Project	**Income Tax**
Topic	**Scope of the income tax project**

Purpose of this paper

1. This paper asks the Board to decide on the scope of the income tax project. The Board published an ED *Income Tax* in March 2009. The staff presented an analysis of the comment letters at the October joint meeting (October joint meeting Agenda Paper 12).

2. At that meeting, both boards indicated that they would consider jointly undertaking a fundamental review of accounting for income taxes at some time in the future. The staff notes that the German and UK standard setters are currently doing some work on such a review. In the meantime, the IASB needs to decide how it should proceed with the proposals in the exposure draft.

3. Overall, there was only very limited support in the comment letters for finalising the ED in its current form. Many respondents questioned whether the Board should be spending time on this project given the Board's heavy agenda and the pressure on the Board to complete other projects. The staff agrees that this is a question that the Board should consider before looking at technical issues in any detail.

4. This paper sets out a number of ways forward, explaining why the Board should consider them and setting out the consequences of following them. They are:

    (a) Continue with the Board's normal process, ie redeliberate all the issues with a view to issuing an IFRS to replace IAS 12 (Option 1)

(b) Stop the Board project completely, leaving the IFRIC/annual improvements process to deal with any consequent submissions on the application of IAS 12 (Option 2)

(c) Consider limited amendments to IAS 12 on issues that cause particular problems in practice (Option 3).

5. Agenda paper 8A lists the changes proposed in the ED and indicates whether the overall balance of responses to the ED supported the changes. Agenda paper 8B lists the practice issues that the IFRIC rejected on the basis that they would be resolved by the Board's project. In addition, the staff has included in Agenda paper 8B the convergence issues and other issues that commentators on the ED asked the Board to address because they cause particular concerns in practice.

6. The staff met representatives from the international accounting firms to get their thoughts on whether and how the Board should address practice issues, and took them into the account when forming a staff recommendation. The staff is consulting some others and will provide the Board with additional feedback as necessary.

Staff recommendation

7. The staff recommends Option 3 (consider limited amendments to IAS 12 on issues that cause particular problems in practice). More specifically, the staff recommends limiting the scope of the project to accounting for uncertain tax positions. The staff recommends carrying out that work after the Board finalises the current project on liabilities (revision to IAS 37).

Option 1 – proceed with full project

8. Reasons why the Board should consider this option:

(a) Doing this would be the Board's normal process. Just because the proposals did not attract general support overall does not mean that we should just drop the proposals without further consideration.

(b) Any resulting IFRS would be an improvement on IAS 12 (or the Board would not approve it)

(c) A rewritten IFRS should be easier to use than IAS 12, which is an ‘old-style’ standard

9. Consequences of this option:

(a) Substantial Board time would be required.

(b) Some of the issues will be difficult to resolve without a fundamental review of income tax accounting.

(c) Additional issues raised by comment letters, eg discounting, share-based payments, intra-group transfers and the scope of income tax could make the scope of the project even bigger, and harder to resolve without a fundamental review.

(d) Based on feedback about the guidance that currently exists to support the application of IAS 12, it could require substantial time and effort for our constituents to learn how to apply any new requirements.

Option 2 – stop the Board project

10. Reasons why the Board should consider this option:

(a) The Board’s current agenda creates a heavy workload for the Board and its constituents. Many respondents argue that accounting for income tax is not a priority.

(b) There is a general lack of support for proposals. The proposals are not seen as an overall improvement to IAS 12, nor do they achieve full convergence with US GAAP.

(c) IAS 12 has caused problems in practice. As a result, a large amount of guidance has been developed to ensure consistent application. Widespread changes to IAS 12 will involve substantial work to revise that guidance. This would only be justified if the changes were a substantial improvement.

(d) If there are practice issues that are still a problem, constituents can submit them to the IFRIC for consideration. If there were no Board project, IFRIC would be free to consider whether guidance is needed in the context of the requirements of IAS 12.

11. Consequences of this option are:

(a) IAS 12 remains as it is, leaving practice issues unresolved. Some of these are likely to be re-submitted to the IFRIC. Particular issues are discussed further in paragraphs 12 and 16.

(b) The existing divergence from US GAAP would remain. However, given that the FASB have no plans to issue amendments to Topic 740 at present, the staff thinks some divergence is inevitable.

12. Of the practice issues raised with the IFRIC and IASB (see list in Agenda paper 8B), the staff think the following are likely to be seen as a notable gap in IFRSs or significant practice issues that will be submitted to the IFRIC:

(a) Uncertain tax positions. IAS 12 is silent on this issue, whereas the FASB issued FIN 48 in 2006, now included in ASC Topic 740-10, and has extended its application to non-public entities in 2009.

(b) Property revaluations. Many jurisdictions with no capital gains tax argue that they should not have to recognise deferred tax on property revaluations. In some jurisdictions, recognition of deferred tax in accordance with IAS 12 results in double counting some tax effects. We have recently received additional comment letters setting out new arguments on this point (CL169).

(c) Single asset entities. In some jurisdictions, some types of assets are often acquired in shell companies because there is tax or other advantages in selling the shares in shell companies instead of selling the underlying asset. There is considerable debate about whether deferred tax should be recognised for a temporary difference arising on the asset within the shell company.

(d) Initial temporary differences arising when the same transaction gives rise to both a liability and asset (or an increase in the cost of an asset). Examples are when an entity enters into a finance lease or incurs a decommissioning liability. There is divergence in practice over whether an entity should recognise the resulting deferred taxes initially and, in particular, subsequently.

(e) The use of an undistributed rate for entities such as real estate investment trusts and co-operative societies. In some jurisdictions, those entities are in effect tax exempt because of tax rate reductions or tax deductions relating to distributions and a policy of distributing all or almost all of their available reserves. Those entities find it counter-intuitive to recognise deferred tax at an undistributed tax rate despite their effective tax exempt status.

(f) Recovery of asset partly through use followed by sale (dual recovery). There is diversity in practice as to whether separate tax bases need to be determined for the part of the asset expected to be recovered through use and the part expected to be recovered through sale, with any resulting temporary differences assessed and measured separately.

Option 3 – limited amendments to IAS 12

13. Reasons why the Board should consider this option:

(a) It could demand less Board time than proceeding with the full project.

(b) Some of the issues noted above could be difficult to justify ignoring.

(c) Some issues may be better resolved by amendments to IAS 12 rather than IFRIC interpretations.

14. Consequences of this option are:

(a) We would have to decide which issues to address. Different respondents listed different issues as being important for the Board to resolve now. Any limited scope project would leave some feeling that their issues had been ignored.

(b) Depending on which issues were in the scope of the project, this option could take considerable Board time (albeit less than a full project) and appear like continuing with ED. This would be a particular danger if the resulting amendments changed the basic 'expected' approach under current IAS 12. IAS 12 requires that tax basis and tax rate to be determined by considering the expected manner of recovery or settlement of an asset or liability. The comment letters largely supported this approach.

(c) Depending on the issues and the resulting amendments, we may have to re-expose the proposals.

15. Possible scopes for such limited amendments include:

(a) Option (a):

(i) some or all the issues noted in paragraph 12 above.

(ii) limited review of disclosures

(b) Option (a) plus the proposals in the ED that could be taken forward without much additional analysis because there were few opposing arguments presented in the comment letters. See Agenda paper 8A for a list of the proposed changes in the ED that attracted little opposition.

16. In considering whether to address any of the issues in paragraph 12, the staff notes the following:

(a) Uncertain tax positions. The staff thinks the Board will have to consider whether any proposals on uncertain tax positions are consistent with its general requirements on uncertain liabilities in IAS 37, and justify any inconsistencies. That is difficult to do until the amendments to IAS 37 are finalised. In addition, we may have to address specific tax issues such as a definition of tax position, unit of account, no discounting, no margin and uncertainty relating to tax assets. Special consideration may have to be given to related disclosure requirements.

(b) Property revaluation. The staff thinks that this issue is difficult to resolve under the existing expected approach in IAS 12, other than by granting an exception. The principle behind such an exception could be to avoid double counting, but as with all exceptions, establishing the boundary is likely to be difficult. Alternatively, the Board could consider whether to change the expected approach under IAS 12, but the proposals to do so in the ED attracted many counter-arguments.

(c) Single asset companies. This issue involves the initial recognition exception and the treatment of temporary differences inside and outside an investment in a subsidiary. It could be difficult to find an answer that does not create knock-on effects or inconsistencies with these aspects of IAS 12.

(d) Initial temporary differences arising on finance leases and decommissioning liabilities. This issue would be resolved by the removal of that exception, but the comment letters to the ED put forward many arguments against doing that. Further, initial temporary differences highlight some fundamental questions about deferred tax, for example should it be discounted? Finding a way of dealing with initial temporary differences is likely to be difficult and time-consuming. Alternatively, the particular issue for finance leases and decommissioning liabilities may be possible to resolve by a relatively minor rewording of the exception.

(e) Use of undistributed rate for quasi-tax exempt entities such as real estate investment trusts and co-operative societies. This issue would be resolved by the proposal in the ED to measure deferred tax including the effect of expected future distributions. However, the comment letters indicated that there could be significant practical problems in applying such a requirement. If we kept the IAS 12 requirement not to include the effect of distributions until the distribution itself is recognised, we would need to find a way of making an exception for the quasi tax-exempt entities. We tried to do that when developing the ED, without success.

(f) Recovery of asset through use followed by sale (dual recovery). The staff thinks that resolving this issue in the context of IAS 12 could lead to further divergence with US GAAP.

17. Discussions with the international firms indicate that they believe that other projects are more important than any tax issues in practice. Further, the staff thinks that the comment letters to the ED indicate that it will be difficult to make consistent and worthwhile improvements to IAS 12 without a fundamental review of accounting for tax. The staff therefore recommends that the Board stop the project, with one exception. The staff thinks that having no requirements on uncertain tax positions is a substantial gap in IAS 12 that we should fill. However, we do not recommend trying to address the issue until the amendments to IAS 37 are finalised, so we know what the requirements are for uncertain liabilities generally. Otherwise, we could end up wasting time trying to be consistent with two models, the existing IAS 37 and the future IAS 37.

Question 1 – the scope of the tax project
The staff recommends that the Board stop the project, except for the work on uncertain tax positions. Does the Board agree with the staff recommendation?

Question 2 – Timing of addressing uncertain tax positions
The staff recommends addressing uncertain tax positions after the amendments to IAS 37 are finalised. Does the Board agree with the staff recommendation?