would be helpful if the IASB would clarify the treatment to be applied to deferred tax assets and their related valuation allowances, in the context of business combinations accounted for under IFRS 3, i.e. should the deferred tax assets be recognised on a gross basis and then reduced by their valuation allowance or should a net amount be recognised and used as the basis for the deferred tax assets going forward? From a theoretical and practical perspective, we believe that it would be more appropriate to do the former as, under the new approach proposed by the ED, the deferred tax and its valuation allowance exist "independently" from one another.

Question 5B

Do you agree that the net amount to be recognised should be the highest amount that is more likely than not to be realisable against future taxable profit? Why or why not?

(40) We agree with EFRAG's draft comments that the net amount to be recognised should be the highest amount that is more likely than not to be realisable against future taxable profit.

Question 6 – Assessing the need for a valuation allowance

Question 6A

The exposure draft incorporates guidance from SFAS 109 on assessing the need for a valuation allowance. (See paragraph BC56 of the Basis for Conclusions.)

Do you agree with the proposed guidance? Why or why not?

(41) We agree with EFRAG's draft comments that the guidance provided in B17 and B25 is very rules-based. In our view, it would make more sense to incorporate a more principles-based guidance since this would allow more opportunity for a proper consideration of the practical needs. We support EFRAG in its call for more principles-based guidance (including implementation guidance) if the standard were to be amended.

Question 6B

The exposure draft adds a requirement on the cost of implementing a tax strategy to realise a deferred tax asset. (See paragraph BC56 of the Basis for Conclusions.)

Do you agree with the proposed requirement? Why or why not?

(42) In principle, in our opinion, it would make sense to include guidance on accounting for significant expenses to implement a tax planning strategy because, logically, if the costs of implementing a tax planning strategy exceed its benefits, the result would be that the particular strategy might not be implemented. Accordingly, the outcome of the

proposed requirement to consider the cost of implementing a tax strategy in determining when to recognise the valuation allowance would appear appropriate.

(43) The IASB should clarify what is meant by "cost of implementing a tax strategy". The last paragraph of B18 is also not clear as to the accounting treatment: expensing or inclusion in the valuation allowance or decrease in the cost of the asset. The IASB needs to explain how the accounting treatment fits with the objective of exit value, what happens if the entity decides on an alternative tax strategy, and whether costs are internal or external costs, full costs or only incremental costs. We tend to favour recognising these costs as an expense at the moment they occur.

(44) We encourage the IASB to work further in this area of the proposals in order to clarify the proposals and develop a more principles-based guidance. In particular, it would be helpful if the IASB explained its rational for the proposed consideration of the costs related to the tax strategy.

Question 7 – Uncertain tax positions

IAS 12 is silent on how to account for uncertainty over whether the tax authority will accept the amounts reported to it. The exposure draft proposes that current and deferred tax assets and liabilities should be measured at the probability-weighted average of all possible outcomes, assuming that the tax authority examines the amounts reported to it by the entity and has full knowledge of all relevant information. (See paragraphs BC57–BC63 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

(45) We agree with EFRAG's overall conclusion in paragraph 69 of its draft comment letter that the probability-weighted average approach is unlikely to produce a precise tax figure, despite the probable onerous requirements involved.

(46) We support EFRAG's suggestion that an approach based on the most likely outcome could be an alternative way to get to a reasonable tax number when uncertain elements exist.

(47) We agree with EFRAG's draft comments that an approach based on the most likely outcome would be consistent with the proposals in the ED regarding the measurement (paragraph 25 of the ED) of deferred tax assets and liabilities based on tax rates that are expected to apply. We encourage the IASB to further explore this suggestion.

Question 8 – Enacted or substantively enacted rate

IAS 12 requires an entity to measure deferred tax assets and liabilities using the tax rates enacted or substantively enacted by the reporting date. The exposure draft proposes to clarify that substantive enactment is achieved when future events

required by the enactment process historically have not affected the outcome and are unlikely to do so.

(See paragraphs BC64–BC66 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

(48) We agree with EFRAG's draft comments and support the proposals to clarify that substantive enactment is achieved when future events required by the enactment process historically have not affected the outcome and are unlikely to do so in the future.

Question 9 – Sale rate or use rate

When different rates apply to different ways in which an entity may recover the carrying amount of an asset, IAS 12 requires deferred tax assets and liabilities to be measured using the rate that is consistent with the expected manner of recovery. The exposure draft proposes that the rate should be consistent with the deductions that determine the tax basis, ie the deductions that are available on sale of the asset. If those deductions are available only on sale of the asset, then the entity should use the sale rate. If the same deductions are also available on using the asset, the entity should use the rate consistent with the expected manner of recovery of the asset. (See paragraphs BC67–BC73 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

Overall conclusion

(49) We agree with EFRAG's overall conclusion that the way assets and liabilities are recovered or settled respectively is a fundamental factor in determining whether there is a temporary difference and consequently whether deferred tax needs to be recognised in the financial statements and that getting the measurement principle right is largely dependent on getting the tax basis of the asset or liability right. We also refer to our earlier observations on management expectations. We agree with EFRAG that the IASB should further explore the relevance of management intent.

(50) In our response to Question 1, we agree with EFRAG that requiring the tax basis of an asset to be determined on the basis that the asset is sold or on the basis that the liability is settled might not be the correct approach from a conceptual point of view and hence that these proposals will not always result in a faithful reflection of the reporting entities' deferred tax consequences.

Question 10 – Distributed or undistributed rate

IAS 12 prohibits the recognition of tax effects of distributions before the distribution is recognised. The exposure draft proposes that the measurement of tax assets and liabilities should include the effect of expected future distributions, based on the entity's past practices and expectations of future distributions. (See paragraphs BC74–BC81 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

(51) The question to be addressed is whether distribution of profit is more likely than not. Relevant to this question is whether management can decide on the distribution. Management can decide on the distribution when it has control. In case of wholly owned subsidiaries management or the parent company has control. In relation to the ultimate shareholders, management in some jurisdictions has full control over dividend distribution, in other jurisdictions the shareholders can determine the (level of) distribution (so the shareholders have control and not the management). We consider that the control element should be part of the expectations on future distributions rather than the past experience element as currently proposed in B32 of the ED. The general principle should be that when management has control, the tax effect of distributions should be taken into account. In addition it may be helpful to give guidance on the meaning of "future". Is this the "foreseeable future" as referred to in B5? We suggest that B32 should be redrafted to reflect the principle set out above.

Question 11 – Deductions that do not form part of a tax basis

An entity may expect to receive tax deductions in the future that do not form part of a tax basis. SFAS 109 gives examples of 'special deductions' available in the US and requires that 'the tax benefit of special deductions ordinarily is recognized no earlier than the year in which those special deductions are deductible on the tax return'. SFAS 109 is silent on the treatment of other deductions that do not form part of a tax basis.

IAS 12 is silent on the treatment of tax deductions that do not form part of a tax basis and the exposure draft proposes no change. (See paragraphs BC82–BC88 of the Basis for Conclusions.)

Do you agree that the exposure draft should be silent on the treatment of tax deductions that do not form part of a tax basis? If not, what requirements do you propose, and why?

(52) We are not aware of any existing problems in practice related to tax deductions in the future that do not form part of a tax basis. We agree that the ED should be silent on the treatment of tax deductions that do not form part of a tax basis, i.e. we agree with the proposals in the ED not to change IAS 12.

Question 12 – Tax based on two or more systems

In some jurisdictions, an entity may be required to pay tax based on one of two or more tax systems, for example, when an entity is required to pay the greater of the normal corporate income tax and a minimum amount. The exposure draft proposes that an entity should consider any interaction between tax systems when measuring deferred tax assets and liabilities. (See paragraph BC89 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

(53) We agree with the proposal that an entity should consider any interaction between tax systems when measuring deferred tax assets and liabilities.

Question 13 – Allocation of tax to components of comprehensive income and equity

IAS 12 and SFAS 109 require the tax effects of items recognised outside continuing operations during the current year to be allocated outside continuing operations. IAS 12 and SFAS 109 differ, however, with respect to the allocation of tax related to an item that was recognised outside continuing operations in a prior year. Such items may arise from changes in the effect of uncertainty over the amounts reported to the tax authorities, changes in assessments of recovery of deferred tax assets or changes in tax rates, laws, or the taxable status of the entity. IAS 12 requires the allocation of such tax outside continuing operations, whereas SFAS 109 requires allocation to continuing operations, with specified exceptions. The IAS 12 approach is sometimes described as requiring backwards tracing and the SFAS 109 approach as prohibiting backwards tracing.

The exposure draft proposes adopting the requirements in SFAS 109 on the allocation of tax to components of comprehensive income and equity. (See paragraphs BC90–BC96 of the Basis for Conclusions.)

Question 13A

Do you agree with the proposed approach? Why or why not?

The exposure draft deals with allocation of tax to components of comprehensive income and equity in paragraphs 29–34. The Board intends those paragraphs to be consistent with the requirements expressed in SFAS 109.

(54) The ED proposes two modifications to IAS 12 relating to tax allocation:

- The removal of the principle that requires tax on current year items to be allocated on a “reasonable pro rata” basis and its replacement with part of the SFAS 109 rules dealing with the same issue; and

- The elimination of “backwards tracing” for tax related to items that were recognized outside the continuing operations in a prior year.

(55) While we acknowledge that guidance in the area of the allocation of tax on current year operations might be considered helpful, we do not agree with the proposal made by the Board. We understand that the rules that have been brought over from US GAAP are onerous to apply in practice and have been the subject of numerous interpretations precisely because they are not based on a sound principle. Accordingly, given the complexity of applying these rules, forcing preparers to change their accounting for current period tax allocation will, in all probability, result in poorer quality financial information than at present. Furthermore, this issue will not disappear after the first application experience as, every time a new transaction is faced, the rules will need to be reinterpreted to apply them to that situation, resulting in ongoing poor quality information.

(56) Preparers are familiar with the concept of backwards tracing and we believe it provides useful financial information. Removing this principle from the standard will not result in better quality information. This being said, given that we do not agree with the proposals made for current period tax allocation, we cannot approve of the “alternative approach” described in the ED either.

(57) The complexity of applying both the partly SFAS 109 rules as well as backwards tracing represents circumstances where we believe, the costs outweigh the benefits.

Overall conclusion

(58) We agree with EFRAG’s overall conclusion in paragraph 92 of its draft comment letter that the existing requirements in IAS 12 should be retained and hence we do not support the proposals regarding the tax allocation requirements, whether it is adopting the requirements in SFAS 109 on the allocation of tax to components of comprehensive income and equity or an approach based on the IAS 12 requirements with some amendment. In our view, the proposals would not appear to represent an improvement to IAS 12 and we would favour a more principles-based approach if the standard were to be amended.

Question 13B

Would those paragraphs produce results that are materially different from those produced under the SFAS 109 requirements? If so, would the results provide more or less useful information than that produced under SFAS 109? Why?
The exposure draft also sets out an approach based on the IAS 12 requirements with some amendments. (See paragraph BC97 of the Basis for Conclusions.)

(59) We agree with EFRAG’s draft comments and prefer retaining backwards tracing. See also our response to Question 13A.

Question 13C

Do you think such an approach would give more useful information than the approach proposed in paragraphs 29–34? Can it be applied consistently in the tax jurisdictions with which you are familiar? Why or why not?

(60) We agree with EFRAG's draft comments and prefer retaining backwards tracing. See also our response to Questions 13A and 13B.

(61) Our understanding is that the alternative approach could be applied consistently in the tax jurisdictions with which we are familiar but would impose high implementation costs on preparers.

Question 13D

Would the proposed additions to the approach based on the IAS 12 requirements help achieve a more consistent application of that approach? Why or why not?

(62) We are of the opinion that the proposed additions in the ED add complexity. In our view the Basis for Conclusions in paragraphs BC 95 to 97 does not provide convincing arguments for the selection of the approach based on IAS 12 requirements with additional guidance to cover the gaps. We agree with EFRAG's draft comments that it is not essential that the allocation method be exactly the same between entities, particularly in light of the complexity introduced. Moreover, we are not aware of evidence of current inconsistency problems in this respect in the application of IAS 12.

Question 14 – Allocation of current and deferred taxes within a group that files a consolidated tax return

IAS 12 is silent on the allocation of income tax to entities within a group that files a consolidated tax return. The exposure draft proposes that a systematic and rational methodology should be used to allocate the portion of the current and deferred income tax expense for the consolidated entity to the separate or individual financial statements of the group members. (See paragraph BC100 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

(63) We agree with the ED proposal to use a systematic and rational methodology to allocate tax expense of the consolidated entity to the separate financial statements of the group members.

Question 15 – Classification of deferred tax assets and liabilities

The exposure draft proposes the classification of deferred tax assets and liabilities as current or non-current, based on the financial statement classification of the related non-tax asset or liability. (See paragraphs BC101 and BC102 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

(64) We favour adopting a principles-based approach and an approach that is consistent, as much as possible, with IAS 1 *Presentation of Financial Statements*. By this we mean that, whenever it is possible to apply the IAS 1 guidance regarding the current/non current distinction, this approach should be adopted for the classification of deferred tax assets and liabilities. In practice, it is likely that this will result in the classification of deferred tax assets and liabilities as current or non-current based on the financial statement classification of the related non-tax asset or liability. Accordingly, in this sense, we agree with the proposals in the ED.

Question 16 – Classification of interest and penalties

IAS 12 is silent on the classification of interest and penalties. The exposure draft proposes that the classification of interest and penalties should be a matter of accounting policy choice to be applied consistently and that the policy chosen should be disclosed. (See paragraph BC103 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

(65) We agree with the proposals that the classification of interest and penalties should be a matter of accounting policy choice to be applied consistently and that the policy chosen should be disclosed.

Question 17 – Disclosures

The exposure draft proposes additional disclosures to make financial statements more informative. (See paragraphs BC104–BC109 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

(66) We welcome the approach taken by the ED to take a fresh look at the disclosures that might provide useful information to users, without adding unnecessarily to the voluminous amounts of information to the existing requirements of IAS 12. We agree with the additional disclosures proposed in the ED.

The Board also considered possible additional disclosures relating to unremitted foreign earnings. It decided not to propose any additional disclosure requirements. (See paragraph BC110 of the Basis of Conclusions.)

Do you have any specific suggestions for useful incremental disclosures on this matter? If so, please provide them.

(67) We agree that no additional disclosures should be required in relation to unremitted foreign earnings. However, if the IASB were to require such disclosure, they should only be narrative in nature.

Question 18 – Effective date and transition

Paragraphs 50–52 of the exposure draft set out the proposed transition for entities that use IFRSs, and paragraph C2 sets out the proposed transition for first-time adopters. (See paragraphs BC111–BC120 of the Basis for Conclusions.)

Do you agree with these proposals? Why or why not?

(68) We are of the opinion that retrospective application is appropriate unless amendments require the use of judgement and hindsight to obtain the information needed. Only such amendments should be applied prospectively.