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European Financial Reporting Advisory Group (EFRAG)
35 Square de Meeûs
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Belgium

Email: commentletters@efrag.org

Dear Sir/Madam

SAICA SUBMISSION ON THE EFRAG's DISCUSSION PAPER ON *IMPROVING THE FINANCIAL REPORTING OF INCOME TAX*

In response to your request for comments on the EFRAG's Discussion Paper on *Improving the Financial Reporting of Income Tax*, attached is the comment letter prepared by Accounting Practices Committee (APC) of The South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of the APC, which comprises members from reporting organisations, regulators, auditors, IFRS specialists and academics.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Financial Reporting

cc: Paul O'Flaherty (Chairman of the Accounting Practices Committee)

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SAICA SUBMISSION ON THE EFRAG AND UK ASB DISCUSSION PAPER ON *IMPROVING THE FINANCIAL REPORTING OF INCOME TAX*

GENERAL COMMENTS

IAS 12 – *Income Taxes,* is a complex standard so we welcome attempts to simplify it. A comparison of the current IAS 12 to the relevant United States Generally Accepted Accounting Principles (US GAAP) in the discussion document would have been more useful.

SPECIFIC COMMENTS

Question to constituents - General

Q0.1 Do you consider that there are deficiencies in IAS 12 that should be addressed? If so, should they be addressed through limited amendments to the standard or by developing a new standard based on different principles?

We do consider that there are deficiencies in IAS 12 that should be addressed through limited amendments to the standard.

Questions to constituents - Part 1: Possible amendments to IAS 12

Q1.1 Under current IAS 12 a difference between the tax paid and the current tax expense reported in the income statement leads to misunderstandings of these relationships.

Do you agree that additional disclosure that would provide a reconciliation of the taxes paid and current tax expense will help in understanding this relationship? (Paragraphs 1.15 to 1.18)

Our consitituents do not believe that such a reconciliation would provide additional relevant disclosure. However, we believe that an additional disclosure, described below, would be useful for the reasons described in the next paragraph.

The tax expense recognised in the financial statements is based on the profits earned at the end of the year. However, tax payments are made during the year based on estimates of the taxable profit, and may include a component of cash flow relating to prior periods, penalties and discontinued operations. These differences are compounded in multinational entities where the tax rates and timing of cash flows vary across jurisdictions.

As users wish to predict the timing of future cash flows of an entity and as taxes are linked to the profits of an entity, the tax disclosures should only be required if similar disclosures are required for the entity's profit.

Should the project team conclude that additional disclosure is required, we recommend that the additional disclosure should rather be provided on the components of the tax cash paid, for example:

- tax relating to current year profits; and
- prior year tax – under or over provisions relating to prior periods.

The above information may be disaggregated to provide further information to users, for example, a multinational corporation may disclose the information by geographical regions.

Q1.2 Do you agree that additional more detailed disclosures regarding deferred tax assets, especially unused tax losses and unused tax credits are necessary and useful? (Paragraphs 1.23 to 1.24)

We agree that additional disclosures are necessary and would be more useful. In particular, entities should provide additional disclosure on the risks associated with the utilisation of the tax losses. This should include the following:

- a disaggregation of unused tax losses,
- more detailed commentary on the risks of recognition, based on the expected timing of the recognition of these unused losses,
- greater disclosure of the nature of the loss, such as, is it a capital gains tax loss or is it normal income tax losses.

Q1.3 Do you agree with the identified users' information needs in Chapter 1 of Part 1? Do you have any suggestion for additional information requirements regarding reporting of income taxes? (Paragraphs 1.8 to 1.24)

Yes we agree with user information needs identified.

In addition to income taxes included in the scope of IAS 12, we believe that the disclosure of an entity's tax obligation should extend to the total tax obligation it has with its government, which represent the non-reciprocal transfer of funds with government, for example other revenue based taxes.

We note that such disclosure would not be in the scope of IAS 12, which focuses on income taxes, but request that it be incorporated into other IFRS standards, when it is appropriate.

Q1.4 Do you agree that tax strategies to accommodate user information needs should be disclosed in the management commentary and not in the financial statements? Why or why not? (Paragraphs 1.8 to 1.9)

The tax strategies applied by an entity should be regarded as confidential information.

Preparers consider its company's tax strategies as information that should not be publically available. Should the disclosure of tax strategies be provided, we believe that this should not be included in the financial statements, nor should they be included in the requirements of IFRS. We believe that such disclosure should have the same status as the IASB's paper on management commentary.

We also note that any project which considers such disclosure should assess the interrelationship between integrated reporting and the annual financial statements.

Q1.5 The reconciliation of the actual tax charge to the charge on profit at the statutory tax rate (tax rate reconciliation) is quite complicated and leads to some misunderstandings.

Do you agree that the suggestions made in the paper are helpful by clarifying the explanation why the current tax charge is not equivalent to the standard rate of tax applied to the accounting profit? Why or why not? (Paragraphs 1.19 to 1.20 and 2.21 to 2.34)

While the suggested reconciliation does not provide any additional disclosure, it would result in a consistent format for the disclosure.

In order to improve the relevance of the reconciliation rather than focussing on a format of the reconciliation, the disclosure framework should:

- describe the starting point of the reconciliation (for example, profit before tax);
- describe an end point for the reconciliation (for example, the statutory rate for an entity or blended rate for a group); and
- provide a basis for the items to include in the reconciliation.

The project team felt that the level of items to include in the reconciliation should be adequate to understand the drivers of the tax rate. We felt that the IFRS standard should not attempt to try to standardise the rate reconciliation through a prescriptive format of what should form part of the reconciliation, but rather provide a guideline. Different entities and tax jurisdictions may have different reconciling items, and the list is unlikely to be comprehensive in this regard.

The proposed reconciliation separates the effect of, for example, rate changes between current and deferred taxes. In order to understand the effect of a change, such as a change in the tax rate, we believe that the effect should be considered on the tax balance as a whole, and not disaggregated into current and deferred tax elements.

Q1.6 The amounts currently disclosed provide limited information about future tax cashflows.

How would you suggest the disclosures in IAS 12 be improved to provide better information about future cashflows? (Paragraphs 1.13 to 1.14 and 2.35 to 2.40)

Information about future tax cash flows should include an expectation of the timing of the reversal of unused tax losses.

Q1.7 The possibility of discounting deferred tax balances is discussed in paragraphs 2.44 to 2.50. In your view, should discounting deferred tax amounts be required? Please explain.

While the principle of discounting is applied consistently in IFRS, and conceptually appropriate for deferred taxes, we concur with the approach adopted in IAS 12. The complexity of discounting deferred taxes, in our opinion, far outweighs the potential benefits. However, we would welcome research into ways to practically address the discounting of deferred taxes.

Q1.8 Currently IAS 12 neither provides explicit guidance for accounting for uncertain tax positions nor contains any special disclosure requirements regarding the tax risk position.

(a) Do you agree required information regarding uncertain tax positions should be disclosed? If so, which of the following do you prefer:

***Alternative 1**: Disclosure requirements should be included in management commentary.*

***Alternative 2**: Disclosure requirements should be split in two parts. Part 1 would include disclosure of all positions for which the tax payer must establish a tax provision under IFRS and will be disclosed in notes to the financial statements. Part 2 would include all other uncertainties regarding income taxes for which no provision is recognised. (Paragraphs 1.10 to 1.12)*

Disputes about an uncertain tax position often involve a complex legal and highly regulated dispute resolution process between the taxpayer and the tax authorities. The due process rights of the tax payer could be undermined if they are required to estimate the outcome of each individual dispute or potential dispute.

The current requirements in IAS 37 on disclosure of contingent liabilities provides sufficient information. We believe that any requirement to disclose this information could result in public disclosure of confidential company information, which may otherwise be legally privileged.

Should the disclosure be required, we do not feel that companies would give any truly beneficial information due to the potential consequence.

We would recommend that any project team considering the disclosure of uncertain tax positions should address whether the unit of account is for an individual tax position, or the entities overall tax exposure.

(b) Do you agree that IAS 12 should address the recognition and measurement of uncertain tax position? Why or why not?
If you agree, should the measurement be based on the most likely outcome or a probability weighted method? Should measurement include the likelihood the tax position will be reviewed by the tax authorities or should that review be assumed? (Paragraph 2.51 to 2.59)?

The majority of our commentators agree that it would be useful for IAS 12 to provide a consistent basis for measuring uncertain tax positions, and believe that uncertain tax positions should be measured on a 'more likely than not' approach The measurement should assume a review by the tax authorities.

Q1.9 Are there any issues with IAS 12, which are not addressed in Part 1 that would significantly improve the standard? What amendments would address these issues?

The IFRS Interpretations Committee is currently debating the recognition of deferred tax as a single asset in a corporate entity. Should the IFRS Interpretations Committee not address this question, we believe any future project on IAS 12 should consider this matter. IAS 12 was amended to address the measurement of deferred taxes on investment properties measured at fair value. Prior to this amendment, the requirements of IAS 12 resulted in the double counting of deferred tax because deferred tax was not only recognised on the fair value of the property but the cash flows that had been used to calculate the fair value included the rental income which were on an after tax basis. This issue also arises on other assets measured at fair value, for example, customer lists in a business combination. We recommend that these issues should be addressed in future.

The scope of IAS 12 only includes income taxes. We believe that IFRS should also address the treatment of other taxes, such as revenue based taxes, although this would be outside the scope of IAS 12.

Q1.10 What is your view on the exemptions that currently exist in IAS 12?

We believe that the exemptions currently in IAS 12 address particular issues arising from the temporary difference approach and are therefore necessary to achieve an appropriate accounting outcome.

However, we believe that the need for the initial recognition exemption could be eliminated by amending the definition of 'a temporary difference' to only include those temporary differences arising on assets or liabilities that will affect taxable profit, for example on certain leases.

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Questions to constituents - Part 2: Alternative approaches to accounting for income tax

Q2.1 If the development of a new standard for income tax, based on different principles from those used in IAS 12 is to be considered, which of the approaches discussed in Part 2 seem to have most merit and should be considered as a basis for further development?

As noted in the discussion paper, each approach has both merits and demerits. The majority of our commentators believe that the temporary difference approach that is currently adopted by IAS 12 has the most merit. Commentators felt that this approach was well understood by users and preparers. We believe that any future project should focus on improving IAS 12.

We see conceptual merit in the **valuation adjustment approach**, which eliminates the need for the exceptions under the temporary difference approach and would therefore be easier to apply in practice.

Q2.2 Do you think that there are any special practical difficulties with implementing the approach(es) that you favour in practice? If so, how can those difficulties be addressed?

We believe that the discussion paper adequately identifies the challenges that arise when applying the temporary difference approach and therefore do not need to be discussed any further.

Q2.3 Are there any approaches that are not discussed in Part 2 that should be considered?

None, please refer to our response to Q2.4.

Q2.4 In your view should a combination of approaches be considered? If so, which approach should be used in what circumstances?

No, our view is that the current IAS 12 approach, with improved disclosures, will give a better answer.

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