STAFF PAPER

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IASB Meeting

Project	**Amendments to IAS 12: Income tax consequences of payments on financial instruments classified as equity**		
Paper topic	Analysis of feedback on the proposed amendments		
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Introduction

1. The International Accounting Standards Board (Board) published the Exposure Draft *Annual Improvements to IFRS Standards 2015–2017 Cycle* (Exposure Draft) in January 2017. One of the proposed amendments included in the Exposure Draft relates to IAS 12 *Income Taxes.* The proposal is to clarify that the requirements in paragraph 52B of IAS 12 apply not only in the circumstances described in paragraph 52A of IAS 12, but to all income tax consequences of dividends.

2. The comment period ended in April 2017, and the Board received 50 comment letters on the proposed amendments to IAS 12. The comment letters can be accessed here.

3. The objective of this paper is to provide an analysis of the comment letters received, and ask the Board whether it agrees with our recommendation to finalise the amendments.

Summary of staff recommendation

4. The staff recommend that the Board should:

   (a) reaffirm the proposed amendments to IAS 12 to clarify that the requirements in paragraph 52B (now proposed as paragraph 58A) apply to all income tax consequences of dividends; and

(b) require an entity to apply the amendments prospectively to income tax consequences of dividends recognised on or after the beginning of the earliest reporting period presented.

Structure

5. We have analysed what we consider to be the main matters for redeliberation in the main body of this paper, and analysed other matters raised in Appendix A to the paper.

6. The paper is structured as follows:

   (a) summary of the proposed amendments;

   (b) summary of feedback; and

   (c) staff analysis.

7. Appendix A to this paper analyses other matters raised.

Summary of the proposed amendments

8. The Board received a request to clarify where to recognise the income tax consequences of payments on financial instruments classified as equity—in equity or in profit or loss. The request asked whether the requirements in paragraph 52B of IAS 12 apply only in the circumstances described in paragraph 52A of IAS 12 (ie when there are different tax rates for distributed and undistributed profits), or whether they also apply beyond those circumstances (for example, to all payments on financial instruments classified as equity if those payments are distributions of profit).

9. Paragraphs 52A and 52B of IAS 12 state the following:

> 52A In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In some other jurisdictions, income taxes may be refundable or payable if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In these circumstances,

> current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits.
>
> 52B In the circumstances described in paragraph 52A, the income tax consequences of dividends are recognised when a liability to pay the dividend is recognised. The income tax consequences of dividends are more directly linked to past transactions or events than to distributions to owners. Therefore, the income tax consequences of dividends are recognised in profit or loss for the period as required by paragraph 58 except to the extent that the income tax consequences of dividends arise from the circumstances described in paragraph 58(a) and (b)

10. The Board concluded that an entity should recognise all income tax consequences of dividends applying the requirements in paragraph 52B. Paragraph BC2 of the proposed amendments to IAS 12 explains the Board's reasons for such a conclusion:

> In considering the request, the Board observed the following:
>
> (a) …
>
> (c) the reason for the income tax consequences of dividends should not affect where those income tax consequences are recognised. It does not matter whether such consequences arise, for example, because of different tax rates for distributed and undistributed profits or, instead, because of the deductibility of dividends for tax purposes. This is because, in both cases, the income tax consequences arise from the distribution of profits.
>
> (d) linking the recognition of the income tax consequences of dividends to how the tax arises (for example, because of different tax rates rather than because of different tax deductibility rules) would lead to arbitrary results and a lack of comparability across entities in different tax jurisdictions. Tax jurisdictions choose different methods of providing tax relief. What matters is the resulting tax effect, not the mechanism.

11. The Board observed that, as written, paragraph 52B could be read to imply that it applied only in the circumstances described in paragraph 52A. Consequently, the

Board decided to clarify that the requirements in paragraph 52B of IAS 12 (now proposed as paragraph 58A) apply to all income tax consequences of dividends.

12. The Board proposed that an entity apply the proposed amendments to IAS 12 retrospectively applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Summary of feedback

13. A large number of respondents agreed with the proposed amendments and a few respondents disagreed. Some of the respondents who agreed with the proposed amendments expressed concerns about particular aspects of the proposals.

14. Those who agreed said that the proposed amendments would:

    (a) improve the clarity of the existing requirements in IAS 12;

    (b) result in consistent accounting for income tax consequences of dividends; and

    (c) help reduce diversity in practice.

15. The main matters identified by some respondents are:

    (a) how to determine whether payments are distributions of profits (ie dividends)[1] (paragraphs 16–30); and

    (b) retrospective application of the amendments (paragraphs 31–36).

Staff analysis

How to determine whether payments are distributions of profits (ie dividends)

Overview of feedback

16. Many respondents suggested that as part of this project, the Board should provide requirements on how to determine whether payments on financial instruments classified as equity are distributions of profits. They said that this determination

[1] In this paper, the terms 'distributions of profits' and 'dividends' are used interchangeably.

would become particularly important because the proposed amendments clarify that the requirements in paragraph 52B apply to all income tax consequences of dividends. Some respondents said that finalising the proposed amendments without additional requirements on how to make such a determination would merely shift the source of diversity in practice from one place to another—from the applicability of paragraph 52B to whether particular distributions are distributions of profits.

17. A few respondents suggested that the Board provide illustrative examples to explain how an entity would apply the proposed amendments. Specifically, one respondent suggested adding an example to clarify the effect of the proposed amendments on the presentation of the tax effect of payments on perpetual bonds classified as equity[2].

18. Some respondents agreed with the Board not to explore a distinction between what is, and is not, a distribution of profits as part of this project for the reasons described in paragraph BC6 of the proposed amendments. They suggested, however, that the Board address this issue as part of a separate project, such as within the Financial Instruments with Characteristics of Equity project.

Staff analysis

Requirements on how to determine whether payments are distributions of profits

19. The Board discussed this particular topic at its meeting in June 2016. Although acknowledging that an entity may need to apply judgement to determine what constitutes a distribution of profits, the Board decided not to provide requirements in this respect. Paragraph BC6 of the proposed amendments to IAS 12 explains the reasons for that decision:

> The Board decided not to propose including requirements on how to determine whether payments on financial instruments classified as equity are distributions of profits, for the following reasons:
>
> (a) including indicators or requirements that distinguish distributions of profits from other distributions goes beyond the

[2] The original submission to the IFRS Interpretations Committee asked about where to recognise the tax effect of payments on perpetual bonds classified as equity.

scope of an amendment to IAS 12. It would affect several other IFRS Standards and Interpretations, with a risk of unintended consequences if the Board were to attempt to define or describe distributions of profits.

(b) the proposed amendments do not change the determination of what is, and is not, a distribution of profits. They simply clarify that the requirements in paragraph 52B (now proposed as paragraph 58A) apply to all income tax consequences of dividends.

20. Although many respondents suggested the Board provide requirements in this respect as part of this project, they did not provide new information the Board had not considered in developing the proposed amendments.

21. We continue to think that any attempt to define or describe a distribution of profits goes beyond the scope of this project. Further, because distributions of profits are part of the definition of dividends, we think that defining a distribution of profits as part of this project could have unintended consequences. For example, there are some requirements in IFRS 9 *Financial Instruments* that refer to dividends, which might be affected by any definition or description of distributions of profits.

22. Some respondents asked for illustrative examples explaining how an entity would apply the proposed amendments, including how to determine whether a particular distribution is a distribution of profits. We think providing such examples, in effect, would result in defining or describing a distribution of profits.

23. Consequently, we recommend that the Board provide neither requirements on how to distinguish between what is, and is not, a distribution of profits nor examples illustrating such a distinction.

Should the Board finalise the proposed amendments without requirements on how to determine whether payments are distributions of profits?

24. Many respondents considered that the intended effect of the proposed amendments would be limited if the amendments were not accompanied by requirements on how to determine whether a payment is a distribution of profits. This is because, as described above in paragraph 16, in their view finalising the amendments as proposed would merely shift the source of diversity in practice.

25. In our view, however, we see benefit in finalising the proposed amendments without requirements on how to determine a distribution of profits. This is because the amendments would eliminate existing diversity resulting from the ambiguity of the scope of the requirements in paragraph 52B of IAS 12.

26. Applying the proposed amendments, an entity would first determine whether payments on particular instruments classified as equity are distributions of profits. If they are, then the entity would recognise any income tax consequences of such payments in profit or loss, other comprehensive income or equity depending on where the entity had originally recognised the transactions or events that generated distributable profits. This applies regardless of the source of the tax consequences.

27. We agree that depending on particular facts and circumstances, judgement would be required to make such a determination and that it may not be straightforward.

28. However, different accounting outcomes resulting from the application of judgement does not necessarily result in inconsistent application of the requirements. Currently, diversity exists because of differing interpretations of the requirements in paragraphs 52A and 52B of IAS 12. After finalising the proposed amendments, different accounting outcomes may result, but that is likely to reflect the differing nature of the payments on different instruments. It will not result from differing interpretations of the scope of the requirements in paragraph 52B (proposed as paragraph 58A).

29. Consequently, we think finalising the amendments as proposed would be an improvement to existing requirements, even without requirements on how to determine a distribution of profits.

Staff recommendation

30. We recommend that the Board reaffirm the proposed amendments to IAS 12.

Question 1 for the Board
Does the Board agree with the staff recommendation to reaffirm the proposed amendments to IAS 12?

Retrospective application of the amendments

Overview of feedback

31. The Board proposed retrospective application of the proposed amendments. Some respondents suggested the Board reconsider such transition requirements and that the Board either require prospective application or provide transition relief.

32. They said that applying the proposed amendments to income tax consequences of dividends that had been distributed many years ago could be challenging, especially tracing where an entity had originally recognised transactions that had generated distributable profits.

Staff analysis

33. We agree with respondents that applying the amendments retrospectively could potentially be challenging depending on the circumstances.

34. In addition, we note that the amendments would affect neither assets nor liabilities. They would affect only components of equity. Depending on the circumstances, there may not be any difference between retrospective application and prospective application. This would be the case if an entity had recognised income tax consequences of payments on financial instruments classified as equity in retained earnings, for which it had recognised the past transactions that generated distributable profits in profit or loss.

35. Considering this, we think the benefits of retrospective application would not outweigh the costs. Consequently, we recommend requiring an entity to apply the amendments prospectively.

36. We think entities would have sufficient information to apply the amendments to income tax consequences of dividends that occur in comparative reporting periods. Consequently, if the Board agrees with the recommendation to require prospective application, we recommend requiring an entity to apply the amendments prospectively to income tax consequences of dividends recognised on or after the beginning of the earliest reporting period presented.

Question 2 for the Board
Does the Board agree with the staff recommendation to require an entity to apply the amendments prospectively to income tax consequences of dividends recognised on or after the beginning of the earliest reporting period presented?

Analysis of other matters

37. Appendix A to this paper summarises other matters raised by respondents together with our analysis and recommendations. Respondents also made some editorial suggestions, which we will consider when drafting the final amendments.

Question 3 for the Board
Does the Board agree with the staff recommendations on the other matters outlined in Appendix A?

Appendix A
Analysis of other matters

Other matters	Staff analysis and recommendation
Comprehensive project to address where to recognise income tax effects	
1. A few respondents suggested that the Board undertake a comprehensive project to explore the principles underlying where to recognise tax effects in the financial statements.	The suggestion goes beyond the scope of this narrow-scope amendment. As part of its Agenda Consultation, the Board decided to add neither a narrow-scope project nor a comprehensive project on IAS 12 to its work plan. We recommend no change in this respect.
Scope of proposed paragraph 58A	
2. One respondent suggested that the scope of proposed paragraph 58A be broadened to capture tax effects of any distributions on financial instruments classified as equity.	Paragraph 52B (now proposed as paragraph 58A) of IAS 12 applies only to income tax consequences of dividends. The suggestion goes beyond clarifying existing requirements, and thus goes beyond the scope of this project. We recommend no change in this respect.
Hierarchy for the attribution of amounts to dividends	
3. One respondent suggested that the Board consider setting a hierarchy for the attribution of amounts to dividends (eg amounts recognised in profit or loss first, followed by amounts in other comprehensive income and then amounts in equity, unless a distribution has clearly been made from a specific item of other comprehensive income or from other component of equity).	The suggestion is not in line with the existing requirements in paragraph 52B of IAS 12, which links the income tax consequences of dividends to the transactions or events that generated distributable profits. The suggestion goes beyond the scope of this project. We recommend no change in this respect.

Distinction between income tax and withholding tax	
4. A few respondents suggested that the Board clarify the distinction between income tax and withholding tax. One respondent said the difference between these is often a matter of tax law and not necessarily one of economic substance (eg distributions that are tax deductible may still give rise to withholding tax).	Paragraph 52B (now proposed as paragraph 58A) of IAS 12 specifies how to account for income tax consequences of dividends, and paragraph 65A of IAS 12 specifies the accounting for withholding tax. The proposed amendments to IAS 12 would clarify the income tax consequences to which paragraph 52B (now 58A) applies. The amendments change neither the interaction nor the distinction between income tax and withholding tax. Addressing that distinction goes beyond the scope of this project. We recommend no change in this respect.