Project	**Income Tax**
Topic	**Comment letter analysis**

Introduction

1. The purpose of this paper is to provide a summary and preliminary analysis of the comments received on the IASB's Exposure Draft *Income Tax* (the ED). The ED was published on 31 March 2009 and the comment period ended on 31 July 2009. We received 168 comment letters.

2. Appendix A contains an analysis of respondents that commented on the ED, classifying them by type of respondent and geographic region. There is only one comment letter from a user group.

3. We have provided comment letter numbers (CL#) in footnotes in each page as examples of views stated in the body of this document.

4. We are not asking the boards to reach any tentative conclusions at this meeting on any of the matters raised in this paper. We plan to bring proposals on how to proceed with the IASB project to the next IASB meeting. The purpose of this paper is to bring the boards a summary of responses from our constituents on the ED well in advance of that decision and to give the IASB sufficient time to consider whether any change in the project plan is necessary.

Background

5. The IASB began work on income tax in September 2002 as part of the short term convergence project with the FASB. The project aims to achieve two objectives; (1) to converge with the US GAAP and (2) to improve IAS 12.

This paper has been prepared by the technical staff of the FASB and the IASCF for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of IFRSs or U.S. GAAP do not purport to be acceptable or unacceptable application of IFRSs or U.S. GAAP.

The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

6. The IASB and FASB conducted the project together from 2002-2007 and reached substantially similar conclusions on most issues, other than uncertain tax positions (see paragraphs 42-55 below). At that stage, the Boards planned to publish the same exposure draft with the aim of publishing a common standard.

7. However, the FASB announced in September 2007 that it would review its strategy for short term convergence projects in the light of the possibility that some or all of US public companies might be permitted or required to adopt IFRSs at some future date. Consequently, the FASB did not formally approve a package as the joint conclusions that the boards had developed during the project, nor did the FASB develop them into an FASB exposure draft. We understand that the FASB will decide how to proceed with the income tax project after it has considered the responses to the IASB ED.

Summary of comments received

8. This paper summarises the main comments received. It is not intended to provide a comprehensive list of all comments received. The following is a list of major issues that the staff identified during the comment letter analysis.

   (a) General comments

   (b) Temporary difference and tax basis (Questions 1 and 9)

   (c) Initial recognition (Question 3)

   (d) Investments in subsidiaries etc (Question 4)

   (e) Valuation allowance (Questions 5 and 6)

   (f) Uncertain tax positions (Questions 7)

   (g) Intra-period allocation (Question 13)

   (h) Other issues

General comments

9. Virtually all respondents supported the two objectives of the project, ie, convergence with the US GAAP and improvement of IAS 12. However, many respondents, except some preparers from Hong Kong, North America and some other jurisdictions, said that the ED failed to achieve the objectives in many parts mainly for the following reasons:

    (a) The FASB suspended the project and has no specific plan to resume it.

    (b) Many respondents viewed many of the proposed changes in the ED not as improvements but as the introduction of complex new rules, without significantly improving the outcome.

10. Those respondents who believed that the proposals in the ED are too complex often suggested that we should perform field tests to understand the actual outcome that would arise if the proposals were applied in different jurisdictions around the world.

11. Respondents who had problems with the current IAS 12 had mixed views. Some of them appreciated our proposal and wished to finalise them in their current form as soon as possible. Others thought more clarification or guidance would be needed.

12. There were also several respondents who expressed their disappointment with the scope of the project. Many of them urged the Board to consider issues such as:

    (a) deferred tax on the share based payment under IFRS 2 which they through was significantly different from the requirement under US GAAP, and

    (b) discounting.

13. Overall, there was only very limited support for finalising the ED in its current form. However, many comment letters suggested improvements to IAS 12 in short term, and a joint project with the FASB and/or a fundamental review of accounting for income tax in long term. Some noted that the German and UK accounting standards boards are conducting such a review.

Temporary difference and tax basis (Questions 1 and 9)

Question 1 – Definitions of tax basis and temporary difference
The exposure draft proposes changes to the definition of tax basis so that the tax basis does not depend on management's intentions relating to the recovery or settlement of an asst or liability. It also proposes changes to the definition of a temporary difference to exclude differences that are not expected to affect taxable profit. Do you agree with the proposal? Why or why not?

Question 9 – Sale rate or use rate
When different rates apply to different ways in which an entity may recover the carrying amount of an asset, IAS 12 requires deferred tax assets and liabilities to be measured using the rate that is consistent with the expected manner of recovery. The exposure draft proposes that the rate should be consistent with the deductions that determine the tax basis, ie the deductions that are available on sale of the asset. If those deductions are available only on sale of the asset, then the entity should use the sale rate. If the same deductions are also available on using the asset, the entity should use the rate consistent with the expected manner of recovery of the asset. Do you agree with the proposal? Why or why not?

14. Most respondents agreed that the definition of a temporary difference should exclude differences that were not expected to affect taxable profit. However, many respondents disagreed with the proposed definition of a tax basis, generally on the grounds that the assumption of sale:

    (a) does not provide decision-useful information when an entity is unlikely to sell the asset, and would conflict with the going concern basis.

    (b) is inconsistent with the treatment of management expectations in other parts of the ED. For example, the ED includes management expectations in the initial step of whether there is a temporary difference, and in the measurement of deferred tax assets and liabilities. It also considers management expectations in determining the applicable tax rate and in considering the effect of distributions.

However, it excludes management expectations when determining the tax basis of an asset and liability[1].

15. On the other hand, respondents from some tax jurisdictions (such as Hong Kong and New Zealand) generally welcomed these proposals, although some of them disagreed partially or would like further clarification on some specific issues[2]. In general, these jurisdictions do not tax on capital gains and the assumption of sale means that no deferred tax liability would be recognised for revaluations of property, plant and equipment, fair value gains on investment property and fair value gains in business combinations. In contrast, at present IAS 12 requires entities to recognise deferred tax liabilities for such items if the entity expects to recover their carrying amount through use.

16. There was no comment from the user group on this question.

Initial recognition (Question 3)

Question 3 – Initial recognition exception
The exposure draft proposes eliminating the initial recognition exception in IAS 12. Instead, it introduces proposals for the initial measurement of assets and liabilities that have tax bases different from their initial carrying amount. Such assets and liabilities are disaggregated into (a) an asset or liability excluding entity-specific tax effects and (b) any entity-specific tax advantage or disadvantage. The former is recognised in accordance with applicable standards and a deferred tax asset or liability is recognised for any temporary difference between the resulting carrying amount and the tax basis. Outside a business combination or a transaction that affects accounting or taxable profit, any difference between the consideration paid or received and the total amount of the acquired assets and liabilities (including deferred tax) would be classified as an allowance or premium and recognised in comprehensive income in proportion to changes in the related deferred tax asset or liability. In a business combination, any such difference would affect goodwill. Do you agree with the proposal? Why or why not?

[1] CL#167
[2] CL#23, CL#32, CL#87 and CL#158

17. While there was general support for the project's objective to eliminate exceptions to the temporary difference approach, there was also much opposition to the proposed method of eliminating the initial recognition exception. Those respondents typically argued that the proposed approach was extremely complex and they would prefer to retain the current exception under IAS 12 as the result would likely be the same[3].

18. Some respondents thought the proposed approach was conceptually superior but also thought it would be very difficult to apply in practice[4]. They thought that if the Board were to proceed with the proposal, it would need to provide further guidance and clarification on, for example, who market participants were and what entity-specific tax advantage meant. Some were also concerned that subsequent tracking of the premium/allowance would be difficult in practice[5].

19. A few respondents suggested other approaches, for example;

    (a) Immediate recognition of the premium/allowance in profit or loss[6],

    (b) The simultaneous equation method used in the US GAAP[7],

    (c) Recognition of the asset at fair value and deferred tax as the difference between that fair value and the purchase consideration[8].

20. There was substantial agreement on retaining the exception for goodwill.

21. There was no comment from the user group on this question.

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[3] CL#167
[4] CL#24
[5] CL#100, CL#112 and CL#125
[6] CL#141
[7] CL#110, CL#126 and CL#162.
[8] CL#54

Investments in subsidiaries etc (Question 4)

Question 4 – Investments in subsidiaries, branches, associates and joint ventures
IAS 12 includes an exception to the temporary difference approach for some investments in subsidiaries, branches, associates and joint ventures based on whether an entity controls the timing of the reversal of the temporary difference and the probability of it reversing in the foreseeable future. The exposure draft would replace these requirements with the requirements in SFAS 109 and APB Opinion 23 *Accounting for Income Taxes—Special Areas* pertaining to the difference between the tax basis and the financial reporting carrying amount for an investment in a foreign subsidiary or joint venture that is essentially permanent in duration. Deferred tax assets and liabilities for temporary differences related to such investments are not recognised. Temporary differences associated with branches would be treated in the same way as temporary differences associated with investments in subsidiaries. The exception in IAS 12 relating to investments in associates would be removed. The Board proposes this exception from the temporary difference approach because the Board understands that it would often not be possible to measure reliably the deferred tax asset or liability arising from such temporary differences. Do you agree with the proposal? Why or why not? Do you agree that it is often not possible to measure reliably the deferred tax asset or liability arising from temporary differences relating to an investment in a foreign subsidiary or joint venture that is essentially permanent in duration? Should the Board select a different way to define the type of investments for which this is the case? If so, how should it define them?

22. There was general support for the project's objective to eliminate exceptions to the temporary difference approach and also support for the statement in BC 43 of the ED which says "the calculation of the amount of deferred taxes for permanently reinvested unremitted earnings of foreign subsidiaries and joint ventures is so complex that the costs of doing so outweigh the benefit".

23. Although some respondents agreed with the proposal to provide an exemption only for foreign subsidiaries and joint ventures[9], many respondents from all regions disagreed with the proposal as they thought it inappropriate to distinguish "foreign" and "domestic" in an accounting standard that would apply

[9] CL#126

globally. In particular they believed that there could be practical difficulties to determine what the terms "foreign" and "domestic" meant in multinational entities that had multi-tier subsidiaries across multiple jurisdictions or that had two or more headquarters in different jurisdictions[10].

24. Many respondents believed that a similar level of difficulty in calculating permanently reinvested unremitted earnings would exist in domestic entities. This is particularly the case in jurisdictions where a dividend from subsidiaries was not tax exempt or where there was a consolidated tax return system under which, although a dividend from a consolidated subsidiary was tax free, a tax basis of a subsidiary would have to be adjusted when and only when a subsidiary would be sold to a third party[11].

25. There were also several respondents who thought that the new concepts "permanent in duration" and "apparent in foreseeable future" could be confusing[12]. Such respondents, together with respondents who proposed not to distinguish between "foreign" and "domestic" suggested retention of the current exception under IAS 12.

26. Some respondents, mainly preparers, argued that deferred tax on investments in subsidiaries should not be recognised because it would rarely be realised or only be realised far in future, in which case they argued that the time value of money would make the discounted amount immaterial[13].

27. The user group on the other hand opposed the use of management expectations in the criteria for not recognising deferred tax liabilities. Doing so allows entities to control the timing of the recognition of the tax. They thought that if the Board permits the timing of the recognition to be based on management expectations, comprehensive qualitative and quantitative disclosures should be

[10] CL#70, CL#84 and CL#125 for difficulties to distinguish foreign and domestic
[11] CL#84, CL#105, CL#113,CL#125 and CL#141 for difficulties to compute the temporary difference of domestic subsidiaries.
[12] CL#104, CL#105, CL#125 and CL#141
[13] CL#64, CL#70 and L#141

required so that users would be able to understand the cash consequences and its impact on the effective tax rate[14].

Disclosures

Excerpt from the ED
(Paragraph 48(c)) The entity shall disclose: (a) - (b) omitted (c) aggregate amount of temporary differences associated with investments in subsidiaries and interests in joint ventures, for which deferred tax liabilities have not been recognised. (d) - (g) omitted Paragraph 81(f) of IAS 12 contains the same requirement.

28. Some respondents (preparers, national standard setters and one of the international accountancy firms) disagreed with the proposed retention of the requirement to disclose the aggregate amount of temporary differences associated with investments in subsidiaries and interests in joint ventures for which deferred tax had not been recognised. Many of them argued that the calculation of the temporary difference was as difficult as the calculation of deferred tax liability and the cost of calculating such an amount would not outweigh the benefit of doing so. They contended that the difficulties would be; (i) timely computation of the carrying amount that might require step-by-step closing of the accounts from the lowest level of subsidiaries to the parent company in the multi-level group organisation and (ii) computation of the adjusted tax basis that would be required under a consolidated tax return system as if all subsidiaries were sold at the reporting date[15].

29. One of the international accountancy firms suggested the disclosure be limited to a narrative of the nature of the tax exposure of the consolidated group and how any tax amount would be determined, without providing details of the amount of those temporary differences or deferred taxes[16]. Some opponents

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[14] CL#160
[15] CL#84, CL#105, CL#125 and CL#141
[16] CL#105

suggested that the disclosures for these temporary differences should be aligned with those under US GAAP. FASB ASC Topic 740-30-50-2c[17] requires an entity to disclose 'the amount of the unrecognised deferred tax liability for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of that liability is practicable or a statement that determination is not practicable'[18].

Valuation allowance (Questions 5 and 6)

Question 5A – Valuation allowances
The exposure draft proposes a change to the approach to the recognition of deferred tax assets. IAS 12 requires a one-step recognition approach of recognising a deferred tax asset to the extent that its realisation is probable. The exposure draft proposes instead that deferred tax assets should be recognised in full and an offsetting valuation allowance recognised so that the net carrying amount equals the highest amount that is more likely than not be realisable against taxable profit. Do you agree with the recognition of a deferred tax asset in full and an offsetting valuation allowance?

30. Some respondents, mainly from Europe and Asia Pacific regions, argued that the requirement to recognise deferred tax assets in full was inconsistent with the Framework[19]. The Framework states that an asset is defined as a resources controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

31. Nonetheless, the vast majority of respondents who commented on this question agreed with the two-step approach proposed in the ED as it would provide more transparent information to users[20].

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[17] Formerly SFAS 109, paragraph 44c
[18] CL#55, CL#104 and CL#156
[19] CL#70, CL#129 and CL#145
[20] CL#167

32. The user group also supported the two-step approach because they believed that key information on asset values, changes in expectations, and recoverability were obscured if the individual deferred tax assets were disclosed net of any valuation allowance[21].

Question 5B – Valuation allowances
Do you agree that the net amount to be recognised should be the highest amount that is more likely than not be realised against future taxable profits?

33. Many respondents also supported the proposal that the net amount to be recognised should be the highest amount that was more likely than not be realisable against future taxable profit, although some respondents expressed concerns that the term "more likely than not" in the ED in the IFRSs was inconsistent with the term "probable" in the Framework[22]. Some respondents were concerned that the use of the term "the highest amount" could imply a need to assess probabilities of all possible outcomes and choose the one with the highest probability[23]. Some also expressed their concerns on the inconsistency in measurement of uncertainties associated with the recoverability of the deferred tax asset and those associated with the result of potential tax examination by the tax authorities[24].

34. The user group thought that the more likely than not rule was broad enough to make the valuation allowance an earnings-management tool. Although the arbitrary nature of the valuation allowance cannot be avoided, they prefer the use of a probability weighted expected value approach which would be consistent with the measurement of uncertain tax positions[25].

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[21] CL#160
[22] CL#62 and CL#156
[23] CL$119, CL#141 and CL#150
[24] CL#84
[25] CL#160

Question 6A – Assessing the need for a valuation allowance
The exposure draft incorporates guidance from SFAS 109 on assessing the need for a valuation allowance. Do you agree with the proposed guidance?

35. Most respondents to this question supported the proposal to incorporate guidance from US GAAP on assessing the need for a valuation allowance.

36. There were two different views among the respondents how much guidance a standard should provide. Some wanted more guidance and clarification on certain issues but others, mainly European, wanted the standard to have less guidance and be based on principles.

37. The respondents with the former view typically wished to have more guidance on how estimates of future taxable profits should deal with tax losses (especially those that can be carried forward indefinitely), unused tax credits, tax planning strategies and reversals of recurring temporary difference[26]. Some wanted the guidance to be closer to the wording in US GAAP[27].

38. There were several specific points on which some respondents had concerns:

    (a) Whether consideration of tax planning strategies in assessing the valuation allowance is consistent with other proposals in the ED (B27) to recognize the effect of a tax election or a voluntary change in tax status on the approval date or the filing date of the final required document[28].

    (b) How uncertainties on the estimation of future taxable profits should be taken into account[29].

Question 6B – Assessing the need for a valuation allowance
The exposure draft adds a requirement on the cost of implementing a tax strategy to realise a deferred tax asset. Do you agree with the proposed requirements?

[26] CL#25 and CL105
[27] CL#119.
[28] CL#105
[29] CL#146

39. Most respondents to this question supported the proposal. Some wanted more guidance on the extent to which the cost of implementing a tax planning strategy should be taken into account (eg, whether the cost should include indirect costs, opportunity costs etc)[30]. Some simply wanted the same wording as US GAAP[31].

40. The opponents of this proposal were divided to two groups. One group believed that that the costs of implementing a tax strategy should be recognised when those costs are incurred in future and they should be presented as operating expenses instead of income tax expenses[32]. Another group believed that the detailed guidance was not necessary because entities already implicitly took into account all future taxable revenue and expenses including costs of implementing a tax strategy[33].

Disclosures

Excerpt from the ED
(Paragraph 41) An entity shall disclose separately the components of tax expense recognised in profit or loss. Components of tax expense include, for example: (a) - (f) omitted (g) any change in a valuation allowance, showing separately any change that arises from a tax benefit that reduces current tax expense. (h) omitted (Paragraph 47) An entity shall disclose the amount of any valuation allowance, any change in the valuation allowance, and a description of any event or change in circumstances that causes that change.

41. Some preparers were concerned that these disclosures could reveal the entity's confidential information[34]. Some thought that the disclosure requirement under paragraph 41(g) was sufficient and therefore the requirement under paragraph 47 was not necessary[35].

[30] CL#105
[31] CL#114
[32] CL#55
[33] CL#125
[34] CL#8 and CL#168
[35] CL#104 and CL#125

Uncertain tax positions (Questions 7)

Question 7 – Assessing the need for a valuation allowance
IAS 12 is silent on how to account for uncertainty over whether the tax authority will accept the amounts reported to it. The exposure draft proposes that current and deferred tax assets and liabilities should be measured at the probability weighted average of all possible outcomes, assuming that the tax authority examines the amounts reported to it by the entity and has full knowledge of all relevant information. Do you agree with the proposal? Why or why not?

42. This question received the most responses, indicating that accounting for uncertain tax positions is one of the topics of highest interests to our constituents. Few respondents supported the proposals.

43. Regardless of whether they supported the proposal or not, many respondents acknowledged the need for clarity in this area because they believed that there is diversity in practice[36].

44. On the other hand, many other respondents, mainly preparers, wanted IFRSs to remain silent on this topic. They believed that, although IAS 12 was silent on this topic, it implicitly required an entity to include potential tax liabilities as a result of future tax examination by the tax authorities in the estimation of their current and deferred tax liabilities. They thought that there was no significant flaw in current practice under IAS 12 for tax uncertainties. They also said that if there were any material tax uncertainties, they should be disclosed in accordance with IAS 1, paragraph 125 (source of estimation uncertainty)[37].

45. Those respondents who supported the need for clarity in this area but did not support our proposal often disagreed with the use of the probability weighted average method to measure the tax uncertainties. They typically argued that

    (a) the outcome of applying this method would rarely equal the actual outcome because all tax positions contain some level of uncertainty and many tax positions are binary in nature.

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[36] CL#146
[37] CL#32 and CL#12

(b) because of the nature of tax uncertainties, it would not often be possible to measure them reliably (eg, tax cases relating to business combination and transfer pricing often differ from one transaction to another and entities do not have enough information to estimate reliably possible outcomes and their probabilities). Therefore, it seems unreasonable to expect the high level of precision implied by this method.

(c) despite the Board's stated intention not to require entities to seek out additional information for the purposes of applying this method (BC63), entities would need to perform significantly more work in analysing and assessing the information in order to demonstrate that they had fully considered all possible outcomes and that the judgements on those outcomes were supportable[38].

46. Many opponents of the probability weighted average method suggested the use of the most likely outcome as it is consistent with the current requirement under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*[39]. Some acknowledged that the most likely outcome is not consistent with proposals in the exposure draft of revisions to IAS 37, but argued that the Board should not rely on a precedent for which the due process is not yet complete. Some, mainly those familiar with US practice, suggested aligning the standard with US GAAP (ie, FIN 48, now FASB ASC Topic 740-10-30-7) which requires an entity to measure the tax benefit from an uncertain tax position at the largest amount that is greater than 50% likely of being realised upon settlement with the tax authorities[40]. Some other opponents suggested that the measurement should be consistent with the measurement of the valuation allowance (or that both uncertainties should be measured together)[41].

47. Many respondents also disagreed with not having any recognition threshold because they believed that all tax positions will have some degree of

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[38] CL#21, CL#80, CL#86, CL#140, CL#147, CL#167
[39] CL#55
[40] CL#155
[41] CL#26

uncertainty. Therefore, not having a recognition threshold would lead to measuring almost all tax positions at a probability-weighted average which would increase entities' compliance costs.

48. There were different views on what kind of recognition threshold would be appropriate for tax uncertainties. Many respondents supported the "more likely than not" recognition threshold because it would be consistent with the current requirement under IAS 37 and with US GAAP in FIN 48[42]. Some suggested a minimum level of recognition threshold or exception for cases where a tax risk was remote or cases where a tax position was highly likely to be sustained[43].

49. Respondents who supported having a recognition threshold also suggested a concept of the unit of account, similar to that in FIN 48, so that preparers could assess the tax benefit from each pool of uncertain tax positions instead of each individual tax position[44]. The introduction of the unit of account could also affect the disclosure requirements.

50. Some respondents asked more clarification and guidance on the proposed requirements. For example, they requested guidance on[45]:

    (a) The definition of a tax position

    (b) The distinction between new information and a new interpretation of existing information

    (c) The de-recognition of uncertain tax positions (eg, when an entity should de-recognise a liability for an uncertain tax position when there is no statute of limitation for tax examination on a particular issue.)

    (d) Classification of a liability as current or non-current for uncertain tax positions

51. While the vast majority of respondents opposed the probability weighted average method, it was strongly supported by the user group, professionals who

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[42] CL#105, CL#108 and CL#114
[43] CL#84, CL#105, CL#108 and CL#114
[44] CL#75, CL#105 and CL#155
[45] CL#75, CL#110, CL#141, CL#155 and CL#158

seemed to have an academic background and the tax authority[46]. Most supporters of this method believed that the expected value approach was conceptually superior to either a "probable" or "more likely than not" approach. Some of them suggested introduction of a lighter version of the expected value approach, for example, a probability weighted average method based on a limited number of scenarios if there are very many possible outcomes.

Disclosures

Excerpt from the ED
(Paragraph 41) An entity shall disclose separately the components of tax expense recognised in profit or loss. Components of tax expense include, for example: (a) omitted (b) any adjustments recognised for current tax of prior periods, including separately the effect of the possible outcomes of a review by the tax authorities, determined in accordance with paragraph 26. (c) omitted (d) omitted (e) the effect on deferred tax expense of any change in the effect of the possible outcomes of a review by the tax authorities, determined in accordance with paragraph 26. (Paragraph 49) An entity shall disclose information about the major sources of estimation uncertainties relating to tax to enable users of the financial statements to assess the possible financial effects of the estimation uncertainties and their timing (for example, the effects of unresolved disputes with the tax authorities), including: (a) a description of the uncertainty; and (b) an indication of its possible financial effects on amounts recognised for tax and the timing of those effects.

52. Many respondents expressed concerns on the proposed disclosure of uncertain tax positions. They disagreed mainly because they believed that this disclosure could severely jeopardise the entity's position against tax authorities as well as

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[46] CL#60, CL#81, CL#96, CL#160

against competitors, and could undermine the legal privilege that taxpayers were entitled to[47].

53. Many opponents proposed the introduction of an exception for cases when disclosure would seriously prejudice the entity, similar to IAS 37 paragraph 92[48]. Some opponents suggested disclosures of uncertain tax positions should be made on an aggregate basis in order not to reveal to the tax authority an individual entity which had an uncertain tax position[49].

54. The user group requested additional disclosure of the following information about uncertain tax positions, which are required under US GAAP[50]:

    (a) Roll-forward of unrecognised tax benefits

    (b) The amount of unrecognised tax benefit that may affect the effective tax rate and

    (c) Significant increases or decrease within the next 12 months.

55. The user group thought that the disclosure of the expected changes in the next 12 months was essential to understanding the continuing effect of past tax positions on current liquidity.

Intra-period allocation (Question 13)

Question 13 – Assessing the need for a valuation allowance
IAS 12 and SFAS 109 require the tax effects of items recognised outside continuing operations during the current year to be allocated outside continuing operations. IAS 12 and SFAS 109 differ, however, with respect to the allocation of tax related to an item that was recognised outside continuing operations in a prior year. Such items may arise from changes in the effect of uncertainty over the amounts reported to the tax authorities, changes in assessments of recovery of deferred tax assets or changes in tax rates, laws, or the taxable status of the entity. IAS 12 requires the allocation of such tax outside continuing operations,

[47] CL#85, CL, 167
[48] CL#55, CL#114
[49] CL#105
[50] CL#160

whereas SFAS 109 requires allocation to continuing operations, with specified exceptions. The IAS 12 approach is sometimes described as requiring backwards tracing and the SFAS 109 approach as prohibiting backwards tracing. The exposure draft proposes adopting the requirements in SFAS 109 on the allocation of tax to components of comprehensive income and equity.

Question 13A
Do you agree with the proposed requirement? Why or why not?

The exposure draft deals with allocation of tax to components of comprehensive income and equity in paragraphs 29-34. The Board intends those paragraphs to be consistent with the requirements expressed in SFAS 109.

Question 13B
Would those paragraphs produce results that are materially different from those produced under the SFAS 109 requirements? If so, would the results provide more or less useful information than that produced under SFAS 109? Why?

The exposure draft also sets out an approach based on the IAS 12 requirements with some amendments.

Question 13C
Do you think such an approach would give more useful information than the approach proposed in paragraphs 29-34? Can it be applied consistently in the tax jurisdictions with which you are familiar? Why or why not?

Question 13D
Would the proposed additions to the approach based on the IAS 12 requirements help achieve a more consistent application of that approach? Why or why not?

56. Almost all respondents who commented on intra-period tax allocation disagreed with the proposal based on the requirements in FASB ASC Topic 740-20 and preferred an approach based on the existing IAS 12 requirements. They thought that the proposed approach was complex and could create counter intuitive results. Some of them regarded the recognition in profit or loss of the effect of

changes in tax rate on items previously charged to other comprehensive income as a distortion[51].

57. Further, many respondents preferred retaining the current requirement under IAS 12 because they did not think there were any practical problems in the application of the existing rule under IAS 12. Many of them further considered the proposed alternative approach with additional guidance as rule-based rather than principle-based[52].

58. Some of respondents, mainly from North America, supported the proposal to align with the US GAAP[53].

59. Some respondents, including the user group, said that either approach would involve arbitrariness, complexity and judgement. Some of them suggested income tax be reported as a single line item so that there would be no need for intra-period allocation. Some further said that this issue would be addressed better by disclosures rather than allocation in the primary statements[54].

Other issues

60. This sections deals with the following issues:

    (a) Tax credit, investment tax credit and special deductions (paragraphs 61)

    (b) Substantively enacted tax rate (paragraph 62)

    (c) Distributed or undistributed rate (paragraph 63)

    (d) Tax based on two or more systems (paragraph 64)

    (e) Allocation of taxes within a consolidated tax filing group (paragraph 65)

    (f) Classification of deferred tax assets and liabilities (paragraph 66)

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[51] CL#11, CL#51 and CL#69
[52] CL#167
[53] CL#110, CL#114 and CL#126
[54] CL#141 and CL#160

(g) Classification of interest and penalties (paragraph 67)

(h) Exceptions in US GAAP but not in IAS 12 and not proposed in the ED (paragraphs 68 – 71)

(i) Disclosures – Use of the parent's tax rate in the rate reconciliation (paragraphs 72 – 74)

(j) Disclosures – A numerical analysis of change in deferred tax balance (paragraphs 75 – 76)

(k) Miscellaneous (paragraphs 77 – 80)

(l) Transition (paragraphs 81 – 82)

Tax credit, investment tax credit and special deductions

Question 2 – Definition of tax credit and investment tax credit
The exposure draft would introduce definitions of tax credit and investment tax credit. Do you agree with the proposed definitions? Why or why not?

Question 11 – Deductions that do not form part of a tax basis
An entity may expect to receive tax deductions in the future that do not form part of a tax basis. SFAS 109 gives examples of 'special deductions' available in the US and requires that 'the tax benefit of special deductions ordinarily is recognized no earlier than the year in which those special deductions are deductible on the tax return'. SFAS 109 is silent on the treatment of other deductions that do not form part of a tax basis. IAS 12 is silent on the treatment of tax deductions that do not form part of a tax basis and the exposure draft proposes no change. Do you agree that the exposure draft should be silent on the treatment of tax deductions that do not form part of a tax basis? If not, what requirements do you propose, and why?

61. There was general support across all regions for the proposed definition of tax credit and investment tax credit. There was also substantial support for the proposal for the standard to be silent on the special deductions. However, many respondents urged the Board to establish a principle to account for tax credits and investment tax credits, as well as government grants, special deductions, tax

holidays and the like[55]. Many respondents suggested the investment tax credit be more widely defined to include other types of the tax incentives such as R&D tax credits[56].

Substantively enacted tax rate

Question 8 – Enacted or substantively enacted rate
IAS 12 requires an entity to measure deferred tax assets and liabilities using the tax rates enacted or substantively enacted by the reporting date. The exposure draft proposes to clarify that substantive enactment is achieved when future events required by the enactment process historically have not affected the outcome and are unlikely to do so. Do you agree with the proposed definitions? Why or why not?

62. There was general support for the proposal to use "substantively enacted tax rate" instead of "enacted tax rate" but many respondents objected to the specific guidance in the Basis for Conclusions for the US tax jurisdiction[57]. Some respondents, mainly from North America, were concerned about potential ambiguity and diversity in judgement over the substantial enactment date in their jurisdiction or other jurisdictions[58].

Distributed or undistributed rate

Question 10 – Distributed or undistributed rate
IAS 12 prohibits the recognition of tax effects of distributions before the distribution is recognised. The exposure draft proposes that the measurement of tax assets and liabilities should include the effect of expected future distributions, based on the entity's past practices and expectations of future distributions. Do you agree with the proposed definitions? Why or why not?

63. A majority of respondents to this question agreed with the proposal. However, some respondents disagreed, mainly for two reasons; (a) the tax consequences arising from a distribution should not be recognised until a liability for the distributions is recognised, and (b) it might be difficult to estimate future

[55] CL#105
[56] CL#69, CL#83, CL#114 and CL#141
[57] CL#167
[58] CL#83, CL#100, CL#126, CL#162

distributions reliably as they were generally discretionary and contingent upon future events[59]. Some further argued that the issue of special types of entities such as REITs (real estate investment trusts) should be dealt with by considering them "tax exempt", instead of requiring all entities to factor the estimated future distributions into the measurement[60].

Tax based on two or more systems

Question 12 – Tax based on two or more system
In some jurisdictions, an entity may be required to pay tax based on one of two or more tax systems, for example, when an entity is required to pay the greater of the normal corporate income tax and a minimum amount. The exposure draft proposes that an entity should consider any interaction between tax systems when measuring deferred tax assets and liabilities. Do you agree with the proposed definitions? Why or why not?

64. There was general support for the proposal to consider any interaction between all applicable income tax systems when measuring deferred tax assets and liabilities. However, some respondents, mainly preparers in Europe and two international accountancy firms, did not think that the guidance was useful or clearly articulated the principle[61]. Some preferred the current IAS 12 approach to use the rate that is likely to apply[62]. Further, some respondents, mainly from Australia giving an example of its Petroleum Resource Rent Tax, requested more clarity and guidance on how to consider the interaction[63].

Allocation of taxes within a consolidated tax filing group

Question 14 – Allocation of current and deferred taxes within a group that files a consolidated tax return
IAS 12 is silent on the allocation of income tax to entities within a group that files a consolidated tax return. The exposure draft proposes that a systematic and rational methodology should be used to allocate the portion of the current and deferred income tax expense for the

[59] CL#125, CL#129, CL#141, CL#158 and CL#167
[60] CL#69, CL#105, CL#141
[61] CL#100, CL#141
[62] CL#70, CL#157
[63] CL#113, CL#114 and CL#141

> consolidated entity to the separate or individual financial statements of the group members. Do you agree with the proposed definitions? Why or why not?

65. There was general support for the proposal. There were requests from some tax jurisdictions for further guidance. For example, respondents in the UK and Germany want to clarify that the group relief / tax pooling arrangements in their tax jurisdictions are considered as a consolidated tax return[64]. Respondents in Australia wish some guidance similar to their domestic interpretation (AASB Interpretation 1052)[65]. Some respondents disagreed with the proposal either because they did not believe there is a lack for clarity in this area, thought it a jurisdiction specific issue, or had a question on consistency with legal or contractual obligations between entities within a group[66].

Classification of deferred tax assets and liabilities

Question 15 – Classification of deferred tax assets and liabilities
The exposure draft proposes the classification of deferred tax assets and liabilities as current or non-current, based on the financial statement classification of the related non-tax asset or liability. Do you agree with the proposed definitions? Why or why not?

66. Most respondents to this question disagreed with the proposal. Many of them thought that the proposed method would not always reflect the liquidity risk relating to deferred tax assets and liabilities. Most of them preferred the existing classification under IAS 1 (ie, classifying all deferred tax as non-current) because they did not think there was a major flaw in IAS 1 approach[67]. Further, several respondents disagreed with the pro-rata allocation of valuation allowance but preferred an itemised allocation to the extent possible[68].

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[64] CL#55, CL#105 and CL#123
[65] CL#67, CL#84, CL#140, CL#163
[66] CL#112, CL#145
[67] CL#17, CL#100 and CL#167
[68] CL#17, CL#138 and CL#141

Classification of interest and penalties

Question 16 – Classification of interest and penalties
IAS 12 is silent on the classification of interest and penalties. The exposure draft proposes that the classification of interest and penalties should be a matter of accounting policy choice to be applied consistently and that the policy chosen should be disclosed. Do you agree with the proposed definitions? Why or why not?

67. There was general support for the proposal. Some disagreed with the proposal because they believed that those items should be classified as operating expenses in accordance with IAS 1[69]. Some argued that those items were not significant enough to warrant a separate disclosure[70]. On the other hand, the supporters of the proposal pointed out that, in many jurisdictions, uncertain tax positions were settled on a 'net' basis that included the additional tax assessed and the associated interest and penalties[71].

Exceptions in US GAAP but not in IAS 12 and not proposed in the ED

68. Several comment letters, mainly from multinational companies and their representative bodies in three geographical regions (Europe, USA and Japan), urged the Board to reconsider its decision not to provide an additional exception for a temporary difference arising from the intra-group transfer of a non-monetary asset and liability[72]. Such an exception would, as in US GAAP, require the group to defer the income tax paid by the selling company, rather than measure the tax consequences for the buying company of recovering the asset's carrying amount in the consolidated financial statements. (The practical consequence is that the group would measure these temporary differences at the tax rates applicable to the selling entity, not the buying entity.)

69. They argued that not permitting such an exception would generally result in deferred tax asset being no resemblance to future tax cash flow, distortion of financial performance and volatility in effective tax rate. One of them further

[69] CL#23, CL#39 and CL#79
[70] CL#67
[71] CL#105 and CL#114
[72] CL#17, CL#53, CL#95, CL#126 and CL#155

argued that the exception would assure the same net result between the equity method and full consolidation[73].

70. The ED proposed additional disclosures for such temporary differences. Some respondents, including preparers, accounting firms and national standard setters, considered that these disclosures would be onerous and the costs of providing them would outweigh the benefit. Some of these respondents requested that the disclosures regarding intra-group transfer of an asset or liability should be limited only to non-customary cases[74]. Some viewed this disclosure as an implicit admission that the underlying accounting treatment would not produce decision-useful information.

71. A few comment letters which discussed the temporary difference arising from a change in a foreign currency exchange rate when a functional currency was different from a local currency. They requested the Board to reconsider providing an additional exception to the temporary difference approach because of the complexity in calculating deferred tax on such differences[75]. US GAAP contains such an exception.

Disclosures – Use of the parent's tax rate in the rate reconciliation

Excerpt from the ED
(Paragraph 43) The applicable tax rate is the rate of tax in the country in which the entity is domiciled, aggregating the tax rate for national taxes with the rates for any local taxes that are computed on a substantially similar level of taxable profit. The average effective tax rate is the tax expense recognised in profit or loss divided by pre-tax profit or loss.

72. Some comment letters, mainly from European countries and four accountancy firms, disagreed with the proposal to use the tax rate in the country in which the entity was domiciled as the start of a numerical reconciliation of the applicable tax rate to the effective tax rate. They argued that the proposal could lead to

[73] CL#126
[74] CL#55, CL#100, CL#129, CL#141 and CL#162
[75] CL#6, CL#107 and CL#126

inappropriate disclosure in the case, for example, where the parent company is domiciled in a low tax jurisdiction and most of the group's operations are elsewhere.

73. Many of those preparers who disagreed with the proposal wanted to continue using the aggregation of separate reconciliations which was permitted under the current IAS 12[76]. Some national standard setters and accounting firms suggested the use of the domestic tax rate applicable to the entity's primary operations in situations where the parent company's domestic tax rate was not indicative of the group's overall tax rate[77].

74. Respondents from the USA pointed out that US companies were using the federal tax rate excluding local tax rates[78].

Disclosures – A numerical analysis of change in deferred tax balance

Excerpt from the ED
(Paragraph 46) An entity shall disclose for each type of temporary difference and for each type of unused tax losses and tax credits: (a) the amount of deferred tax liabilities and deferred tax assets for each period presented. (b) a numerical analysis of the change in deferred tax liabilities, and deferred tax assets, including separate disclosure of the items in paragraphs 41(c)–(f) and 45; (c) the expiry date, if any, of temporary differences, unused tax losses and tax credits.

75. Some comment letters disagreed with the proposal under paragraph 46(b) to disclose for each type of temporary difference and for each type of unused tax losses and tax credit a numerical analysis of the change in deferred tax balances. Many of those opponents were preparers but they also included accounting firms, their professional bodies and national standard setters.

76. Most of them believed that the disclosure requirements would be onerous and the costs of providing the disclosures would not outweigh the benefit. They also

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[76] CL#17, CL#70 and CL#167
[77] CL#141
[78] CL#155 and CL#162

pointed out that an entity was already required to disclose similar information, although on an aggregate basis. Some suggested that a narrative disclosure as to timing of reversals and effect on cash taxes should be more useful to users[79].

Miscellaneous

77. Some respondents suggested the Board should provide further guidance on or include in the scope of the project the following topics:

    (a) Reconsideration of deferred tax accounting for share based payment[80]

    (b) Discounting deferred tax assets and liabilities[81]

    (c) Boundary of what is included and what is excluded from "income tax"[82]

    (d) Definition of "change in tax status" and "tax election" and how they are accounted for[83]

    (e) Offsetting deferred tax asset and deferred tax liability[84]

    (f) Consequential amendments to IAS 34 *Interim Financial Reporting* and IFRS 3 *Business combination*[85]

    (g) UK Life insurance policyholder's tax[86]

78. Some respondents disagreed with the proposal that the classification of exchange differences on foreign tax assets and liabilities was an accounting policy choice. Some believed that an entity should be required to classify such exchange differences as normal operating expense[87]. Others believed that, as the classification of foreign currency exchange gains and losses should follow the

[79] CL#55, CL#110, CL#125 and CL#141
[80] CL#28, CL#107, CL#162 and CL#167
[81] CL#15, CL#26 and CL#64
[82] CL#84, CL#105, CL#113 and CL#114
[83] CL#23, CL#105 and CL#114
[84] CL#139
[85] CL#167
[86] CL#46
[87] CL#23

nature of the underlying transactions, such exchange differences should be classified as income tax expense[88].

79. Some respondents found the drafting difficult to understand. More specifically, some suggested that some or all of the provisions in the application guidance should be moved to the body of the standard[89].

80. The staff developed illustrative examples for the IASB to publish with the ED. Ultimately, the IASB decided not to publish such guidance, but authorised the staff to post it on the IASB web site. Some respondents found this useful. However, others felt that such examples should be either included in the final standard (to provide necessary guidance), endorsed by the Board or withdrawn.

Transition

81. As transitional measures, the ED proposed that entities should apply the new IFRS, prospectively and recognise any resulting net change in the assets and liabilities as an adjustment to retained earnings. In relation to intra-period allocation (backwards tracing), no transfer between retained earnings and other comprehensive income would be permitted. Assets and liabilities subjected to the initial recognition exception in the past should be assumed to have been acquired outside a business combination for their carrying amount at the date of the opening statement of financial position.

82. Many respondents agreed with the proposal although some preferred retrospective application either mandatorily (only to parts which would not involve risk of potential hindsight) or optionally[90]. Some respondents had concerns on the requirements for assets and liabilities currently covered by the initial recognition exception[91]. Others had concerns on the possible impact to a revaluation surplus and asked the Board to permit reclassification between retained earnings and the revaluation surplus[92].

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[88] CL#168
[89] CL#105, CL#112, CL#114 and CL#167
[90] CL#42, CL#15, CL#100 and CL#150
[91] CL#105, CL#114 and CL#141
[92] CL#2, CL#14, CL#23

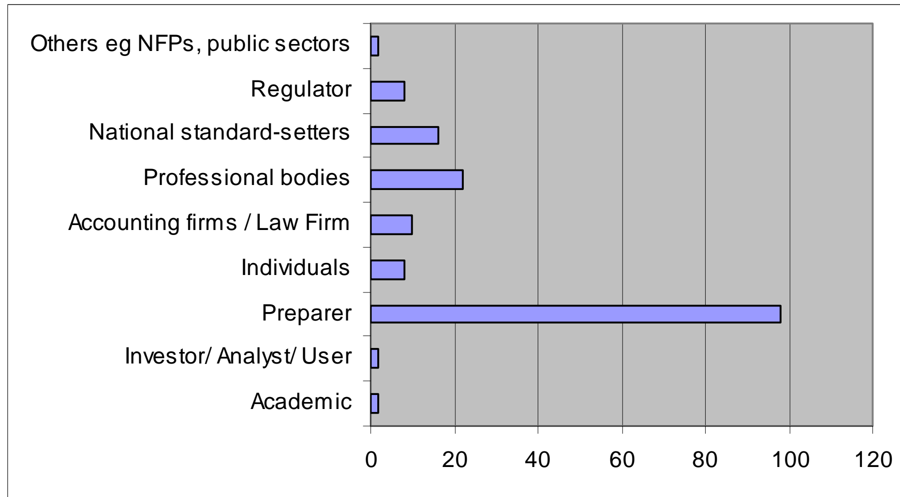
83. Countries such as Canada which will adopt IFRS from 2011 asked the Board to consider the timing of the introduction of the new standard so that they would have sufficient lead time for the new requirements and would not need to change their accounting treatment twice in a short period[93]. There were also some requests to permit early adoption which was not explicitly stated in the ED.[94]

[93] CL#75, CL#108 and CL110
[94] CL#31, CL#114, CL#138

Appendix A: Analysis of comment letters by type and region

We have received 168 comment letters.

By type of respondents



By geographic region