Accounting Standards Board
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277 Wellington Street West, Toronto, ON Canada M5V 3H2 Tel: (416) 977-3222 Fax: (416) 204-3412 www.acsbcanada.org
277 rue Wellington Ouest, Toronto (ON) Canada M5V 3H2 Tél : (416) 977-3222 Téléc : (416) 204-3412 www.cnccanada.org

June 29, 2012

(by e-mail to commentletters@efrag.org)

European Financial Reporting Advisory Group
35 Square de Meeûs,
B-1000 Brussels
Belgium

Dear Sirs,

**Re: Improving the Financial Reporting of Income Tax (Discussion Paper)**

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the European Financial Reporting Advisory Group's (EFRAG) Discussion Paper, "Improving the Financial Reporting of Income Tax", issued in December 2011.

The views expressed in this letter take into account comments from individual members of the AcSB staff. They do not necessarily represent a common view of the AcSB, or its committees. In forming these views we have consulted with the AcSB's User Advisory Council ('UAC'). The UAC consists of financial statement users, including investors, investment professionals, credit grantors in financial institutions, equity and credit analysts, and rating agencies. The purpose of the UAC is to assist the AcSB in understanding how users use financial information and provide advice on standard setting priorities and on specific agenda projects.

We appreciate the opportunity to provide comments on the Discussion Paper and we recognize that the Discussion Paper represents a substantial amount of work and analysis in respect of a challenging topic. We acknowledge that the objective of the Discussion Paper is to encourage debate on the accounting for income taxes. We agree that the current accounting for income taxes can, in certain areas, be difficult to understand and has certain shortcomings in respect of providing decision useful information to financial statement users.

***Recommendation***

Overall, we think that the current model for accounting for income taxes is working reasonably well, i.e., it is not fundamentally broken. We think that the revised conceptual framework should provide the foundation for any fundamental revisions in respect of accounting for income taxes. In particular, the revised definition of financial statement elements and the measurement principles should guide the approach to accounting for income tax. Since the IASB expects to be developing this material over the next 3-4 years, we do not believe that a fundamental revision of the accounting for income taxes should be undertaken in the short to medium term. As noted in our response to the recent IASB Agenda Consultation, we believe there are other issues that should be given priority.

However, we do believe that a limited scope improvements project focusing on certain disclosures related to deferred income taxes could provide substantial benefits to financial statement users, and that such a project should be undertaken as soon as resources permit.

***User needs – a general comment***

The Discussion Paper notes that many users disregard income taxes in their analysis. As a result of discussing the Discussion Paper with the UAC we understand that users who share this view generally have a relatively short-term involvement with an enterprise; for example, they may be involved with an enterprise through extending or maintaining credit. However, other financial statement users, typically those who perform analysis on a longer timeline, generally seem to be of the view that deferred taxes are important. It is these users who undertake the effort to understand deferred taxes and they appear to believe that IAS 12 provides useful information. We note that general purpose financial reporting is designed to meet the needs of a diverse group of users. We think that research in respect of the needs of users regarding income taxes should include perspectives of a wide range of financial statement users, including those who conduct financial statement analysis over the long-term.

***Discounting and uncertain tax positions***

Based on discussions with the UAC we agree that the current position with respect to discounting and uncertain tax positions should be reconsidered. However, we think that, prior to doing so, research should be undertaken in respect of the practical application challenges. We understand that earlier attempts to address these challenges were met with significant resistance from financial statement preparers. The views previously expressing opposition should be carefully re-examined prior to pursuing these issues.

***Potential improvements to IAS 12***

The Discussion Paper notes a number of potential improvements to the disclosures in IAS 12. As noted above we think that certain of these issues should be pursued as soon as practicable. We have the following comments in respect of these potential improvements:

<u>Tax strategies and objectives</u>

While there would be benefits to having detailed information in respect of an enterprise's tax strategy we do not think that this information belongs in the financial statements per se. This type of discussion seems better suited to the management commentary included in the annual report.

We think that management will generally be very reluctant to provide detailed information in respect of tax strategies. Accordingly, if this disclosure was required in the financial statements the result would likely be boilerplate disclosures that would have little information value to financial statement users. Accordingly, we do not think that disclosure of tax strategies and objectives should be pursued.

<u>Current and future tax cash flows</u>

The Discussion Paper notes that some users have expressed difficulty in assessing how temporary differences will translate into actual cash payments. It notes that an explanation of when significant deferred tax assets and liabilities will reverse may address this issue.

We note that IAS 12 currently requires identification of amounts of deferred tax assets and liabilities for each type of temporary difference. An enterprise's current deferred tax position is simply a 'point in time' measure. We think that providing information in respect of the current balances would generally not provide useful information to users. To enable users to understand how cash flows will be affected in the future, an enterprise would have to forecast future activities and their effect on deferred taxes. We agree that this would be useful information, however forecasting operations for purposes of estimating tax cash flows would go beyond the current bounds of the financial statements and raise significant legal liability concerns amongst preparers and auditors. Accordingly, we do not think that further disclosure in respect of this topic should be pursued.

<u>Explanation of difference between taxes paid and income statement expense</u>

The Discussion Paper notes that users who are not tax experts often have difficulty understanding the relationship between the current tax expense as reported in the income statement and cash taxes paid in the current period. It specifically notes difficulties relating to intra-period allocations and estimation of taxes payable.

The users we consulted did not indicate any difficulties in respect of this issue. They commented that intra-period tax amounts are almost always separately identified, allowing them to calculate the total tax expense. In respect of estimates, they note that it is common under accrual accounting to make estimates and adjust them in a subsequent period. Accordingly, we do not think that modification of the disclosures in IAS 12 regarding this issue should be pursued.

<u>Tax reconciliation</u>

The Discussion Paper notes a number of potential improvements to the reconciliation between the accounting profit and the tax expense. Based on discussions with the UAC we agree that improvements should be made to this requirement, particularly:

(a) ensuring that the disaggregation of reconciling items, and their description, results in clear and meaningful information, and

(b) using a tax rate for a group carrying out its operations mainly outside its local territory that is the geographically weighted tax rate.

Sustainable effective tax rate

We agree that users would find a reasonably understandable sustainable tax rate useful, presumably for use in forecasting of future cash flows. However, we think that this information should not be included in the financial statements. The Discussion Paper notes that a sustainable effective rate should incorporate forecasted changes in tax legislation, as well as how tax legislation will be applied to the business. We note that these issues are beyond the control of an enterprise, and accordingly it may often be the case that an enterprise cannot make reasonable estimates in respect of how tax legislation may change in the future. We think that users may be looking for detailed forecasts in respect of what the effective tax rate will be in future periods. Such forecasted information generally resides in the management discussion in the annual report, as opposed to the financial statements. Accordingly, we do not think that IAS 12 should be amended in respect of this issue.

Valuation of losses carry forward

The users we consulted agreed that information in respect of deferred tax assets can be very valuable, and that current disclosures in respect of deferred tax assets do not necessarily provide sufficient detail. We think that more detail in respect of deferred tax assets should be required, particularly in respect of unused tax losses and credits. Possible additional disclosure includes

(a) a geographical breakdown of losses carried forward,

(b) an expiry schedule in respect of unused losses and credits, and

(c) any restrictions in respect of deferred tax assets.

In conclusion, we commend EFRAG for publishing the Discussion Paper and express our appreciation to the authors. We support further research regarding the accounting for income taxes, but think that efforts in the short-to mid-term should be restricted to improvements to certain disclosures in IAS 12.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me at +1 416 204-3276 (email peter.martin@cica.ca), or Greg Edwards, Principal, Accounting Standards at +1 416 204-34620 (email greg.edwards@cica.ca).

Yours truly,

Peter Martin, CA
Director
Accounting Standards