



 **Conseil National de la Comptabilité**

3, Boulevard Diderot  
75572 PARIS CEDEX 12

Paris, 21<sup>st</sup> July 2009

**Téléphone** 01.53.44.52.01

**Télécopie** 01 53 18 99 43 / 01 53 44 52 33

**Internet** <http://www.cnc.minefi.gouv.fr/>

**Mel** [jean-francois.lepetit@cnc.finances.gouv.fr](mailto:jean-francois.lepetit@cnc.finances.gouv.fr)

**Le Président**

**JFL/PhS**

**N°44**

**The Income Tax Project Manager  
IASB  
30 Cannon Street  
London EC4M 6XH  
UNITED KINGDOM**

**Exposure Draft ED/2009/02 Income Tax**

Dear Sir/Madam,

I am writing on behalf of the CNC to give you our comments on the above-mentioned Exposure Draft(ED). Our detailed comments are set out in the attached Appendix.

For the reasons set out below, we disagree with all of the main changes proposed in the ED which does not in our view provide a satisfactory basis for revising IAS 12.

**1. We think that the objectives of the ED, to achieve convergence with US GAAP as well as to clarify IAS 12 without modifying its fundamental principles, are not achieved.**

We note that the FASB has postponed the decision to revise its own tax standards. Consequently, this is not anymore a joint project.

Moreover we note that the project is not fully convergent, especially regarding the weighted average methodology proposed to measure and recognize uncertain tax position (even though we would prefer an approach based on management's best estimate).

Furthermore the proposed redrafting of the standard, instead of clarifying the principles, raises various difficulties of interpretation which lead us to question whether these principles have in fact been modified particularly regarding the new definition of a temporary difference and the application of the initial step for recognizing deferred tax. We note that the ED introduces a number of complex rules rather than principles.

y:\cnc\encours\jflepetit-adc\lepetit\reponses\iasb\incometax\_comment letter\_200709.doc

**2. We note that the proposals are in contradiction with the core principle of the ED which stipulates that deferred tax should reflect “tax payable or tax recoverable on taxable profits for future period as a result of past transactions or events”.**

As the ED requires the tax basis to be determined on a sale or settlement basis at reporting date, it does not take into account management intentions and will not therefore always be consistent with expected cash flows. Consequently, we believe that it would not result in an improvement to financial reporting.

According to the ED, the accounting principles for uncertain tax positions would be recognized without application of a probability of occurrence threshold (and therefore not convergent with SFAS 109) and measured using the probability-weighted average of all possible outcomes. We believe that the “more likely than not” recognition criterion and measurement taking into account management’s best estimate, would better reflect the expected cash flows.

**3. We believe that some major proposals would not improve financial reporting**

As the initial recognition exception has been eliminated, the initial accounting described in the ED requires separate recognition of “entity-specific” tax effects, adjusted carrying values after deduction of entity-specific tax effects and an allowance or premium as a balancing amount so that the total of these items is equal to consideration paid or received. These requirements are complex and this proposal would appear to introduce a new measurement base for assets which is outside the scope of a revision of IAS 12. We believe that these requirements are intended for single asset entities. However the way the text is drafted could lead us not to separate out the tax effect for these entities because it may not be entity specific.

The requirements for allocation of tax to components of comprehensive income and equity are complex and rules-based. For allocation of tax effects in respect of current year operation, the proposed approach is too complex and might have adverse effects on the quality of financial information. The allocation of tax effects relating to prior periods operations to the continuing operations is not relevant and is likely to increase volatility of the reported result from continuing operations after tax. We would prefer an approach based on “backwards tracing”.

The proposals in the ED also introduce different rules for recognizing deferred tax in respect of foreign and domestic investments. The current exception is maintained for temporary differences that are essentially of a permanent nature exclusively for foreign subsidiaries, joint ventures and branches. We recognize there may be practical difficulties in obtaining the relevant information but this might also apply to domestic investments. We do not believe that this is a justification for introducing different accounting according to whether an investment is considered domestic or foreign. As a result the accounting principles applied will depend on group structure and how the undefined term foreign is interpreted.

The ED maintains the position of IAS12 regarding intergroup transfers of assets. However we think that the application of the tax rate of the seller is more appropriate and better reflects cash flows.

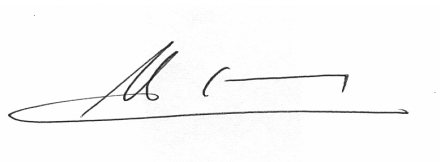
**4. We consider that the proposals do not cover certain topics for which guidance is currently lacking**

Among the subjects for which guidance is necessary, we have identified:

- Measurement of deferred tax assets generated by losses for which an unlimited carry forward is available
- Clarification of the scope of IAS 12 with respect to certain tax credits
- Accounting for investment tax credits

We hope you find these comments useful and would be pleased to provide any further information you might require.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'J. Lepetit', is written over a light grey rectangular background.

Jean-François Lepetit

# APPENDIX

## 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?**

#### Management intentions

1.1. We do not believe that the proposals in the ED represent an improvement over the current version of IAS 12. Whilst we agree with the core principle set out in paragraph 1, we note that the rule imposing the use of a sale basis contradicts this core principle, as it will lead to recognizing deferred tax assets and liabilities that are not “tax payable or recoverable on taxable profit for future period as a result of past transactions or events”.

We are concerned that, by disregarding management intention, reported deferred tax assets and liabilities may not reflect the expected cash flows of an entity and will therefore not provide decision useful information for users of financial statements. Moreover, reported deferred tax assets and liabilities will not meet the definition of assets and liabilities in the Framework.

In the case of an asset, for example, the proposed tax basis will equal the amount deductible from taxable income in the event of a sale at the end of the reporting period even though in many cases assets will have been acquired for use in the business. In those jurisdictions where tax bases for sale and use are different this would lead to deferred taxes being measured on a basis inconsistent with management expectations.

For instance, we note that Example 16 illustrates the proposed requirements through recognition of a deferred tax liability after two years even though the entity intends to recover the carrying amount through use and will therefore be entitled to future tax deductions (CU120) exceeding the carrying value of the asset (CU 80). We question the meaning of such a deferred tax liability as there is no corresponding taxable temporary difference (as defined in Appendix A).

Conversely, in the opposite situation (deductions available on sale higher than deductions available on use), would the standard require recognition of a deferred tax asset even if the entity does not intend to sell the asset?

1.2. Furthermore, we are concerned that there is not a consistent approach to management intention in the exposure draft. We note for example that management intention:

\* is taken into consideration for:

- the initial step in determining whether there will be an effect on taxable profit on recovery of an asset or settlement of a liability,
- the tax rates where the tax basis is the same for both sale and use,
- the tax rates on expected distribution.
- in appraising the permanent nature of the investments in foreign subsidiaries, branches, joint ventures.

- in assessing the recoverability of deferred tax assets.
- \* but is not taken into consideration for:
- determining the tax basis of assets and liabilities.
  - recognizing tax on investments in domestic subsidiaries, branches, joint ventures and associates.

The Board itself admits this (ref: BC22 and BC23), but nevertheless accepts this for the purposes of convergence with US GAAP as stated in BC20. We do not believe that introducing a rule purely for the sake of convergence is justified, especially given that SFAS109 does not contain an explicit definition of tax basis (BC19). We consider that application of the core principle takes priority over convergence.

1.3. We believe that there should be consistency between the tax basis and the tax rate used to measure deferred tax assets and liabilities. We consider it would be more relevant to use a tax basis and tax rate that reflect management intentions.

### **Changes to the definition of a temporary difference and initial step**

#### Points for clarification

1.4. The ED proposes changes to the definition of a temporary difference to exclude differences that are not expected to affect taxable profit. It is not clear to us whether the ED introduces a change in the wording of the definition or whether it changes the basic principle.

As stated in BC 18, such differences would not give rise to deferred tax under the existing version of IAS 12 because the tax base is considered to be equal to the carrying amount. We understand that the change of definition is intended as a clarification with a view to convergence with SFAS 109.

1.5 However, paragraph 10 of the ED is not clear, and we believe it would be useful to include examples to illustrate the application of paragraphs 10 a) to c) to clarify – for example – how this requirement would apply in the following circumstances:

- 1) In the case of depreciable assets that the entity intends to recover through use rather than sale, when the depreciation is not tax deductible - but revenues generated by using the asset are taxable.
- 2) For investments in bonds classified as Available For Sale assets but that the entity intends to hold to maturity (and therefore, changes in fair value are not expected to affect taxable profit).
- 3) For compound financial instruments. In Example 6, the first step with respect to management's intentions is not discussed. However, the financial instrument is accounted for as an interest-bearing liability and deferred tax recognized accordingly. It is not clear whether management's intentions have been taken into account e.g. would the treatment have been different if management expected the loan to be converted ultimately without any tax consequences?

1.6 The initial step appears only to apply to items having a carrying amount (see paragraphs 10 and 16) and would therefore presumably exclude, for example treasury shares. It should be clarified if, and if so, why such items are excluded from the initial step.

Indeed, although equity instruments are specifically included in the scope of the ED, their deferred tax treatment requires clarification. Where an entity holds its own equity instruments, we could read paragraphs 16 and 18(a) as meaning that deferred tax should be systematically recognized on a temporary difference between the carrying amount of nil and the tax base, which in some jurisdictions would be the cost of the equity instruments. However, there would only be tax consequences if the entity were to realize a capital gain on sale. Consequently, it would be inconsistent to recognize deferred tax on the difference between the carrying amount (nil) and tax basis (acquisition cost). This deferred tax will not reflect expected cash flows.

## **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?**

### **Tax credit**

2.1. A tax credit is defined as “A tax benefit that takes the form of an amount that reduces income tax payable”. The definition raises certain issues that require clarification in particular with respect to the standards applicable to tax credits when for example:

- the tax credit is not based on taxable profit and
- the recovery of the tax benefit is not limited to the amount of income tax liability.

For example, some tax credits – computed as a percentage of R&D expenses - may be used to reduce current and future income tax liabilities for a specified period (e.g. 5 years). However, if insufficient taxable income is generated during that period, the tax credit is refundable by the tax authorities. We believe IAS 20 provides relevant guidance to account for this type of tax credit and that either the definition or the scope of the standard should be clearer in that respect. We regret that guidance in respect of the accounting for investment tax credits is provided neither in the standard nor by reference to another standard such as IAS 20. In particular, it would be useful to clarify the scope of IAS 12 and define the accounting with respect to non-refundable investment tax credits e.g. for development costs.

2.2 Non taxable tax credits accounted for according to the requirements of IAS 20 are one of the sources of temporary differences arising on the initial recognition of an asset. With the elimination of the initial recognition exception, we understand that entities will have to recognise deferred tax on these sources even though they are not taxable i.e. permanent differences.

### **Investment tax credit**

2.3. An investment tax credit is defined as “A tax credit that is directly related to the acquisition of depreciable assets”. This definition also raises issues for clarification.

2.4. It may be asked why the definition is limited to depreciable assets i.e. it excludes non-depreciable assets such as land or brands. Moreover, internally produced assets which are not “acquired” would also appear to be excluded. Additionally, the notion of “directly related” should be clarified: must the “acquisition of depreciable assets” be the sole condition for benefitting from the tax credit, or may it be one of several conditions of a different nature?

### **Additional comments on the scope of the standard**

2.5. We note that income tax is defined in paragraph 2 of the ED as including all domestic and foreign tax that is based on taxable profit. Paragraph 3 has been added to specify that taxable profit implies a net amount of income and expense rather than a gross amount or individual item. We regret that Board has not provided a specific question for this amendment. There are taxes that are equivalent in substance to income tax, such as tonnage taxes or withholding tax on royalties which reduce income tax payable. We regret that those taxes are not treated similarly.

### **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?**

3.1. In general we are in favour of eliminating exceptions to principles in IFRSs. However, the proposals in the ED raise a number of issues.

3.2. Firstly, we note that the proposals lead to adjusting existing carrying values to exclude entity-specific tax effects. The ED states that the carrying values are recognized and measured in accordance with applicable IFRSs. However we are not certain that the adjusted values would necessarily comply with the requirements of existing IFRSs.

The ED would therefore appear to introduce a new valuation base for assets and liabilities which is outside the scope of the draft IFRS on Income Tax. Such a fundamental change would require an extensive debate before implementation.

3.3. Secondly, a clarification is required of what is meant by an “entity-specific tax advantage” and how that advantage can be identified. In most cases, tax advantages available to an entity would also be available to other market participants within the same tax jurisdiction. Does the specificity refer to the unique tax status of the entity or to some specific advantage negotiated in a particular transaction? We are unclear on whether the guidance in B10 would apply to transactions involving “single asset entities”, which enable the carry-over of the tax basis of an asset from the seller to the purchaser. In such a circumstance, if the carried over tax basis could be available to any market participants in that tax jurisdiction (e.g. any market participant could acquire the shell company with a single asset rather than the asset itself), and because the transaction is not a business combination, no “entity-specific tax effect” would be identified under paragraph B10 (a). However, we believe that this particular transaction should comply with the proposed requirement (excluding tax effect from the cost of the asset).

Moreover, we wonder whether the requirement to assess the tax basis available to any market participant means that only tax deductions available on sale should be reflected. If so, we question whether this requirement would enable a proper assessment of how tax effects have affected the transaction price.

We regret that none of the illustrative examples provide guidance on both the identification and the assessment of such entity-specific tax effects.

3.4. Thirdly, we fear that the proposals lead to more complex accounting, even when no entity-specific tax effects have been identified:

- the requirement to reduce the allowance/ premium proportionally to changes in the related deferred tax asset or liability is unclear when tax law allows depreciation / amortization of the tax base over a period that is shorter than the economic life of the asset, or when the asset is subsequently carried at its fair value.
- it is also unclear whether and how such changes in the related deferred tax asset (if at initial recognition, the tax basis of an asset is higher than its carrying value) should take into account valuation allowances, for the purpose of measuring changes in the allowance or premium.

We are not convinced that the complexity leads to more relevant information for users of financial statements.

3.5. For the reasons stated above, we disagree with the proposals. On balance, we think it would be preferable to maintain the existing exemption rather than to implement these proposals. Should the Board decide to keep that provision in the final standard, we believe that additional guidance and examples would be necessary to clarify the above mentioned concerns.

#### **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?**

4.1. We do not agree with the proposals for a number of reasons.

4.2. The ED proposes maintaining the exception with respect to temporary differences relating to foreign subsidiaries, joint ventures and branches that are essentially permanent in duration. Accordingly, a difference of accounting treatment is introduced between foreign and domestic subsidiaries, joint ventures and branches. The reasons given for proposing an exception to the temporary difference approach for foreign subsidiaries, joint ventures and branches (see BC 43) are the complexity and the costs of producing the information for “permanently reinvested unremitted earnings”. Whilst we agree there may be practical difficulties in obtaining the information for foreign investments, we believe this also to be the case for many domestic subsidiaries. It is not appropriate to have different treatment for domestic and foreign investments because it makes accounting treatment dependant on group structure.



4.3. The ED is not clear on whether the tax basis of an investment in a domestic subsidiary / joint venture should be determined under the assumption that the investment will be recovered through use (dividend distribution) or through sale:

- On the one hand (sale assumption), we question the relevance of information based on the assumption that a group would sell all of its subsidiaries, joint ventures and branches.
- On the other hand, we believe that the standard should indicate how to determine the tax effect (based on all unremitted earnings, pre-acquisition profits, or only the portion which is expected to be distributed in a foreseeable future). In our view it would be appropriate to recognize deferred tax only on distributions expected in the foreseeable future as this is the most relevant information for assessing future cash flows (assuming that the intention is not to sell the investment)

Moreover, if the tax rate applicable to sale differs from the tax rate applicable to dividends distributed, which tax rate should be applied?

4.4. For the reasons set out above, we disagree with the proposals that could lead to deterioration in the quality of the financial statements.

We believe that the practical difficulties noted with respect to foreign investments apply equally in many jurisdictions to domestic investments and we believe that national and foreign investments should not be treated differently.

We also believe that the management expectation (use or sale) for the foreseeable future should be taken into account in recognizing and in measuring any deferred tax asset / liability for investments.

Finally, assuming the entity has no intention to sell an investment in associates, it would be appropriate to recognize deferred tax on all distributable earnings as the entity does not control dividend distribution.

#### Additional points requiring clarification

4.5. The proposal raises certain definition issues with respect to how to assess whether the investment is “foreign” and “permanent in duration”. More particularly:

- What are the criteria for determining whether an investment is “foreign”: is it the country of incorporation, the functional currency as defined by IAS 21, the tax jurisdiction or other criteria? Also, should the assessment be made by reference to the reporting entity or by reference to the direct parent of the subsidiary in question?
- The use of the word “apparent” in the ED (B5 (b)). This term is not commonly used in IFRSs and its introduction here merits an explanation. Alternatively, could another term, more commonly used in IFRSs such as “probable” or “more likely than not” rather be used?
- Regarding the permanent nature of foreign investments it is not clear whether this is an “all or nothing” approach, i.e. in the event that a part of an investment in a subsidiary will be distributed (as envisaged in paragraph B7 of the ED), should the deferred tax be calculated based on only that portion which will be distributed or should it be calculated on the whole of the temporary difference, the wording of B7 is not clear in the regard: “If circumstances change and it becomes apparent that all or part of an investment in a foreign subsidiary or joint venture is no longer essentially permanent in duration, the entity shall recognise the **related [emphasis added]** deferred tax asset or liability”.

### **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?**

5A. Under the proposed approach an entity recognizes all deferred tax assets and requires a valuation allowance to be recognized where it is more likely than not that some part of the asset will not be realized against taxable income. As unrecognized deferred tax assets are currently required to be disclosed in the notes, we believe that the proposal to recognize all deferred tax assets in the accounts provides improved traceability and better quality information.

#### **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?**

5B. We believe that a best estimate approach would be more appropriate as in practice entities do not consider several scenarios. This approach is also consistent with our position on uncertain tax position.

If the Board wants to maintain its proposal, the Board should provide some additional guidance and examples to illustrate how to determine the highest amount that is more likely than not to be realisable against future taxable profit.

While as currently drafted, IAS 12 allows recognition of a deferred tax asset only to the extent that it is probable that future taxable profit will be available (positive evidence is required), the ED suggests that a valuation allowance must be recognized if sufficient taxable profit is less likely than not (negative evidence is required).

While we believe that the net amount reported under the proposed approach should not be fundamentally different to amounts recognized under the current requirements of IAS 12, we question whether this change could not be perceived as resulting in the recognition of more deferred tax assets, especially in those jurisdictions where tax losses can be carried forward indefinitely (see question 6A).

### **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?**

6A. We find the guidance in B16 to B25 useful.

We do, however, regret that no guidance is given in respect of the treatment of tax losses that may be carried forward indefinitely. For these losses, how would the highest amount that is more likely than not to be realisable against future taxable profit be determined? We note that deferred taxes are not discounted so that the timing of the recovery of tax losses will not be reflected in their measurement.

### **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?**

6B. According to the ED (see B18), where tax strategies are implemented to recover deferred tax assets, the related costs, if significant, should be taken into account in determining any valuation allowance. The current version of IAS 12 is silent on this subject and we therefore consider this guidance to be useful.

The clarification of certain issues would, however, be helpful:

1. Firstly we suggest that it would be helpful to define the nature of costs to be taken into account. For example, is it intended that only incremental costs should be taken into account? Would internal restructuring costs be included or only external costs such as fees?
2. Can a change in tax status be considered to form part of a tax planning strategy? According to B27 the effect of a voluntary change in tax status is only recognized either on the approval date or the filing date. The effect of a tax strategy, on the other hand, may be anticipated for the purposes of determining a valuation allowance (see B17 and 18). The ED would appear to maintain this inconsistency which already exists between SIC 25 and the current version of IAS 12.

### **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?**

7.1. We disagree with the proposals. We believe that the application of the “more likely than not” recognition criteria as in the current version of IAS 37 would lead to more relevant information than the approach proposed. Furthermore, our suggestion is that such tax positions should be measured in accordance with the management’s best estimate, as this basis is more likely to reflect expected cash flows and to produce decision-useful information.

7.2. As a result of the lack of recognition threshold, entities would be required to seek out information on uncertain tax positions even when the chances of the positions materialising are remote. The collection process could prove burdensome and the decision-usefulness of the information low. Indeed this information may have an unnecessarily negative impact on corporate communication.

We disagree with the approach set out in the ED. As stated in the CNC’s comment letter relating to the proposed revision of IAS 37, we disagree with the elimination of a recognition threshold for provisions. As under the existing requirements of IAS 37, we believe a provision should be recognized when it is more likely than not there will be an outflow of resources.

7.3. The proposed measurement approach requires establishing the different possible outcomes and evaluating the probability they will be realized. Such evaluations are necessarily subjective and may be onerous to provide. The probability weighted average of the different scenarios will not provide estimates of amounts expected to be paid or deducted. We question the relevance of this information for users because it does not reflect the management's best estimate of expected cash flows.

7.4. We further note that revised estimates are subject to the existence of new information whereas IAS 8 §34 allows also for changes based on "more experience". We disagree with the adoption of a more restrictive approach than in IAS 8.

#### **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?**

8.1. The exposure draft provides a clarification of the term "substantial enactment" which is already used in the current version of IAS 12. We understand this definition to be broadly in line with current practice and agree with the proposed clarification.

8.2. We do, however, consider it inappropriate that in a supposedly principle-based IFRS direct reference is made to the interpretation of "substantively enacted" applicable under the legislation and rules existing in a particular country. We refer to B 26 which states that "In the US tax jurisdiction, substantive enactment is achieved only on enactment".

#### **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 of the Basis for Conclusions.)**

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

9.1. We agree with the proposal in the ED that the tax rate used should be consistent with the tax basis in order to ensure a consistent measurement of deferred tax assets and liabilities.

However, as stated above in our answer to Q.1, we disagree with using a sale rate and tax deductions available on sale where management intends to use rather than sell an asset. Indeed we see no clear rationale in the ED for adopting the sales tax basis and tax rate. We consider that the tax basis and tax rate used to measure deferred taxes should both reflect management intentions because this measurement approach is the most likely to reflect expected cash flows and provide decision-useful information to users of financial statements.

9.2. We note that where the same deductions are available on sale or use of an asset then the tax rate should reflect the expected rate applicable on recovery. It does however mean that the tax rate will not be determined by a consistent principle as it will depend on whether the tax bases on sale and use are the same, depending on the tax jurisdiction.

9.3. We believe that the requirements of paragraph B29 are unclear when the intention of management is mixed i.e. where management intends to use an asset for a number of years then sell it. For instance, example 17 does not provide guidance on how the average tax rate used to measure the deferred tax liability at the end of year 2 would be computed, and we believe that using temporary differences to weight sale rate and use rate would lead to recognizing an amount of deferred taxes that would be difficult to understand.

9.4. In conclusion, we disagree with the proposals because:

- They are not always consistent with management intentions and expectations
- Deferred tax assets and liabilities will not always reflect expected cash flows
- The information provided under the proposals will not always be relevant for users of financial statements
- The proposals are not based on a consistent principle

In our view, the current requirements of IAS12 are more likely to provide relevant information that reflects an entity's expected cash flows.

#### **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?**

10.1. We are in favour of taking into account expected future distributions in the measurement of deferred tax as this provides decision-useful information. However, we regret that this approach has not been applied consistently in the ED.

10.2. The ED proposes that an entity should take account of the effect of expected future distributions in measuring tax assets and liabilities. According to BC 81 this is "consistent with the general approach of using the rate expected to apply in measuring deferred tax assets and liabilities". However, as stated in our answer to Question 1 the ED does not adopt a consistent approach to management expectations and intentions. The tax basis and rate applicable to an asset will be determined on the assumption of a sale (except where the tax basis is the same in the event of sale or use) without taking into account management expectations and intentions.

10.3 We believe that the ED should not introduce any inconsistency between tax rates used by subsidiaries (distributed or not) and the way the parent should determine deferred tax on temporary differences arising on this investment (ref. question 4).

### **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?**

11.1. While we agree that the ED should not include any specific rules related to a particular jurisdiction, we regret that the ED does not give any guidance to enable us to assess in which circumstances a future deduction would not form part of a tax basis.

### **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?**

12.1. The interaction between alternative tax systems reflects legal requirements specific to certain jurisdictions. As such, an entity in these jurisdictions would necessarily consider the interaction between tax systems when measuring tax assets and liabilities.

We believe that guidance and examples are necessary to illustrate how deferred taxes should be measured in these circumstances.

### **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.**

13A.1. We note that the process of allocation of tax to components of comprehensive income and equity can be divided into two separate issues:

- Allocation of tax in respect of current year operations.
  - Allocation of tax effects relating to prior years operations.
- The alternative approach described in the ED only relates to the second issue.

### **Allocation of tax in respect of current year operations**

13A.2. We regret that no alternative approach is proposed for allocation of tax in respect of current year operations as the proposed approach is a very complicated set of rules. We acknowledge that this set of rules might be useful to properly allocate tax effects in complicated situations but we are concerned that it will also considerably increase difficulty in carrying out the allocation in situations where the current guidance in IAS 12 i.e. a “reasonable pro rata allocation” provides correct and intuitive information.

We are also concerned that such a complicated set of rules might have adverse effects on the quality of financial information as preparers may have a lot of difficulty in properly applying the requirements of the ED. It is our understanding that US preparers still have difficulties in applying similar requirements in SFAS 109.

Should the Board continue with this proposal, it seems to us that the following issues should be addressed:

- In order to apply the requirements properly, a more comprehensive set of illustrative guidance is needed. Particularly, example 20 is not sufficient to illustrate the requirements in paragraph 34(c) as to:
  - how to allocate the remaining tax effect in case there are both loss components and gain components (it seems that the provisions in paragraph 34(c)(i) as written are not applied in example 20)
  - how to determine the “effect on tax expense of the total loss for all loss items recognised outside continuing operations” in case there are several loss items.
- It is not clear why paragraph 34 applies to both tax effects in respect of current year operations and in respect of prior year adjustments.
- Guidance should be provided as to how the requirements in paragraph 32(d) relating to share-based payments and the requirements illustrated in example 6 relating to compound financial instruments interact with the provisions of paragraph 34.

### **Allocation of tax effects relating to prior years operations**

13A.3. The objective of the proposed approach is convergence with SFAS 109. Under this approach, allocation of tax related to items recognized outside continuing operations in a prior year will, subject to specific exceptions, be through continuing operations. The current version of IAS 12 requires allocation of such tax outside continuing operations in application of the approach known as “backwards tracing” by which tax is allocated back to the component of comprehensive income or equity where the originating transaction was recognized.

We do not agree with the proposed approach and we would prefer an approach based on “backwards tracing”.

#### ***13A.4. We disagree with the proposed approach which we consider is not principle-based.***

We believe the “backwards tracing principle” should be maintained as it provides relevant information in many cases to users of financial information. In our view, the approach proposed in the ED does not improve the quality of information for users of financial statements.

Moreover, it seems to us that there is an inconsistency in the proposed approach regarding the tax effect allocated to continued operations as, on the one hand, the tax effect allocated to continuing operations is the tax effect which gives rise to the most precise calculation (in respect of transactions of the period), and, on the other hand, virtually all changes in tax effects of prior periods transactions are recognised as tax effect on continuing operations and thus distort the tax

effect allocated to continued operations. In our view, the proposed approach is likely to increase the volatility of the reported result from continuing operations after tax, which is a key indicator for users of financial statements.

**13A.5.** Should the Board continue with this proposal and reject “backwards tracing”, it seems to us that the following issues should be addressed:

- more comprehensive illustrative guidance should be provided in order to apply the requirements properly, and in particular:

- it seems to us that example 19 (year 2) only deals with the reversal of the valuation allowance and that the effect of reversal of the initial DTA could be added

- illustrative examples should be provided in respect of reclassification adjustments from OCI to P&L and their related tax effect

- we question the reason why a very specific “backwards tracing” is retained in the ED in respect of changes in a valuation allowance relating to an item initially recognised as a transaction with equity holders (paragraph B36(b)). We wonder whether numerous transactions would be concerned and whether it is worth maintaining this complexity for such transactions. We would be in favour of eliminating this exception in the proposed approach.

**13A.6.** *We would prefer an approach based on backwards tracing (modified alternative approach)*

We believe that “backwards tracing” is an application of the principle that tax should be allocated to the component of comprehensive income or equity of its originating transaction.

We note that the ED (see §29) adopts this approach for tax expense arising at the time of transactions but not for transactions recognized in prior periods and is therefore inconsistent.

**13A.7.** The Board notes in BC 93 that “backwards tracing” may be difficult or result in arbitrary allocations. However, an absence of “backwards tracing” may also prove difficult or arbitrary.

If we take the example of a bond classified as “available for sale” for which changes in value are recognized in other comprehensive income, we note that related changes in tax rate would be dealt with in continuing operations under the proposals in the ED. Moreover, in such a case, the difficulty of “backwards tracing” consists in tracking the changes in tax rates that relate to the specific temporary difference so as to book them in OCI. Generally such information is available. On the contrary, no “backwards tracing” implies that the tax effect relating to OCI is recorded using the historical tax rate, and that a specific follow-up is required in order to be able to reclassify the correct tax amount from OCI to P&L. Moreover, it seems to us that when the reclassification adjustment to P&L is made, the effective tax rate cannot be explained.

**13A.8.** However, we agree with the Board that application of the “backwards tracing” approach raises difficulties in some cases for which specific guidance would be necessary. We agree with the Board’s remarks in BC 92 that the reversal of a valuation allowance in respect of a deferred tax asset (loss carry forward) could logically be allocated to that component of comprehensive income in which the transaction originating the reversal is recognized. However, example 19 which we believe is intended to illustrate this principle requires clarification.

**13. A.9.** In conclusion, we disagree with the proposed approach because we consider that it is not principles-based and introduces complex allocation rules that are difficult to apply and that may produce counter-intuitive results in some cases. The Board does not seek to demonstrate that the proposed approach introduces an overall improvement to financial reporting. In our view, the elimination of backwards tracing is likely to increase the volatility of reported results from continuing operations after tax. We are in favour of maintaining backwards tracing because we consider it provides more relevant information to users in most cases.



However, we recognize that a different approach to backwards tracing may be appropriate in dealing with the allocation of valuation allowances in respect of loss carry forwards and that special guidance should be developed to cover these cases.

#### **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.)**

13. B.1 We are unable to comment on whether the proposed requirements produce results different from those obtained under SFAS 109 requirements.

#### **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?**

#### **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?**

13C.1. Our comments on the alternative approach are set out in 13A above.

**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?**

14.1. We agree with the proposal to use a systematic and rational methodology to allocate income tax expense in the individual financial statements of members of a group that files a consolidated tax return. We consider this approach to be reasonable and principles-based.

#### **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?**

15.1. According to the current requirements of IAS 1 all deferred tax assets and liabilities are classified as non-current. The ED proposes a classification based on that of the underlying assets and liabilities that give rise to the deferred taxation.

15.2. We also note that the proposed classification would appear inconsistent with the proposals of the IASB Discussion Paper Preliminary Views on Financial Statement Presentation .The latter proposes the presentation of tax assets and liabilities in a single section of the statement of financial position.

15.3. According to BC 101 and 102, this change enables two objectives to be met: (1) convergence with SFAS 109 (2) improved quality of information.

15.4. However we doubt that this change will provide better information on liquidity or a reliable breakdown between current and non-current. The proposal takes into account the classification of the related assets and liabilities and not the timing of the expected reversal of temporary differences. For example, under the proposals, deferred taxes relating to Property, Plant and Equipment would be treated systematically as non-current even though some of them may reverse within twelve months of the reporting date. However, we recognize that a classification based on the expected reversal dates for deferred taxes would be unduly burdensome.

15.5. We note that no specific guidance is provided in respect of the classification of uncertain tax positions.

15.6. In conclusion, we do not believe that the proposals represent an improvement over current requirements and we would therefore propose maintaining the latter.

#### **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?**

16.1. We note that the classification of interest and penalties is considered in the ED to be an accounting policy choice. As a result, diversity of practice is in effect tolerated. In practice, interest or penalties might be either classified in finance or operating expense. We appreciate, however, that it might be difficult to determine a common classification taking into account the various situations existing in different jurisdictions. We note that this accounting policy choice in classification is consistent with the principle exposed in the DP “Preliminary views on financial statements presentation”.

16.2. The ED would require disclosure of the chosen accounting policy. However the amounts of interest and penalties would not require disclosure under IAS 12, although significant amounts would be disclosed under IAS 1§ 97. These disclosures would help to restore the comparability of the financial statements of entities with diverging accounting policies and represent a relevant information. We therefore agree with the proposals although we note that the systematic disclosure of the total amount of interest and penalties would be necessary to enable full convergence with FIN 48.

## 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 for Conclusions.)

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

17.1. The ED proposes certain specific disclosures of a sensitive nature which might have a damaging effect for the reporting entity. Drawing attention to certain issues may affect their outcome. We therefore suggest that entities should not be required to disclose separately potentially damaging information which might affect the outcome of issues outstanding with the tax authorities.

We note that revised IAS37 (§71) allows sensitive information not to be disclosed. The same exceptions should be allowed for tax.

Examples of such disclosures are:

§ 41(b) the *separate* presentation of the effect of possible outcomes of a review by the tax authorities (adjustments recognized for current tax of prior periods).

§49 the major sources of estimation uncertainty relating to tax (for example “*the effects of unresolved dispute with the tax authorities*”) *including a description of the uncertainty.*

17.2. The ED proposes the adoption of the requirements of SFAS 109 with respect to the reconciliation between tax expense and accounting profit, whereby the tax reconciliation of the reporting entity is to be based on the domestic rate in the parent company jurisdiction. The ED proposes eliminating the option available under IAS 12 of aggregating separate reconciliations using the domestic rate in each individual jurisdiction. We agree with this proposal.

17.3. The disclosure of the aggregate amount of temporary differences associated with foreign investments is required by §48(c). We understand that the reason why the ED does not require the recognition of deferred tax in respect of temporary differences relating to foreign subsidiaries branches and joint ventures is linked to the difficulty in obtaining the relevant information. We therefore question whether it will be possible to obtain the information for the required disclosures.

17.4. As part of the new disclosures (see BC 109) the Board proposes a numerical reconciliation of the opening and closing amounts of deferred tax assets and liabilities, *for each type of temporary difference* and for each type of unused tax losses and tax credits. We question the relevance of the information required and consider that it would be burdensome to supply.

We think this information should be only disclosed for significant transactions.

**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?**

18.1. The exposure draft proposes retrospective application with two exceptions:

1. No transfers are to be made between retained earnings and other components of equity to restate cumulative amounts previously recognized in profit or loss, other comprehensive income or directly in equity (see paragraph 51 of the ED).
2. Assets and liabilities acquired outside a business combination are to be treated as if they had been acquired or assumed for their carrying amount in the opening financial statement of financial position (see paragraph 52 of the ED). These items are to be restated in accordance with paragraph B13(c).

18.2. We have reservations about point 2. Firstly we are unsure how any entity specific tax effects could be identified retrospectively. Secondly, we find the accounting treatment set out in B13(c) difficult to follow and suggest that a practical example including an entity specific tax adjustment would be useful to illustrate the restatement of the opening statement of financial position.