Project **Financial Statement Presentation**

Topic **Income tax allocation and presentation**

Introduction

1. This paper discusses the preliminary views of the IASB and the FASB [collectively, the boards] on **intraperiod tax allocation**[1] in the statement of comprehensive income (SCI) in the context of respondents' feedback to the Discussion Paper (discussion paper), *Preliminary Views on Financial Statement Presentation*. This paper also briefly addresses the proposal to have a separate income tax section on the statement of financial position (SFP) and the statement of cash flows (SCF).

Proposal in the discussion paper

Intraperiod tax allocation

2. The discussion paper proposes that an entity should apply existing requirements for allocating and presenting income taxes in the SCI. This may result in an entity presenting income tax expense or benefit in the discontinued operations and other comprehensive income (OCI) sections in addition to determining the income tax effect for continuing operations (the income tax section). An entity should not allocate income taxes to the business or financing section or to categories within those sections.

Premise of retaining profit or loss and OCI

3. In the discussion paper, the boards propose that the SCI should continue to present a subtotal (ie *profit or loss* or *net income*) for a component of

[1] Existing standards require an entity to allocate income tax expense or benefit for the period among particular components of comprehensive income and equity (a process referred to as *intraperiod tax allocation*).

comprehensive income. In addition, the proposed presentation model requires segregation of continuing operations, OCI items and discontinued operations all presented on a net-of-tax basis in the SCI.

4. Prior to issuing the discussion paper, the boards heard from a number of users and preparers of financial statements who favour keeping OCI and discontinued items and their income tax effects separate from *income from continuing operations*. Much of the support for intraperiod tax allocation arises because it allows for the presentation of *after-tax income from continuing operations*, a subtotal that many of the boards' constituents find important in their decision-making. Therefore, the discussion paper proposes retaining the existing intraperiod tax allocation guidance. Thus, income tax expense or benefit should continue to be allocated among income from continuing operations, discontinued operations, OCI items, and items charged or credited directly to equity.

Exception to cohesiveness

5. As noted above, the boards believe that allocating income taxes in the SCI is important in helping users assess the amount, timing, and uncertainty of future cash flows, which is more important than strict adherence to the cohesiveness objective. Therefore, the boards propose in the discussion paper that an entity should present income tax assets, liabilities, and cash flows in an income tax section in the SFP and the SCF but propose to retain allocation of income taxes in the SCI. The result is that an entity might present some income tax expense or benefit in the discontinued operations and OCI sections of the SCI rather than in the income tax section that corresponds to the SFP and the SCF.

Summary of comment letter responses

6. Question 17 in the discussion paper asked to which sections and categories, if any, should an entity allocate income taxes to in the SCI in order to provide information that is decision-useful to users of its financial statements.

7. The **majority of respondents agree** with retaining the existing requirements for allocating and presenting income taxes in the SCI. Those respondents note that a subtotal of *income from continuing operations* before and after tax is important and that separate income tax information about discontinued operations and OCI items is also useful.

8. Respondents note that the current practice of allocating income taxes to continuing operations, discontinued operations, OCI, and certain components of equity is well established, understood by both prepares and users of financial statements, and gives a meaningful display of an entity's results.

Not allocating income taxes

9. A handful of respondents are against **any** allocation of income taxes and suggest that income taxes should be presented in a separate section. One respondent states that income taxes are transactions separate from the underlying taxable activity to which they relate. In addition, this respondent notes that intraperiod tax allocation is currently an arbitrary, difficult, and time-consuming process, made even more so by items such as valuation allowances and tax rate changes.

Allocating income taxes to components of OCI

10. A few IFRS respondents are against the allocation of income taxes to individual components of OCI. Those respondents propose that OCI items be presented on a pre-tax basis and that an aggregate income tax amount related to the total of OCI items be presented in the OCI section. One respondent doubts the usefulness of the information provided by allocating income taxes to each OCI item, noting that income taxes related to continuing operations are presented on a single line. Another respondent states that estimating the tax effects would involve a significant amount of judgement, approximation, and arbitrariness, at least partly because of the interdependence between the different OCI items.

Further allocation of income taxes to sections and categories

11. A few respondents suggest that an entity be required to further allocate income taxes to business and financing sections. One respondent indicates that because a typical starting point for computing future cash flows is NOPAT (net operating profit after taxes) or EBIAT (earnings before interest after taxes), a significant benefit to the user community would be any presentation or disclosure that enabled them to separately allocate income tax expense to the business and financing components of net income. Another respondent notes that because users need to allocate income tax in order to predict future sustainable cash flows, preparers should provide useful information on income tax allocation when they are able to do so.

12. However, most respondents are against allocating income taxes to the sections and categories within continuing operations. They state that a further allocation of income taxes would prove to be an arbitrary and difficult process that would not provide useful information.

Staff analysis and recommendation

Not allocating income taxes

13. Prior to issuing the discussion paper, the boards considered presenting all income taxes in the same section in the SCI as well as the SFP and the SCF. One reason for not allocating income taxes and presenting them in a separate section is that income taxes are a form of income appropriation and are managed by the entity as a whole. Therefore, the income tax expense relates to the entity as a whole and should be presented as a single amount.

14. Users of financial statements told the boards that allocating income taxes in the SCI is important in helping them assess the amount, timing, and uncertainty of future cash flows. If income taxes were to be presented as a single amount, profit or loss that is on a net-of-tax basis could not be derived. As the boards indicated at their July 2009 joint meeting that profit or loss (net income) and an OCI section are to be maintained, income taxes must continue to be allocated at a minimum to profit or loss (net income) and OCI.

15. The discussion paper did not specifically ask respondents about the proposal that income taxes be presented separately in the SFP and the SCF. The staff do not recall any letters raising any concerns with that proposal and, therefore, the staff see no reason to modify that aspect of the discussion paper.

Allocating income taxes to components of OCI

16. In 2007 the IASB amended IAS 1 to permit components of OCI to be displayed either (a) net of related tax effects or (b) before related tax effects and to require disclosure of income tax allocated to each component of OCI. That amendment is similar to the requirement in US GAAP.

17. Many respondents to the exposure draft that preceded the 2007 amendment to IAS 1 agreed in principle with the proposed disclosure of income tax allocated to individual components of OCI. This is because the disclosure would help to

improve the clarity and transparency of such information, particularly when components of OCI are taxed at rates different from those applied to profit or loss (eg income tax on foreign currency translation effects). However, as noted previously, some respondents continue to criticise the requirement that an entity present or disclose the income tax relating to each component of OCI because the allocation process is arbitrary.

18. As the IASB just recently amended IAS 1 to converge with US GAAP on this issue, the staff see no reason to change existing requirements to disclose the amount of income tax allocated to each component of OCI. Furthermore, the staff believe that any concerns constituents have with the allocation of income taxes to OCI items should be addressed in an income tax project, not the financial statement presentation project.

Further allocation of income taxes to sections and categories

19. The staff agree with the respondent who said that it would be beneficial to users of financial statements if an entity could "appropriately" allocate income taxes to the business and financing sections and categories. However, the staff agree with the boards' conclusion in the discussion paper that the arbitrary nature of existing income tax allocations would increase if income taxes were to be allocated to the sections and categories within continuing operations.

Allocate income taxes to discontinued operations

20. In September 2009, the boards tentatively decided that an entity should present discontinued operations in a separate section in each of the primary financial statements. Most respondents support presenting discontinued operations on a net-of-tax basis with the amount of income taxes allocated to discontinued operations presented separately on the SCI. Allocating income taxes to discontinued operations is consistent with the notion of presenting a subtotal for after-tax income from continuing operations. Therefore, the staff see no reason for the boards to change their preliminary view on allocating income taxes to discontinued operations.

Staff recommendation

21. The majority of respondents agree with the boards' preliminary view on income tax allocation. The boards recently affirmed the proposals in the discussion paper

to retain a profit or loss subtotal, and separate sections for OCI items and for discontinued operations. In addition, the proposal related to intraperiod tax allocation in the recent IASB exposure draft *Income Tax* [2] is consistent with the proposal in the discussion paper for allocating income taxes in the SCI. Therefore, the staff see no reason why the boards should change their view on this issue as proposed in the discussion paper.

22. The staff recommend that the boards:

(a) retain the proposal in the discussion paper that an entity should apply existing requirements for allocating and presenting income taxes in the SCI, including the requirement that an entity present components of OCI either (i) net of related tax effects or (ii) before related tax effects

(b) retain the existing requirement that an entity disclose the amount of income tax allocated to each component of OCI

(c) retain the proposal in the discussion paper that an entity present current and deferred income tax assets and liabilities recognized in accordance with IFRSs or US GAAP and related cash flows in an income tax section on the SFP and the SCF.

Questions

1. The staff recommend that the exposure draft retain the proposal that an entity allocate and present income taxes in the SCI in accordance with existing requirements. **Do the boards agree with the staff recommendation**?

2. The staff recommend that the exposure draft retain the existing requirement that an entity disclose the amount of income tax allocated to each component of OCI. **Do the boards agree with the staff recommendation?**

3. The staff recommend that the exposure draft retain the proposal that an entity present current and deferred income tax assets and liabilities recognized in accordance with IFRSs or US GAAP and related cash flows in an income tax section on the SFP and the SCF. **Do the boards agree with the staff recommendation?**

[2] That exposure draft is to replace IAS 12 *Income Taxes* and to converge with US GAAP. The exposure draft proposes that an entity recognise income tax expense arising at the time of a transaction or other event in the same component of comprehensive income (ie continuing operations, discontinued operations, or items in OCI) or equity in which it recognises that transaction or other event.