

## STAFF PAPER

May 2016

## IASB Meeting

<b>Project</b>	<b>IAS 12 <i>Income Taxes</i> research project</b>		
<b>Paper topic</b>	Appendix D: Income Taxes feedback from the 2015 Agenda Consultation		
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***Purpose of this paper***

1. The purpose of the paper is to provide input for the Board to consider when it sets its work plan priorities in response to feedback received on the 2015 Agenda Consultation. The paper provides a reminder of the objective of the Income Taxes research project and summarises the feedback received on the project in the 2015 Agenda Consultation. No questions will be asked.

**Structure of this paper:**

2. This paper contains the following sections:
  - (a) Objective and scope of the existing research project on income taxes (paragraphs 3-6).
  - (b) Who thinks this project is important and why? (paragraphs 7-14)
  - (c) Who thinks this project is unimportant and why? (paragraphs 15-17)
  - (d) Timing/ Priorities (paragraphs 18-19).
  - (e) Other information (paragraphs 20-22).

### **Objective and scope of the existing research project on income taxes**

3. The objective of the income taxes research project is to identify whether the application problems of the existing Standard can be solved by narrow-scope amendments or whether, instead, a fundamental change in principle is needed.
4. The scope of the research project includes consideration of application issues included in two submissions to the IFRS Interpretation Committee (the Interpretations Committee):
  - (a) Recognition of deferred tax for single assets in a corporate entity ('Corporate Wrapper'); and
  - (b) Recognition of deferred taxes for the effect of exchange rate changes on the tax basis of non-current assets through profit or loss.
5. The research project also covers some issues that were expected to be dealt with in the earlier project to converge with US GAAP (see paragraphs 18-19 of Agenda Paper 19A). However, as the 2009 Exposure Draft published as part of that project was not finalised, these issues remain unresolved. The issues considered are:
  - (a) tax effect of intercompany transfer of inventory;
  - (b) tax effect of share based payment;
  - (c) issues relating to fair value measurement; and
  - (d) tax effect of dividends.
6. Further issues covered in the research project include:
  - (a) the scope of IAS 12 *Income Taxes*; and
  - (b) discounting of deferred tax assets and liabilities.

### **Who thinks this project is important and why?**

7. 70 out of 119 comment letters received in response to the Board's 2015 Agenda Consultation Request for Views (RFV) commented on the income taxes research

project.<sup>1</sup> Most of the respondents identified issues either at an application level or at a fundamental level. The level of priority differs from respondent to respondent (see paragraph 18).

8. In addition to comment letters received, 169 responses were received from the online survey conducted to supplement the RFV. 13 respondents, including six users of financial statements, named income taxes as one of the top three priority projects (see paragraph 19).
9. The following are the major comments received and the reasons given for supporting further work to be done related to the accounting for income taxes.

### ***Fundamental Review***

10. Some standard setters and accounting bodies in Africa, Australia, Europe, Hong Kong, Japan and Singapore and preparers in Switzerland and Brazil support a fundamental review of the principle of IAS 12 because, in their view:
  - (a) IAS 12 is inconsistent with the *Conceptual Framework*;<sup>2</sup>
  - (b) IAS 12 generates inappropriate results,<sup>3</sup> and
  - (c) Narrow-scope amendments to IAS 12 have not effectively solved problems identified.
11. Some respondents, including accounting bodies in Belgium and Brazil, one academy in Russia and one accounting firm, support a fundamental review and suggest that the Board covers the following issues if a fundamental review is performed:
  - (a) Interaction with IFRS 2 *Share-based Payment*, IFRS 3 *Business Combinations* and IFRS 13 *Fair Value Measurement*;

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<sup>1</sup> Seven responses did not mention the priority of the income tax project.

<sup>2</sup> For instance, one respondent commented that a deferred tax asset (liability) recognised for temporary differences arising from non-monetary items due to exchange rate changes is not reflecting a real effect caused by the operation of the entity and, therefore, is inconsistent with paragraph OB17 of the *Conceptual Framework* (financial performance reflected by accrual accounting).

<sup>3</sup> For instance, one respondent commented that calculating the deferred tax impact resulting from eliminating intercompany profits within inventory on consolidation at the buyer's tax rate produces an inappropriate result.

- (b) Scope of the standard to be expanded to include all mandatory fiscal payments; and
- (c) Discounting of deferred tax assets and liabilities.

### ***Narrow scope amendments***

- 12. In contrast to those who support a fundamental review, some respondents think that IAS 12 is not fundamentally broken but believe that narrow-scope amendments are needed because application issues arise frequently in their regions.
- 13. International accounting firms, some standard setters and accounting bodies in Africa, Brazil, Canada, Europe, Malaysia and the Interpretations Committee commented that the project is important because there are many application issues noted.

### ***Improvement in disclosure***

- 14. Users of financial statements, business federations in Australia, accounting bodies in Australia and the UK, noted that it is important to improve tax disclosures because:
  - (a) there is increasing public interest in tax matters as a result of the Base Erosion and Profit Shifting (BEPS) project of the Organisation of Economic Co-operation and Development (OECD) and G20;
  - (b) the current disclosures lack transparency and are difficult to understand. Users of financial statement are looking for more information related to tax strategy, tax risks and tax cash flows;
  - (c) One private entity federation supports the improvement of tax disclosure in the sense that the requirements should be simplified and reduced.

### Who thinks this project is unimportant and why?

15. One international accounting body and one business federation in Europe think that IAS 12 is inconsistent with the *Conceptual Framework*, but also think that there is no completely satisfactory solution.
16. Some preparers and accounting bodies in India, Korea, Sweden and the UK think the project is not important because:
  - (a) earlier attempts to replace IAS 12 were not successful;
  - (b) there are not many issues in their own territory; and
  - (c) IAS 12 provides sufficient guidance.
17. One multinational company and one international accounting firm suggested removing the project from the Board's work plan because they think that IAS 12 is not fundamentally broken and implementation issues should be dealt with by the Interpretations Committee.

### Timing/ Priorities

18. In the 63 comment letter responses to the 2015 Agenda Consultation that commented on the priority of the income taxes project:
  - (a) 13 respondents (including one user group) ranked income taxes as a high priority project; reasons include:
    - (i) while income taxes represent a material part of a company's expenses, investors found it difficult to make assumptions about future taxes based on the current information disclosed;
    - (ii) application issues frequently arise; and
    - (iii) the time value of money is not reflected under the current Standard.
  - (b) 24 respondents ranked income taxes as medium priority; reasons include:
    - (i) IAS 12 has a different measurement basis from other standards;

- (ii) interactions between IAS 12, IFRS 3 and IFRS 13 and the interaction between the initial recognition exception (paragraph 15 of IAS12) and IFRS 13 should be revisited;
  - (iii) given the continuing public interest concern with BEPS, the Board should revisit the current disclosures in IAS 12;
  - (iv) deferred tax accounting is complex and should be simplified;
  - (v) the scope of IAS 12 should be expanded to include all mandatory fiscal payments.
- (c) 26 respondents ranked income taxes as low priority, reasons include:
- (i) IAS 12 is not fundamentally broken;
  - (ii) there are limited application issues in the respondents' jurisdictions;
  - (iii) there are deficiencies in the standard but other projects are of a higher priority.

19. In the 169 responses to the Online Survey,

- (a) 27 respondents (including 10 users) ranked income taxes as a high priority project; reasons include:
- (i) Preparers tend not to account for deferred tax assets and create a too low tax rate for later years (one user);
  - (ii) The standard has not kept up with advancements in tax planning strategies (one non-user);
  - (iii) Forward looking information, including key drivers of tax expense (taxes paid), is missing and, therefore, it is difficult to predict future tax (several users);
  - (iv) Deferred tax arising from non-monetary assets due to changes in the exchange rate of a local currency that is not the functional currency creates inappropriate results, which may give misleading results to users (one user and several non-users); and
  - (v) Deferred tax is too complex and amounts should be discounted (one non-user).

- (b) 69 respondents (including 36 users) ranked income taxes as a medium priority project; reasons include:
  - (i) Disclosures should be improved—especially those related to key drivers of tax expense, tax losses, a deeper explanation of differences between statutory and effective tax rates, taxes paid in major jurisdictions and more granularity about tax liabilities etc (several users).
- (c) 29 respondents (including 17 users) ranked income taxes as a low priority project; 44 respondents did not express opinions on priority of the project.

### Other information

- 20. In November 2015, the FASB issued Accounting Standards Update No. 2105-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*. This eliminates the requirement for entities to classify deferred tax assets (liabilities) as current and non-current, resulting in all deferred tax liabilities and deferred tax assets being classified as non-current (the same as IAS 12).
- 21. In March 2016, as part of its simplification project, the FASB issued an Accounting Standard Update No. 2016-09 *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-based Payments Accounting*. This Update requires entities to recognise:
  - (a) the excess tax benefit, regardless of whether the benefit reduced taxes payable in the current period (the same as IAS 12); and
  - (b) the tax effect of windfalls or deficiencies in profit or loss, rather than in additional paid in capital (different from IAS 12).
- 22. The FASB is current working on the following projects relating to income taxes:
  - (a) Simplification project, including a proposal to eliminate an exception for deferred tax accounting on intra-entity asset transfer.
  - (b) Disclosure framework project which includes proposals to improve the following tax disclosures:
    - (i) a change in tax law that will affect the entity in the future;

- (ii) separate presentation of domestic income tax and foreign income tax;
- (iii) explanation of provision and reversal of the valuation allowance;
- (iv) some improvements in the tax rate reconciliation; and
- (v) some improvements in the carryforward disclosure.