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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

Board Meeting:	**January 2009, London**
Project:	**Income Taxes**
Subject:	**Ballot draft sweep issue: discounting current tax (Agenda paper 19)**

Discounting current tax

1. The ballot draft of the tax ED proposes that current tax should be discounted. Some Board members have requested that this issue be discussed at a Board meeting.

2. A paper on the issue was distributed to the Board last week. It is reproduced below, with additional paragraphs to cover the following issues:

    a. Additional discussion on the treatment of the government grant (paragraphs 5 and 6)

    b. Loss carrybacks (paragraph 8)

    c. Alternatives for the Board (paragraph 10)

3. The staff originally raised the issue in the cover note to the second pre-ballot draft, as an issue arising from an IFRIC rejection. The IFRIC request, rejection and staff comment from the cover note are attached as an appendix for information.

4. The following example illustrates the staff proposal.

   Facts

   Current tax calculated under IAS 12 without any discounting is 100. The government has allowed it to be paid a year later than usual. The present value using a risk-free rate is 80.

   Proposed treatment

   The entity would recognise current tax expense of 100, a liability for current tax payable of 80 and a government grant of 20. Interest expense of 20 is recognised over the period to settlement which increases the liability to 100. Under IAS 20, the government grant would be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate. So the question is whether the delay in payment is intended to reduce the tax expense or the interest expense.

5. The staff thinks that this could depend on the circumstances. If the normal tax payment date is sufficiently close to the end of the period to which the tax relates that the effect of any discounting is immaterial, the staff would argue that the tax authority sets the tax amounts without including any effect for the time value of money. In that case, if the tax authority allowed late payment in a specific case without charging interest, the staff thinks the government grant would be regarded as compensation for the interest that is recognised on the liability as the present value grows to the amount due, not as a reduction in the tax expense. So the journal entries would be:

   a. Dr tax expense 100
      Cr tax payable 80
      Cr government grant 20

   on the recognition of the tax

b. Dr interest expense	20	
Cr tax payable		20

on the unwinding of the discount

c. Dr government grant	20	
Cr income		20

on the recognition of the government grant as income to match the interest expense.

6. On the other hand, if the normal tax payment date is sufficiently long after the end of the period to which the tax relates that the effect of discounting is material, the staff would argue that the tax authority sets the tax amount to include the effect of the time value of money. In that case the journal entries would be:

a. Dr tax expense 100		
Cr tax payable		80
Cr income to match the tax expense		20

7. The staff proposed to clarify the wording of the proposal in the ED to read as follows:

> An entity shall include in the amounts recognised in accordance with paragraphs 6 and 7 [ie current tax amounts] the effect of uncertainty over the amounts reported to the tax authorities, measured in accordance with paragraph 25. An entity shall recognise these undiscounted amounts as current tax expense and ~~also~~ the amounts discounted ~~the amounts recognised in accordance with paragraphs 6 and 7~~ to include the time value of money as a current tax asset or liability. An entity shall treat any difference between the discounted and undiscounted amount as a government grant in accordance with IAS 20.

8. A Board member has pointed out that these words will not work if the entity has current tax income and a current tax asset rather than current tax expense and a current tax liability. Suppose the entity has a loss carryback giving rise to current tax income calculated under IAS 12 without discounting of 100 but the tax

authority will not pay the amount until 2 years in the future. The present value using a risk-free rate is 80. In that case, if discounting were required, the entity would recognise current tax income and a current tax asset of 80. This differs from the proposals when there is current tax expense and a current tax liability, because the difference between the effect of the time until payment cannot be treated as a government grant. The wording of the ED would need to be amended to reflect this. The Board member also notes that there could be considerable uncertainty over the timing of payments from the tax authority for loss carrybacks, making discounting difficult.

9. Finally, Board members expressed concern that discounting current tax would be divergent from US GAAP. Neither IAS 12 nor SFAS 109 include specific requirements or prohibitions to discount current tax. The staff understands from comments from the large accounting firms that it is accepted practice under IAS 12 when the effect is significant. The proposal formalises that existing practice. The basis for conclusions would note that SFAS 109 does not include a specific requirement or prohibition.

10. Questions for the Board:

    a. Do you wish the ED to propose that current tax assets and liabilities should be discounted?

    b. If not, do you wish the ED to be silent on the matter (as IAS 12 is) or to specify that discounting is prohibited? What would you include in the basis on these decisions?

    c. If you do wish the ED to propose that current tax assets and liabilities should be discounted, for current tax liabilities do you wish to specify that the effect of the discounting is a government grant, or do you wish to specify that the effect should reduce the current tax expense?

Appendix: IFRIC issue dated June 2004 Discounting of current taxes payable

Request to IFRIC

Is it appropriate to discount current taxes payable under IFRSs when an agreement with the taxing agency has been reached to permit the entity to pay such taxes over a period greater than twelve months?

IFRIC rejection wording

The general view of the IFRIC was that current taxes payable should be discounted when the effects are material. However, it was noted that there is a potential conflict with the requirements of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. As the IASB has tentatively decided to withdraw IAS 20, the members agreed that the issue of discounting current taxes payable should no longer be uncertain and that the topic need not be added to its agenda.

Staff comment

Since the IFRIC decision was made, the Board has changed its tentative decision to withdraw IAS 20. The Board has also addressed a similar conflict between the requirements of IAS 39 and IAS 20 in its 2007 annual improvements project. On that issue, it required loans issued by government at favourable rates to be measured on initial recognition in accordance with IAS 39 at fair value. Any difference between the proceeds of the loan and its fair value should be treated as a government grant in accordance with IAS 20. Consistent with this approach, the staff recommends that the ED should specify that current taxes should be discounted and any difference between the discounted amount and the undiscounted amount treated as a government grant.

Some staff noted a concern that such a proposal would include discounting tax loss and credit carryforwards. Such items are regarded as deferred tax, not current tax under IAS 12. The staff proposes amending the definition of current tax to refer to income tax payable or *refundable* in respect of the taxable profit (tax loss) for the current period or past reporting periods. The term *refundable* replaces the current term recoverable. The aim is to distinguish between amounts that the tax authority regards as an existing payable or receivable (current tax) from amounts that will be payable or receivable in the future (deferred tax).