Project **Income Tax**

Topic **Scope - Proposals in the ED**

Purpose of this paper

1. This paper discusses whether there are any proposals in the ED that the Board should consider in a limited scope project to amend IAS 12.

2. At the end of this paper, the staff has provided its recommendation which forms part of the staff recommendation in Agenda Paper 4.

Background

3. In the November board meeting, the Board instructed the staff to bring back a list of issues which the Board should consider in a limited scope project to amend IAS 12.

4. In addition to the practice issues which the staff discusses in Agenda Paper 4A, the staff has considered whether the Board should include in the limited scope project some of the proposals in the ED which attracted general support from constituents, and hence which can be dealt with relatively quickly.

Approach

5. The staff has analysed proposals in the ED which attracted general support from respondents and discussed whether finalising them would improve financial

reporting without requiring significant Board time. The staff categorised the proposals into:

(a) proposed changes to IAS 12 that the staff recommends finalising in this project (Appendix A)

(b) proposals that require no change to IAS 12 (Appendix B) and

(c) proposed changes to IAS 12 that the staff recommends should not be finalised (Appendix C).

Staff recommendation

6. Based on the analysis in the Appendices, the staff recommends that the Board proposes changes to IAS 12 to finalise the following proposals in the ED :

(a) Introduction of an initial step to consider whether recovery of an asset or settlement of liability will affect taxable profit

(b) Recognition of a deferred tax asset in full and an offsetting valuation allowance to the extent necessary

(c) Guidance on assessing the need for a valuation allowance

(d) Guidance on a substantively enacted tax rate

(e) Allocation of current and deferred taxes within a group that files a consolidated tax return

Appendix A

Proposals in the ED which should be finalised by amending IAS 12

Introduction of an initial step to consider whether recovery of an asset or settlement of liability will affect taxable profit

Description of the proposal The exposure draft proposed to introduce an initial step in recognition of deferred tax assets and liabilities so that no deferred tax arises in respect of an asset or liability if there will be no effect on taxable profit when the entity recovers or settles its carrying amount.
Reason for general support The proposal would make clear that there would be no deferred tax if there would be no tax consequence from the recovery of an asset or settlement of a liability.
Any counter-argument made A few argue that the proposal raises scope issues and lacks clarity.
Conclusion US GAAP also contains the requirement to consider whether or not there is a tax consequence of recovery of a temporary difference. The staff thinks that the guidance would be helpful as it would scope out from the outset transactions that are not affected by the standard.

Recognising a deferred tax asset in full and an offsetting valuation allowance to the extent necessary

Description of the proposal The exposure draft proposed 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 proposed instead that deferred tax assets should be recognised in full and an offsetting valuation allowance should be provided so that the net carrying amount equals the highest amount that is more likely than not to be realisable against future taxable profit.
Reason for general support It makes communication of the requirements easier.
Any counter-argument made A few argue that when it is not probable that economic benefit will flow to the entity, recognising a deferred tax asset in full may contradict the definition of an asset in the *Framework*.
Conclusion The proposal has no effect on the amounts recognised or disclosed. But the staff has found that the valuation approach makes it easier to talk about the requirements clearly.

It also emphasises the consistency with US GAAP.

Guidance on assessing the need for a valuation allowance

Description of the proposal The exposure draft proposed to incorporate additional guidance from US GAAP on assessing the realisability of deferred tax assets, including the treatment of significant expenses for any relevant tax planning strategies.
Reason for general support The proposal should help reduce divergent application of the general principles in practice.
Any counter-argument made A few argue that the guidance is rule based.
Conclusion Although adding the guidance increases the length of the standard and the staff does not expect any change in the amount recognised or disclosed, the staff thinks it is useful and emphasises the consistency with US GAAP.

Use of and guidance on the substantively enacted tax rate

Description of the proposal 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 proposed 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.
Reason for general support The proposal should help to avoid the situation in which recognising the effects of changes in tax law is delayed pending the outcome of legislative procedures that are more perfunctory or ceremonial than substantive.
Any counter-argument made It is not appropriate to provide generic guidance on this issue in an accounting standard meant for application across jurisdictions that have vastly different forms of government, constitution, legislative, and administrative procedure.
Conclusion Although the proposal may not provide a crystal clear answer in all situations, it could provide some additional guidance. The staff thinks that there is more benefit from introducing the guidance to IAS 12 than not doing so.

Allocation of current and deferred taxes within a group that files a consolidated tax return

Description of the proposal IAS 12 is silent on the allocation of income tax to entities within a group that files a consolidated tax return. The exposure draft proposed that a systematic and rational methodology should be used to allocate the portion of the current and deferred income tax expense for the consolidated entity to the separate or individual financial statements of the group members.
Reason for general support Given the unique nature of the tax regime in each jurisdiction, an approach based on a high level principle is appropriate.
Any counter-argument made It is not clear why there is a need to include this requirement in the standard. The standalone accounts of reporting entities within a group should comply with IAS 12.
Conclusion Paragraph B37 of the ED contains some of the methods that are not appropriate. US GAAP does this too. The staff thinks that the guidance, particularly examples of methods that are not appropriate, is helpful.

Appendix B

Proposals in the ED which do not require a change to IAS 12

Stay silent on deductions not forming part of tax basis

Description of the proposal An entity may expect to receive tax deductions in the future that do not form part of a tax basis. US GAAP, Topic 740 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'. Topic 740 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 proposed no change.
Reason for general support Developing consistent requirements for all possible deductions would be time-consuming and difficult.
Any counter-argument made The treatment of additional deductions is a difficult area and there is significant diversity in practice; accordingly, guidance would be useful.
Conclusion No action is required since IAS 12 is already silent on this topic. Some constituents argue that this issue also relates to investment tax credits and government grants and requests consistent accounting. The staff thinks that the interaction with government grants etc should be considered in a future project.

Appendix C

Proposals in the ED which attracted general support but which the staff do not recommend be finalised

Classification of interest and penalties

Description of the proposal IAS 12 is silent on the classification of interest and penalties. The exposure draft proposed 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.
Reason for general support In many jurisdictions, uncertain tax positions are settled on a 'net' basis that includes the tax and the associated interest and penalties. Providing entities with the choice of presenting such settlements as a single amount in income tax expense avoids the need to undertake arbitrary allocations.
Any counter-argument made The interests and penalties, even through they are income tax related, are not income tax themselves. The proposal does not constitute a significant improvement in financial reporting, since an accounting policy choice does not eliminate existing diversity in practice.
Conclusion Although the proposal seems easy to finalise, the staff thinks it much too detailed for the Board to deal with in a limited scope project. If the Board wishes to introduce the proposal, the staff thinks that it should do so when it will consider accounting for uncertain tax positions in the future.

Tax based on two or more systems

Description of the proposal 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 proposed that an entity should consider any interaction between tax systems when measuring deferred tax assets and liabilities.
Reason for general support The requirements are sufficiently high-level that there is nothing to object to.
Any counter-argument made The proposal does not add useful guidance compared to the general approach of using a tax rate expected to apply in measuring deferred tax and the existing guidance in IAS 12 when different tax rates apply to different level of taxable income.

Conclusion Although the proposal attracted general support, it would not seem to add useful guidance to the current practice under IAS 12.