Australian Government
Australian Accounting Standards Board

AASB Staff Comments on EFRAG Discussion Paper – Improving the Financial Reporting of Income Tax

Please note that the views expressed below are AASB staff views only and do not necessarily reflect the views of the Australian Accounting Standards Board. If you have any questions in relation to the comments below, please contact Nikole Gyles at ngyles@aasb.gov.au.

Overall comment

We continue to support the efforts of the Tax Advisory Panel to contribute to the debate on accounting for income tax, and in particular, the future of IAS 12 *Income Taxes*.

The following comments should be read in the context of our overall view that, consistent with the AASB's submission to the IASB on its *Request for Views on Agenda Consultation 2011*, standards-level projects should not be a major focus for the IASB in the next three years, other than in the context of research.

We think that a limited review focusing on issues arising in practice may be the most effective way in relatively the short-term to deal with concerns about IAS 12. In that context, our strong preference is that any amendments arising from such a limited review should be consistent with the principles underlying IAS 12, rather than introduce further exceptions to the principles as practical expedients.

We are concerned that any such exemptions would add to the complexity of the Standard – the existing exemptions are already a source of much of the criticism of IAS 12. Therefore, we think the focus of any amendments should be on clarifying the existing principles in relation to their application to practice. For example, we think that many of the practical issues relating to questions about manner of recovery of assets would best be addressed through clarification of the principle rather than the introduction of exceptions to the principle.

Specific Comments on Part 1 – Improving IAS 12 Income Taxes

Improving presentation and disclosure requirements (paragraphs 2.4–2.40)

We agree that the user information needs can be addressed, in part, by improved disclosure by entities.

However, rather than prescribing additional specific disclosure requirements in IAS 12, we think that many of the current disclosure issues could be addressed by including a general principle in IAS 12 along the lines of the following, which is based on similar paragraphs included in the recently issued IFRS 12 *Disclosure of Interests in Other Entities*[1]:

> **X The objective of the disclosure requirements in this Standard is for an entity to provide information that enables users of its financial statements to evaluate:**
>
> **(a) the nature of, and risks associated with, its tax strategy; and**
>
> **(b) the effects of that strategy on its financial position, financial performance and cash flows.**

[1] paragraphs 1–3.

Y To meet the above objective, an entity shall disclose the significant judgements and assumptions it has made in determining its tax balances (and refer to specific disclosure paragraphs).

Z If the disclosures required by this Standard, together with disclosures required by other IFRSs, do not meet the above objective, an entity shall disclose whatever additional information is necessary to meet that objective.

More detailed disclosure requirements could follow from this type of general requirement, perhaps in the form of application guidance.

In terms of the specific disclosure recommendations in the DP, we disagree with the 'rule' suggested in paragraph 2.34 that disclosure of individual reconciling items be required when they are more than five per cent of the income before tax multiplied by the tax rate. We consider that an entity's decision as to what items to disaggregate within a reconciliation should be based primarily on presenting the information that is relevant to a user's understanding of the financial statements. Providing a 'bright line' rule, such as five per cent, should not be necessary to ensure that such information is provided by entities. Rather, such a rule may result in information being provided that *decreases* the understandability of the reconciliation such that users are unable to distinguish the important information.

As an alternative to the 'rule' suggested in paragraph 2.34, we suggest including further guidance in any amendments to IAS 12 that would require the disaggregation of significant reconciling items on the basis of either nature or amount.

Introducing discounting of deferred tax asset and liabilities (paragraphs 2.44–2.50)

Although, in principle, we agree with discounting assets and liabilities (where appropriate), we disagree with the recommendation to introduce discounting for deferred taxes. As noted in the Basis for Conclusions to the March 2009 *Income Taxes* ED (para. B7) this would, in many circumstances, introduce an onerous requirement for entities.

> The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each temporary difference. In many cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between entities. Therefore, IAS 12 does not require or permit the discounting of deferred tax assets and liabilities.

Uncertain tax positions (paragraphs 2.51–2.59)

We agree that IAS 12 should explicitly address the recognition and measurement of uncertain tax positions. However, we note that the measurement of uncertain tax positions is a contentious issue. In its comment letter to the IASB dated 31 July 2009 in response to ED/2009/2 *Income Taxes*, the AASB noted the following in relation to measurement of uncertain tax positions:

> Although there is conceptual merit with the 'probability-weighted average' approach, the AASB has reservations about this proposal for the following reasons:
>
> (a) the AASB thinks that it would be preferable not to adopt this approach ahead of the Board finalising its Liabilities project. At that point the IASB should consider whether uncertainty should be accounted for consistently across all Standards... Consistent with the AASB's previous comments to the IASB in its submission on the proposed amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in 2005, unless the

measurement basis is clearly defined as being fair value, a probability-weighted average approach would not necessarily provide, without significant disclosure, useful information in situations where normally there are binary outcomes;

(b) the AASB is concerned that the ED does not adequately address the 'unit of account' for which uncertainty is measured, given that uncertainty permeates all aspects of income tax accounting, not just in relation to tax positions. Often individual tax deductions are accepted by the tax authorities on an 'all or nothing' basis and settlements with the tax authorities are made based on an entity's tax position as a whole; and

(c) it does not achieve consistency between IFRS and US GAAP.

However, the AASB notes that this is an area of IAS 12 that particularly needs updating and accordingly considers the 'more likely than not' measurement of uncertain tax positions is preferable as an interim measure (which is consistent with the proposed treatment of valuation allowances in Question 6 and US GAAP), with other pertinent information regarding uncertain tax positions included in disclosures.

…

We continue to think the views previously expressed by the AASB in its comment letter have merit.

Specific Comments on Part 2 – A review of approaches to accounting for income tax

We acknowledge that the description of the approaches in the DP is high level and is not intended to be a complete discussion.

We consider that to fundamentally alter the approach to accounting for income tax there would need to be a sound conceptual basis for change. We do not support changing to a new approach that has the same, or even a greater, number of shortcomings (albeit, different) as the current approach to accounting for income taxes. We are not convinced, at this stage, that any of the alternatives put forward in the DP would make a substantive improvement over the fundamental principles in IAS 12.

Our high level comments on the specific approaches are as follows:

(a) <u>Temporary difference approach</u> (Chapter 2)

We consider that there is no persuasive argument that would justify the *fundamental basis* for accounting for income tax in IAS 12 being amended (although, as noted above, we acknowledge that the approach would benefit from some limited scope amendments).

(b) <u>Flow-through approach</u> (Chapter 3)

We disagree with this approach.

This approach does not reflect the economics of transactions as it does not allocate the tax effect of timing (or temporary) differences. We note that an argument in its favour is simplicity, however, do not think that simplicity for simplicity's sake is an objective of accounting for income tax.

(c) Partial tax allocation (Chapter 4)

We disagree with this approach.

This approach appears to take a 'cash basis' approach to accounting for income tax. That is, it focuses on the amount of cash that is likely to be paid by an entity. Even though the payment of a tax liability may be remote, such payment is outside the control of the entity. Therefore, we do not think this approach has a sound conceptual basis. In addition, as noted in the paper, the requirement to schedule timing differences would result in additional costs for entities. Also, the arguments in the paper do not persuade us that such scheduling would require significant judgement. It is also unclear to us how this is an improvement to the current requirements of IAS 12.

(d) Valuation adjustment approach (Chapter 5)

We disagree with this approach.

This approach does not appear to provide useful information about taxes to users as it effectively nets off the deferred tax against the underlying asset/liability. Also, the arguments in the paper do not persuade us that this is an improvement to the current requirements of IAS 12.

(e) The accruals approach (Chapter 6)

We disagree with this approach.

The accruals approach, as described in the DP, appears to encourage or support 'matching' for matching sake, rather than any fundamental principle based on the *Framework*. To have credibility, we consider that this approach would need to be clearly explained in terms of fundamental principles that do not include applying 'matching' as a basis for the approach, without regard to the definitions of assets and liabilities.

We are not convinced that the 'accruals approach' is superior to the current balance sheet (temporary difference) approach to accounting for income tax. In concept, it appears to be very similar to the 'profit and loss' approach applied by superseded IAS 12, with additional consideration of OCI. It is difficult to understand how this would represent an improvement to the current requirements of IAS 12, particularly at a conceptual level.

It is also not clear to us on what basis items recognised directly in equity for which there is a tax effect (such as share issue costs) should be excluded from recognition.

Finally, we think that the title of the approach should be reconsidered. We think that referring to the alternative as 'accruals' may inappropriately suggest to some that the current IAS 12 is not based on an accrual approach to accounting. Further, we do not think that the title of the approach is reflective of the nature of the approach. A title such as 'Modified profit and loss approach' or 'Modified timing difference approach' may be more appropriate.