



Exposure Draft (ED/2009/2)

Income Taxes

Public Discussion

Frankfurt am Main, 12 June 2009



Overview

1. Objective of the Tax Project

2. The Exposure Draft

2.1. Significant changes to IAS 12

2.2. Restructure format of the standard

2.3. Align definitions of tax basis and temporary difference with practice under US GAAP

2.4. Remove initial recognition exception

2.5. Amend exceptions for investments in subsidiaries, associates and joint ventures

2.6. Align recognition of deferred tax asset with US GAAP

2.7. Add requirements on uncertain tax positions

2.8. Align requirements on tax allocation with US GAAP

3. Conclusion

4. Appendix



Overview

1. Objective of the Tax Project

2. The Exposure Draft

- 2.1. Significant changes to IAS 12
- 2.2. Restructure format of the standard
- 2.3. Align definitions of tax basis and temporary difference with practice under US GAAP
- 2.4. Remove initial recognition exception
- 2.5. Amend exceptions for investments in subsidiaries, associates and joint ventures
- 2.6. Align recognition of deferred tax asset with US GAAP
- 2.7. Add requirements on uncertain tax positions
- 2.8. Align requirements on tax allocation with US GAAP

3. Conclusion

4. Appendix



1. Objective of the Tax Project

- Clarify and improve IAS 12
- Reduce differences between IAS 12 and SFAS 109
 - Remove most exceptions
 - Arrive at common recognition and measurement requirements
 - Require the same allocation to comprehensive income and equity



Overview

1. Objective of the Tax Project

2. The Exposure Draft

- 2.1. Significant changes to IAS 12
- 2.2. Restructure format of the standard
- 2.3. Align definitions of tax basis and temporary difference with practice under US GAAP
- 2.4. Remove initial recognition exception
- 2.5. Amend exceptions for investments in subsidiaries, associates and joint ventures
- 2.6. Align recognition of deferred tax asset with US GAAP
- 2.7. Add requirements on uncertain tax positions
- 2.8. Align requirements on tax allocation with US GAAP

3. Conclusion

4. Appendix



2.1. Significant changes to IAS 12 (as published by IASB)

- Restructure format of the standard
- Align definitions of tax basis and temporary difference with practice under US GAAP
- Remove initial recognition exception
- Amend exceptions for investments in subsidiaries, associates and joint ventures
- Align recognition of deferred tax asset with US GAAP
- Add requirements on uncertain tax positions
- Align requirements on tax allocation with US GAAP



2.2. Restructure format of the standard

- Principles on the objectives should be clearer



2.3. Align definitions of tax basis and temporary difference with practice under US GAAP

- If the recovery or settlement of an asset or liability is not expected to affect taxable profit, there is no temporary difference
- Tax basis is the measurement under existing tax law for consolidated or separate tax returns
- For assets, tax basis is determined through recovery through sale



2.3. 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.)

GASB: Deletion of management's intention is not consistent with other IFRS and within the ED (Question 9 sale or use rate)



2.4. Remove initial recognition exception

- Proposal
 1. Separate asset or liability into:
 - a. The asset or liability excluding entity-specific tax effects
 - b. Entity-specific tax advantage or disadvantage
 2. Recognise a. in accordance with other IFRS
 3. Recognise any resulting deferred tax asset or liability
 4. Recognise any difference between 2. + 3. and the purchase price as a premium or allowance.
- Effect

Same as existing exception unless there is an entity-specific tax effect



2.4. 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.)



2.4. Question 3 – Initial recognition exception

GASB:

- Basically we support the attempt to eliminate exception requirements. Nevertheless, we would like to point out the fact that so far no definition of entity-specific tax advantage or disadvantage exists. This may lead to difficulties concerning practical application and to different interpretations by preparers.
- The proposed new requirement does not achieve convergence between IFRS and US GAAP.
- Furthermore, we agree with retaining the exception for the initial recognition of goodwill. Nevertheless, we do not understand why deferred tax assets are not exempted as well. Therefore, we suggest that an entity shall neither recognize a deferred tax liability nor a deferred tax asset that arises on the initial recognition of goodwill.



2.5. Amend exceptions for investments in subsidiaries, associates and joint ventures

- Remove exception for investments in associates
- Remove exception for domestic subsidiaries
- Change exception for investments in foreign subsidiaries, joint ventures and branches:
 - No longer based on controlling the timing of the reversal of the temporary difference and the probability of it reversing in the foreseeable future
 - Instead, no deferred tax if the investments is essentially permanent in duration, unless the temporary difference is likely to reverse in the foreseeable future



2.5. 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.)



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

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?

GASB: We do not agree with the proposals. In our opinion, a revision limited to foreign subsidiaries and joint ventures cannot be sustained conceptually. This is based on the complexity of a reliable computation of tax effects in certain countries. Moreover, these effects often differ with regard to their taxability, tax type and tax rates, depending on how a reversal is achieved (disposal, distribution, liquidation or merger). We agree that the measurement of these tax effects is complex in any case (domestic and foreign) and cannot be justified from an economic viewpoint. Thus we regard an exception that comprises domestic as well as foreign entities and corresponds to the current standard IAS 12 to be preferable.



2.6. Align recognition of deferred tax asset with US GAAP

- Recognise in full
- Determine highest amount, more likely than not, realisable from future profits
- Raise a valuation allowance for the difference



2.6. 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?

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?



2.6. Question 5 - Valuation allowances

GASB: We support the two-step approach for the recognition of deferred tax assets as included in current SFAS 109.

We 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. In our view, the criterion “more likely than not” is more precise than the term “probable” used in current IAS 12 and therefore reduces existing judgment and improves comparability of IFRS financial statements.

BC 54 mentions that in some jurisdictions that currently apply IFRSs, the term “probable” is currently understood to denote a higher likelihood than the term “more likely than not”. The final IFRS should clarify in its transitional provisions, whether necessary adjustments due to the first-time adoption of the “more likely than not” criterion should be treated in accordance with the requirements in IAS 8 as a change in accounting policies, as a change in accounting estimates or as a correction of an error.



2.6. 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?

GASB: We support the incorporation of guidance from SFAS 109 on assessing the need for a valuation allowance. The guidance on the realisability of deferred tax assets included in B16 to B19 of ED/2009/2 is comprehensive and appropriate.



2.6. Question 6 – Assessing the need for a valuation allowance

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?

GASB: We support the described addition. However, we recommend clarifying whether or to what extent internal cost of implementing a tax strategy to realise a deferred tax asset should be included.



2.7. Add requirements on uncertain tax positions

- Measure current and deferred tax assets and liabilities at the probability-weighted average of all possible outcomes
- 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.)



2.7. Question 7 – Uncertain tax positions

GASB: In terms of the measurement of current and deferred taxes, the proposal requires that all possible outcomes of a tax audit should be taken into account. As described in the ED, the measurement shall be based on a probability-weighted average approach. In theory, such a measurement method can be preferable if it is based on a sufficiently large population of outcomes which inherently assumes that the normal (Gaussian) distribution applies. Without an appropriate population the probability weighted average approach could result in a misleading amount. For tax uncertainties a large population of different outcomes might be unusual in practice. To avoid a practice of ‘working back’ from a single best estimate to a full probability-weighted calculation as required by the ED from developing in practice, it might be helpful if the standard acknowledges that in some circumstances there may only be a single best outcome which the uncertainty should be recognised at.



2.9. Align requirements on tax allocation with US GAAP

- Proposal
 - SFAS 109 requirements
 - Recognise tax effects in the same component as the transaction or event giving rise to the tax
 - Recognise changes in those tax effects in continuing operations, subject to specific exceptions
- Alternative
 - Current IAS 12 requirements
Recognise tax effects and subsequent changes in the same component as the transaction or event giving rise to the tax
 - Plus
 - Tax on continuing operations is the fixed amount
 - Deferred tax asset should be recognised in the same component as the transaction or other event giving rise to the asset
 - Not the component containing the profit that allows it to be realised



2.9. 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.



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

GASB: We do not agree with the proposed approach over all.

We continue to consider the current IAS 12 guidance of recognising the effects of tax changes in the income statement except to the extent that they relate to items previously recognised in equity to be both conceptually superior to the FAS 109 approach and, all aspects considered, easier to apply. We therefore strongly recommend adopting the alternative approach of allocating tax to comprehensive income and equity that the Board proposes not to adopt.

The application of the proposed accounting requirement produces misleading and illogical results in the financial statements, especially as it relates to financial assets available for sale.



Overview

1. Objective of the Tax Project

2. The Exposure Draft

2.1. Significant changes to IAS 12

2.2. Restructure format of the standard

2.3. Align definitions of tax basis and temporary difference with practice under US GAAP

2.4. Remove initial recognition exception

2.5. Amend exceptions for investments in subsidiaries, associates and joint ventures

2.6. Align recognition of deferred tax asset with US GAAP

2.7. Add requirements on uncertain tax positions

2.8. Align requirements on tax allocation with US GAAP

3. Conclusion

4. Appendix



3. Conclusion

- Clarify and improve IAS 12

GASB does not agree with the ED due to

- Tax basis
- Initial recognition
- Outside basis differences
- Intraproduct allocation

Therefore GASB recommends a revised version of IAS 12.

- Reduces differences between IAS 12 and SFAS 109

Due to the FASB not intending to pursue the idea of a separate standard on accounting for income taxes in the USA, convergence can no longer be the primary objective for issuing ED/2009/2.



Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany



Sabine Grawunder

Tel. 030 20 64 12 28
grawunder@drsc.de

Zimmerstr. 30
10969 Berlin

Fax 030 20 64 12 15

-
www.drsc.de



Overview

1. Objective of the Tax Project

2. The Exposure Draft

2.1. Significant changes to IAS 12

2.2. Restructure format of the standard

2.3. Align definitions of tax basis and temporary difference with practice under US GAAP

2.4. Remove initial recognition exception

2.5. Amend exceptions for investments in subsidiaries, associates and joint ventures

2.6. Align recognition of deferred tax asset with US GAAP

2.7. Add requirements on uncertain tax positions

2.8. Align requirements on tax allocation with US GAAP

3. Conclusion

4. Appendix



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.)

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



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.)

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



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, i.e. 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.)

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



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.)

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



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 recognised 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?



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?



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

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.)

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.

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?



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

The exposure draft also sets out an approach based on the IAS 12 requirements with some amendments. (See paragraph BC97.)

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?

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?



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?



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 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?



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?



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?

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.



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?