

STAFF PAPER

12-13 November 2013

IFRS Interpretations Committee Meeting

Project	IFRS 10 Consolidated Financial Statements		
Paper topic	Investment Entities Amendments—The definition of investment-related services or activities		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*. The approval of a final Interpretation by the Board is reported in *IASB Update*.

Introduction

1. In July 2013, the IFRS Interpretations Committee (‘the Interpretations Committee’) received a request to clarify some issues related to the Investment Entities amendments to IFRS 10, IFRS 12 and IAS 27. One of the issues relates to the definition of investment-related services or activities.
2. An investment entity is permitted to provide investment-related services to third parties as well as to its investors or provide activities to an investee either directly or through a subsidiary. If an investment entity provides investment-related services or activities through a subsidiary, the investment entity shall consolidate that subsidiary.
3. Some investment entities establish wholly-owned intermediate subsidiaries in certain jurisdictions, which own the portfolio of investments in the group structure. The sole purpose of the intermediate subsidiaries is to minimise the tax paid by investors in the ‘parent’ investment entity. There is no other activity within the subsidiaries and the tax advantage comes about simply by virtue of returns being channelled through the jurisdiction of the subsidiaries.

4. The issue is whether the ‘tax optimisation’ described above should be considered investment-related services or activities.

Paper structure

5. This paper is organised as follows:
 - (a) Submission received
 - (b) Extract from the Standards;
 - (c) Staff analysis of the issue;
 - (d) Summary of outreach conducted;
 - (e) Assessment against the interpretations agenda criteria; and
 - (f) Staff recommendation.

Submission received

6. An investment entity is permitted to provide investment-related services either directly or through a subsidiary. IFRS 10 paragraph B85C provides examples of investment-related services that include investment advisory services, investment management, investment support and administrative services.
7. In order to manage their investments in the most tax-efficient way, some investment entities establish one or more wholly-owned intermediate subsidiaries in certain jurisdictions, which have the following characteristics:
 - the subsidiaries own the portfolio of investments in the group structure;
 - the sole purpose of the intermediate subsidiaries is to minimise the tax paid by investors in the ‘parent’ investment entity on their investments; and
 - there is no activity within the subsidiary and the tax advantage comes about simply by virtue of returns being channelled through the jurisdiction of the subsidiary.

8. The question is whether the ‘tax optimisation’ described above, can be considered to be an investment-related service for the purposes of IFRS 10 paragraph B85C.

9. The submitter notes that there are two alternative views in practice.

(a) **View A: tax optimisation is not an investment-related service.**

Submitter claims that proponents of this view believe that the type of entity described above has already been discussed by the Board and is referred to in IFRS 10 paragraph BC272. The Board’s conclusion described in BC272 was that in the circumstance in which a wholly-owned investment entity subsidiary is created for legal, tax or regulatory purposes, this subsidiary should be measured at fair value by the investment entity parent and not consolidated. From this conclusion, it is apparent that ‘tax optimisation’ does not fall within the definition of investment-related services in accordance with IFRS 10 paragraph 85C.

(b) **View B: Entity A should consolidate Entity B in accordance with IFRS 10 paragraph 32.** Submitter claims that proponents of this view do not believe that IFRS 10 paragraph BC272 is conclusive on this issue. It states that an investment entity should ‘measure all of its subsidiaries at fair value (**except for those subsidiaries providing investment-related services**) even those investees who are themselves investment entities (emphasis added). IFRS 10 paragraph BC272 refers to “wholly-owned investment entity subsidiaries created for tax purposes” but it is not clear whether the IASB considers all wholly-owned subsidiaries created for tax purposes to be investment entities. Furthermore, this paragraph does not definitively state that ‘tax optimisation’ is not an investment-related service.

IFRS 10 paragraph B85C provides examples of the types of services that might be considered investment-related, but the list is not exhaustive. It therefore seems reasonable to conclude that any service that maximises investment return is an investment-related service.

Extract from the Standards

10. An investment entity shall measure its investments in a subsidiary at fair value, in accordance with paragraph 31. If a subsidiary provides services that relate to the investment entity's investment activities, the investment entity shall consolidate the subsidiary, in accordance with paragraph 32.

11. Investment-related services and activities are described as follows:

B85C An investment entity may provide investment-related services (eg investment advisory services, investment management, investment support and administrative services), either directly or through a subsidiary, to third parties as well as to its investors, even if those activities are substantial to the entity.

B85D An investment entity may also participate in the following investment-related activities, either directly or through a subsidiary, if these activities are undertaken to maximise the investment return (capital appreciation or investment income) from its investees and do not represent a separate substantial business activity or a separate substantial source of income to the investment entity:

- (a) providing management services and strategic advice to an investee; and
- (b) providing financial support to an investee, such as a loan, capital commitment or guarantee.

12. BC 272 states that the Board considered requiring an investment entity to consolidate only those investment entity subsidiaries that are formed for legal, tax or regulatory purposes, but decided against this (emphasis added):

BC272 The Investment Entities ED proposed that an investment entity would measure all of its subsidiaries at fair value (except for those subsidiaries providing investment-related services), even those investees who were themselves investment entities. **Some respondents questioned this proposal and suggested that at least**

some investment entity subsidiaries should be consolidated (for example, wholly-owned investment entity subsidiaries that are created for legal, tax or regulatory purposes). However, the Board thinks that fair value measurement of all an investment entity's subsidiaries (except for those subsidiaries providing investment-related services or activities) would provide the most useful information and therefore decided to retain this proposal. The Board considered requiring an investment entity to consolidate only those investment entity subsidiaries that are formed for legal, tax or regulatory purposes, but decided against this because there is no conceptual basis for distinguishing between different investment entity subsidiaries. Moreover, the Board thinks that it would be very difficult to distinguish between an investment entity subsidiary formed for a specific legal, tax or regulatory purpose and those that are set up only for other business reasons.

Staff analysis of the issue

Whether 'tax optimisation' is considered to be investment-related services or activities

13. According to paragraph BC272, the Board thinks that fair value measurement of all of an investment entity's subsidiaries would provide the most useful information, except for subsidiaries providing investment-related services or activities. In addition, the Board considered requiring an investment entity to consolidate investment entity subsidiaries that are formed for tax purposes, but decided against this. We think it is clear that the Board does not think that an investment entity should consolidate subsidiaries simply because the subsidiary was formed for tax optimisation purposes described in the submission.
14. We also note that the tax optimisation described in the submission does not necessarily match the descriptions of investment-related services or activities

under paragraphs B85C and B85D, although we note that the investment-related services or activities could take various forms.

15. In addition, as stated in the submission, one of the characteristics of the ‘tax optimisation’ subsidiaries is “that there is no activity within the subsidiary.” We note that the ‘tax optimisation’ subsidiaries described in the submission are merely pass-through entities, as opposed to subsidiaries performing investment-related activities as described in paragraph B85D, which are subsidiaries that are actively performing services. Accordingly we consider that the parent should not consolidate such subsidiaries because they do not provide investment-related services or activities, and do not meet the requirements to be consolidated in accordance with paragraph 32 of IFRS 10.
16. With regard to the views provided by the submitter, our conclusion is consistent with the conclusion provided by View A, if the ‘tax optimisation’ is as described in the submission.

Fair value measurement of the ‘tax optimisation’ subsidiary and its investees

17. The question is whether the current Standards provide enough guidance for the accounting treatment above. We believe that paragraphs B85C, B85D and BC272 of IFRS 10 provide sufficient guidance as to whether the ‘tax optimisation’ subsidiary and its investees should be measured at fair value as discussed above.

Summary of outreach conducted

18. We asked IOSCO, ESMA and national standard-setters to provide information on the issue raised in the submission by posing the following questions to them:
 - (a) *Q1. How common are each of these issues? If these are common, could you provide us with information that the Interpretations Committee could use to assess how widespread the issues are?*
 - (b) *Q2. In your view, is there diversity in practice in interpreting each issue? Please describe the predominant approach that you observe in practice.*

Responses from regulators and national standard-setters

19. We received responses from the following 14 jurisdictions: Europe (4), Asia (3), Americas (3), Oceania (1), Africa (1) and International (2).
20. Most of the respondents stated that they have limited experience of the Investment Entities Amendments because entities are not required to apply the amendments until the annual period on or after 1 January 2014. However, most of the respondents with experience of the issue are aware of it and some of the respondents stated that the issue could cause diversity in practice.

Assessment against the interpretations agenda criteria

Agenda criteria	
We should address issues (5.16):	
that have widespread effect and have, or are expected to have, a material effect on those affected.	Yes. Entities are not required to apply the amendments until the annual period on or after 1 January 2014. Accordingly, the issue is not common in all jurisdictions at this point. However, on the basis of our analysis from the outreach, we expect that this issue would be widespread and would have a material effect on those affected.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.	No. We think that paragraphs B85C, B85D and BC272 of IFRS 10 sufficiently address the issue.
that can be resolved efficiently within the confines of existing IFRSs and the <i>Conceptual Framework for Financial Reporting</i> .	Not applicable. We think that paragraphs B85C, B85D and BC272 of IFRS 10 sufficiently address the issue.
In addition:	
Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRSs (5.17)?	Not applicable. We think that paragraphs B85C, B85D and BC272 of IFRS 10 sufficiently address the issue.
Will the solution developed by the Interpretations Committee be effective for a reasonable time period (5.21)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified).	Yes. The issue is not being addressed in a forthcoming Standard because the Investment Entities amendments were issued in 2012.

Staff recommendation

21. We recommend that the Interpretations Committee should not take this issue onto its agenda, because paragraphs B85C, B85D and BC272 of IFRS 10 sufficiently address the issue.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree that the 'tax optimisation', described in the submission is not considered to be investment-related services or activities?
2. Does the Interpretations Committee agree with the staff's recommendation that the Interpretations Committee should not take this issue onto its agenda?
3. If so, does the Interpretations Committee have any comments on the proposed wording in Appendix A for the tentative agenda decision?

Appendix A—Proposed wording for tentative agenda decision

A1 The proposed wording for the tentative agenda decision is presented below.

IFRS 10 Consolidated Financial Statements: Investment Entities Amendments—The definition of investment-related services or activities.

The Interpretations Committee received a request to clarify the definition of investment-related services or activities.

An investment entity is permitted to provide investment-related services or activities, either directly or through a subsidiary. If an investment entity provides investment-related services or activities through a subsidiary, the investment entity shall consolidate that subsidiary.

Some investment entities establish wholly-owned intermediate subsidiaries in certain jurisdictions, which own the portfolio of investments in the group structure. The sole purpose of the intermediate subsidiaries is to minimise the tax paid by investors in the 'parent' investment entity. There is no other activity within the subsidiaries and the tax advantage comes about simply by virtue of returns being channelled through the jurisdiction of the intermediate subsidiary. The submitter asked whether the 'tax optimisation', described should be considered investment-related services or activities.

The Interpretations Committee noted that the Board thinks that fair value measurement of all of an investment entity's subsidiaries would provide the most useful information, except for subsidiaries providing investment-related services or activities. In addition, the Interpretations Committee noted that the Board considered requiring an investment entity to consolidate investment entity subsidiaries that are formed for tax purposes, but decided against this.

The Interpretations Committee noted that one of the characteristics of the 'tax optimisation' subsidiaries is "that there is no activity within the subsidiary." Accordingly, 'tax optimisation' subsidiaries described in the submission are merely pass-through entities. Accordingly the Interpretations Committee consider that the parent should not consolidate such subsidiaries because they do not provide investment-related services or activities, and do not meet the requirements to be consolidated in accordance with paragraph 32 of IFRS 10. The parent should therefore account for such an intermediate subsidiary at fair value.

The Interpretations Committee considered that in the light of its analysis of the existing IFRS requirements, neither an interpretation nor an amendment to a Standard was necessary and consequently [decided] not to add the issue to its agenda.