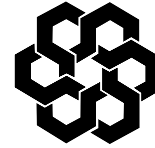

30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: **May 2007, London**

Project: **IAS 12 *Income Taxes* – Deferred taxation arising from un-remitted overseas earnings (Agenda Paper 11 (viii))**

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1. The IFRIC received a request asking for guidance to be issued considering how an entity should account for potential deferred tax liabilities which arise from temporary differences created by income that is earned overseas but is not taxable until it is remitted to the entity's home country.

2. IAS 12.39 states:

An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied:

(a) the parent, investor or venturer is able to control the timing of the reversal of the temporary difference; and

(b) it is probable that the temporary difference will not reverse in the foreseeable future.

3. The submission considered the situation in which an entity earned income overseas and that income was not taxable until it was remitted to the entity's home country. Specifically, it considered the situation in which such income gave rise to a timing difference and the conditions in IAS 12.39(a) and IAS 12.39(b) were met, but the income did not arise in an overseas subsidiary, branch, associate, or joint venture. In such situations, the submission stated that it was not clear whether a deferred tax liability should be recognised or not.

4. This paper discusses whether the IFRIC should take a project to consider this issue onto its agenda.

DIFFERING VIEWS

5. The staff considered the following example. Entity A is based in Country Z which has a tax rate of 35%. A holds a bank account in Country Y which has a tax rate of 20%. A earns CU1,000 in interest in country Y. Tax of CU200 will therefore be payable immediately in country Y at 20%. A will also have to pay a further CU150 tax in country Z if it remits the interest earned in Y to Z.

6. Should A account for the deferred tax liability of CU150 arising as a result of the timing difference caused by the un-remitted earnings in Y.

7. The submission to the IFRIC included two differing views which are summarised below.

View 1 – no deferred tax liability should be recognised

8. Supporters of view 1 note that, if the overseas bank account were held in a subsidiary, branch, associate or joint venture, and the conditions in IAS 12.39 were met then no deferred tax asset would be recognised in respect of the un-remitted earnings.

9. Supporters of this view believe that, whether A operates a branch with its own bank account in country Y, or a standalone bank account in country Y, should have no impact on the accounting for deferred tax arising on earnings from that bank account. The accounting for deferred tax on un-remitted earnings from a standalone bank account should therefore be consistent with the accounting for deferred tax on un-remitted earnings from a bank account in a branch in country Y.

10. Supporters of this view believe that no deferred tax should therefore be provided on any un-remitted overseas earnings that meet the criteria in IAS 12.39 (a) and (b).

View 2 – a deferred tax liability should be recognised

11. Supporters of this view note that IAS 12.39 is an exception to the general principle that deferred tax should be provided in respect of all temporary differences. As an exception to a principle, it is inappropriate for it to be extended to apply to situations that are not specifically identified in that paragraph (ie investments in subsidiaries, branches, associates and joint ventures).

12. Supporters of this view therefore believe that a deferred tax liability should be recognised in Entity A.

13. The submission received by the IFRIC did not consider that the guidance in IAS 12 was clear in this respect and therefore requested that further guidance be issued.

STAFF ANALYSIS

14. The staff notes that the Board currently has a project on its agenda to consider accounting for Income Taxes.

15. The project summary for that project states:[1]

   Investments in subsidiaries, branches and associates, and interests in joint ventures

   Currently, IAS 12 provides an exception from the recognition of a deferred tax liability for taxable temporary differences relating to investments in subsidiaries, branches, and associates, and interests in joint ventures if the parent can control the timing of the reversal and it is probable the temporary difference will not reverse in the foreseeable future.

   Statement 109 prohibits a deferred tax liability from being recognised for the excess for financial reporting over the tax base of an investment in a foreign subsidiary or a foreign corporate joint venture that is essentially permanent in duration.

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[1] As on 16 April 2007

The IASB decided that an entity should recognise the income tax consequences of all temporary differences arising in the consolidated financial statements. An implication of this decision is that an entity should take into account any taxes payable by a subsidiary on the distribution of earnings to the parent in determining the tax rate to be used to measure its consolidated deferred tax liability. The practical difficulties of doing this for foreign subsidiaries are addressed below. In addition, the Board decided to eliminate from IAS 12 the notion of 'branches'.

At the joint meeting in October 2004, the boards decided to retain the exceptions in IAS 12 and SFAS 109 for the recognition of deferred tax liabilities for certain investments in foreign subsidiaries (or foreign corporate joint ventures) because of the practical difficulties in measuring the liabilities. The IASB agreed to move to the SFAS 109 wording for the exception.

16. The IASB Workplan[2] states that an Exposure Draft on Income Taxes is expected to be issued in Q4 2007, with a final standard expected in H2 2008.

17. One of the criteria for taking an issue onto the IFRIC agenda is whether it is being considered by a Board Project.

18. If the IFRIC were to take this issue onto its agenda in May 2007, then it would not have its first substantive discussion of the issue until July 2007. Assuming that the IFRIC took 3 meetings to develop a draft Interpretation, this would not be completed until November 2007.

19. Since the Board's Income Tax project anticipates publishing an exposure draft which is expected to address this issue in Q4 2007, it is unlikely that the IFRIC would be able to produce a draft Interpretation in advance of the Board Project.

20. However, the staff notes that the issue highlights the fact that tax can arise on income earned overseas when it is remitted home even if the income is not earned by a subsidiary or joint venture. The same treatment should apply whether or not the income is earned by a subsidiary or joint venture. Given that the Board has an ongoing project to amend IAS 12, the staff has brought this question to the attention of the Board's income tax project team to consider whether the point should be clarified further in the amendments to IAS 12.

[2] As on 16 April 2007

CONCLUSION

21. Since the issue is being considered as part of the Board's project on Income taxes, the staff does not consider that it meets the criteria to be taken onto the IFRIC's agenda. The staff therefore recommends that the IFRIC declines to take the issue onto its agenda on the basis that it is being considered by a Board project that will be completed in the near future.

22. [Paragraph omitted from observer note]