

International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH

10 July 2009

Grant Thornton International  
Regent's Place  
7th Floor  
338 Euston Road  
London NW1 3BG

Submitted electronically through the IASB Internet site ([www.iasb.org](http://www.iasb.org))

### Exposure Draft ED/2009/2 Income Tax

Grant Thornton International is pleased to comment on the International Accounting Standards Board's (the Board) Exposure Draft ED/2009/2 Income Tax (the ED).

We summarise our views and set out our main comments below. Additional comments and suggestions are set out in Appendix 1 as part of our responses to the invitation to comment questions. A number of other suggestions (mainly of a drafting nature) are set out in Appendix 2.

#### Summary

In summary, we do not support the introduction of an IFRS along the lines proposed in the ED. We are not convinced that the proposals, taken as a whole, represent an overall improvement on IAS 12. We also believe that the proposals will fail to achieve the goals set by the Board.

#### Main comments

##### **Need for a fundamental review of deferred tax accounting principles**

We recognise that the Board does not view this project as the time for a fundamental review of deferred tax accounting principles. Nonetheless we believe that such a review is necessary. We consider that the existing temporary difference model:

- results in information that is of questionable decision-usefulness
- is (and, based on the proposals, will remain) difficult to apply and poorly understood by many constituents.

A more fundamental review should aim to improve the decision-usefulness of the information in financial statements on the future tax effects of past transactions. We believe that this may require substantive changes to the existing recognition and measurement principles for deferred tax assets and liabilities.

We do however believe there is also a case for making limited short-term improvements pending a more comprehensive re-examination. However, we suggest that a short-term project should focus on limited simplification and clarification. The ED's proposals go beyond that.

### No net improvement

We believe the following aspects of the ED's proposals are an improvement on IAS 12:

- a more logical structure
- introduction of guidance on uncertain tax positions
- the proposed clarification of 'substantively enacted' in a manner that perfunctory steps that will not affect the outcome.

However, we suggest that the following proposals will not improve the usefulness of the information provided and will, in some cases, increase complexity:

- the requirement to determine the tax basis based on sale of an asset, irrespective of whether the asset is expected to be recovered by sale
- inconsistent principles regarding the expected manner of recovery or settlement and its tax consequences
- the replacement of the 'initial recognition exemption' with complex new rules
- largely US GAAP based rules on allocation of income tax expense to components of comprehensive income.

The other main changes seem likely to be neutral in their effect. Some of these changes will have little practical effect (the new proposals of addressing recoverability of deferred tax assets by way of valuation allowance for example).

### Convergence with US Generally Accepted Accounting Practice (US GAAP)

A cornerstone of this project is to achieve convergence (or near-convergence) with US GAAP. Had the FASB decided to propose amendments to SFAS 109 along the lines of its various tentative decisions, that goal might have been achieved (subject to the significant exception of uncertain tax positions).

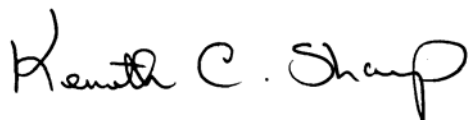
As it is, the ED is clearly directionally convergent but would leave some important issues unconverged. We note that FASB do now intend to expose the ED in some form, as explained in the Basis for Conclusions. However, this process seems one-sided and somewhat unsatisfactory for the IASB's constituents.

In summary, we do not believe the ED's proposals can be justified on convergence grounds in view of the extent of remaining differences and the apparent absence of a commensurate commitment by the FASB.

\*\*\*\*\*

If you have any questions on our response, or wish us to amplify our comments, please contact our Executive Director of International Financial Reporting, Andrew Watchman (andrew.watchman@gtuk.com or telephone + 44 207 391 9510).

Yours sincerely,

A handwritten signature in black ink that reads "Kenneth C. Sharp". The signature is written in a cursive style with a large initial 'K' and a distinct 'S'.

Kenneth C Sharp  
Global Leader - Assurance Services  
Grant Thornton International

Invitation to comment questions

***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 asset or liability. It also proposes changes to the definition of a temporary difference to exclude differences that are not expected to affect taxable profit. (See paragraphs BC17–BC23 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?***

***Definition of tax basis***

The proposed definition at Appendix A itself is not helpful in isolation, and is very much dependent on the more detailed guidance at paragraphs 14 to 16. Taken together, we note that this proposed guidance would preserve what we regard as a flaw in the existing model - namely that the model presumes that jurisdictional tax laws specify the measurement of assets and liabilities recognised in IFRS financial statements. In fact, in most jurisdictions tax law operates on a profit or loss basis not on an asset-liability basis. Accordingly, applying an asset-liability model for deferred tax is a hypothetical exercise with a questionable link to real world economic phenomena.

Turning to the ED's proposals, the most substantive change is determination of the tax basis using a sale notion for assets and a settlement notion for liabilities. We do not agree with this proposal. We acknowledge that, in certain cases, this would clarify the determination of the tax basis. However, we consider that this approach may not reflect economic reality if tax consequences differ depending on whether an asset or liability is recovered (settled) by sale or by use.

We also note that determination of a tax basis on a sales notion will be hypothetical for assets such as prepayments that are not sold outside a business combination.

We are also concerned that the ED's approach to management's intended use of assets and liabilities is inconsistent (see comment below and our response to Question 9).

***Temporary differences that are not expected to affect taxable profit***

The ED proposes an additional step in the determination of deferred tax, being that no deferred tax arises if assets or liabilities will be recovered or settled with no effect on taxable profit (paragraph 10). We note that this proposal will inherently require consideration of how assets and liabilities will be recovered and is therefore at odds with the rationale for eliminating this concept from the definition of tax basis.

However, we believe that the proposed drafting of this paragraph may not reflect the Board's intentions. Consider for example the following scenarios:

- prepaid expenses may be tax deductible on a cash basis. Accordingly no further deduction is available on receipt of the goods or services. Paragraph 10(a) seems to have the effect that no deferred tax liability is recognised because no future tax deduction is available. This outcome differs from IAS 12 and could also be viewed as leading to an income statement mismatch.
- an entity receives an upfront payment for goods or services (advance revenue). The advance revenue is taxable on receipt. For the reasons noted in the preceding bullet, the ED's proposal would prohibit recognition of a deferred tax asset in this situation.

These outcomes may reflect the Board's intention. However, we find them anomalous. Perhaps the underlying question is how best to describe what is meant by a future effect on taxable profit. Our suggestion is to amend the proposal along the lines that no deferred tax arises if recovery or settlement is not expected to give rise to any difference between accounting profit (or comprehensive income) and taxable profit.

### ***Question 2 – Definitions of tax credit and investment tax credit***

***The exposure draft would introduce definitions of tax credit and investment tax credit. (See paragraph BC24 of the Basis for Conclusions.) Do you agree with the proposed definitions? Why or why not?***

#### ***Tax credit***

We have some difficulty with the proposed definition on the grounds that an expense could also meet the definition. We suggest that the definition should be reworded along the lines: “reduces income taxes that would otherwise be payable”.

#### ***Investment tax credit***

If investment tax credits (ITCs) are to be excluded from the scope of an IFRS on income taxes we agree that a definition is necessary. However, we are not clear as to why this type of tax credit is or should be excluded. We recommend that the scope exclusion is reconsidered, which could in turn remove the need to define ITCs. The challenge in defining this term is to adequately distinguish ITCs from the tax basis of an asset. We consider that the proposed definition probably achieves this. However it might be useful to state explicitly that deductions described as ITCs in tax law that also meet the definition of tax basis are within the scope of the IFRS.

We are unclear as to why the proposed definition includes only depreciable assets. Why, for example, should land be excluded?

### ***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 amounts. 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. (See paragraphs BC25–BC35 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?***

We have significant concerns with these proposals. In summary our concerns are that the proposed approach:

- lacks clarity
- will increase complexity
- will not provide more useful information
- does not achieve US GAAP convergence.

We expand on these comments and offer some suggestions in the following paragraphs.

#### *Lack of clarity*

A number of aspects of the guidance in B10 to B13 require clarification and supporting examples. We note the following:

- the reference in B10 to disaggregation implies that the asset or liability is divided into the two components, being those described in B10(a) and (b). It is however unclear whether or not the 'entity-specific tax effect' referred to in B10(b) is actually recognised. We assume not but the use of the word 'disaggregation' is unhelpful.
- the approach described in B10 involves determination of the tax basis that would be available to market participants. To put this into practice it will be necessary to consider a notional transaction by market participants. This in turn will involve ascribing a transaction price to that notional transaction. We assume that the notional price should be the amount recorded by the reporting entity (cost or fair value in most cases) but this is not specified by B10.
- the guidance does not specify how the disaggregation should be performed. BC 29 indicates that it should be on the basis of the difference between the actual transaction price and the price the entity would have paid (received) if the actual tax basis were the same as a market participant would receive in a (same-price) transaction. This needs to be clarified in the IFRS itself
- B11 is confusing in that the approach required will actually deviate from the requirements of other IFRSs in many cases. For example, if an IFRS specifies 'cost' on initial recognition, the adjustment required by B10 would deviate from the basic measurement. It would be clearer to be explicit that this is an adjustment to the amount required by other IFRSs
- in a business combination, a tax amortisation benefit is commonly included in determining a fair value measurement to acquired assets. This tax amortisation benefit would normally reflect the tax basis available to a normal market participant. Put another way, the a fair value measurement should generally exclude the entity-specific tax effects referred to in paragraph B10(a). The ED could usefully make this clear.
- the use of the terms 'allowance' and 'premium' in B13(c) is presumably intended to avoid creating an impression that these debits and credits are assets or liabilities. The terminology is unhelpful.

Although we do not support the approach proposed, we suggest an alternative and in our view clearer way of describing it in Appendix 2.

#### *Increased complexity*

The Board asserts (at BC26 for example) that the approach proposed will be easier to understand and apply compared to IAS 12's initial recognition exemption. We disagree.

Our main reasons are as follows:

- the disaggregation exercise would require entities both to obtain information about the tax basis available to normal market participants and to adjust the carrying amounts of assets and liabilities. If an asset (say) is measured at cost on initial recognition, the entity will be required to determine the cost of a notional asset (the asset it owns adjusted to reflect the entity-specific tax advantage or disadvantage)
- BC 34 asserts that 'subsequent tracking' of the initial difference will be easier under the proposals. That seems questionable. Preparers will still need to distinguish between the initial amount of deferred tax and any amounts arising from subsequent differences such as on a revaluation. This will be necessary because only the initial difference gives rise to a possible allowance or premium
- increasing the initial carrying amount of assets for which the entity's tax basis is less than the basis for market participants may give rise to additional impairments and does not fit it well with IAS 36's pre-tax approach to determination of recoverable amount.

*Not useful*

The effect of the proposed approach is that entities will sometimes record a deferred tax asset and liability and an equal and opposite 'allowance or premium'. Moreover, the adjusted carrying amount has questionable information value.

*Not US GAAP convergent*

Given the FASB's decision not to propose corresponding amendments to SFAS 109 at this time, this proposal would replace one GAAP difference with another.

***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. (See paragraphs BC39–BC44 of the Basis for Conclusions.) Do you agree with the proposals? 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?***

We are not convinced that the recognition of deferred tax for 'outside basis' temporary differences is either conceptually justified or provides useful information in practice. These requirements can lead to recognition of liabilities (or, less commonly, assets) in relation to potential future transactions that the entity is not obliged to undertake, and may also be argued to be inconsistent with consolidation principles. We suggest that the Board should reconsider the conceptual and practical justification for recognition of these amounts before implementing changes to IAS 12's existing recognition requirements.

Should the Board consider that recognition is appropriate in certain circumstances, we believe those circumstances should be clarified. In particular which tax effects are the proposals intended to portray? For example, is the intention to present tax effects of remitting earnings, of selling the investment or of management's intended manner of recovery? We note the tax consequences often differ. Remittance of earnings between a parent and subsidiary in the same jurisdiction will typically have no tax consequences while sale of the investment may have.

Turning to the specific proposals, we do not support the proposed adoption of the US GAAP 'essentially permanent' rule as expressed. We accept the criticism in BC42 of the lack of a conceptual basis for IAS 12's exception, being founded on the investor's ability to control timing of reversal. The essentially permanent rule, however, amounts to a more limited version of the same rule. The difference is that the investor must have evidence of long-term postponement of any reversal. We also note that the effect of this approach is that the amount of tax recognised depends on the extent of documented plans and is therefore elective to some extent.

#### ***Question 5 – 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 to be realisable against taxable profit. (See paragraphs BC52–BC55 of the Basis for Conclusions.)***

#### ***Question 5A - Do you agree with the recognition of a deferred tax asset in full and an offsetting valuation allowance? Why or why not?***

We support this proposal on the grounds that it is US GAAP convergent. We believe it to be no better or worse in principle than the existing IAS 12 approach.

#### ***Question 5B - Do you agree that the net amount to be recognised should be the highest amount that is more likely than not to be realisable against future taxable profit? Why or why not?***

We agree with the expression of the basis of measurement. In our view, however, the application guidance in B16-25 sets a higher hurdle for evidence and thereby overwhelms the proposed principle. This is not a new problem, the evidential threshold being an existing feature of both IAS 12 and of US GAAP. However, we would prefer that the measurement principle is expressed consistently with the supporting guidance.

**Question 6 – Assessing the need for a valuation allowance**

**Question 6A - The exposure draft incorporates guidance from SFAS 109 on assessing the need for a valuation allowance. (See paragraph BC56 of the Basis for Conclusions.) Do you agree with the proposed guidance? Why or why not?**

See preceding comment.

**Question 6B - The exposure draft adds a requirement on the cost of implementing a tax strategy to realise a deferred tax asset. (See paragraph BC56 of the Basis for Conclusions.) Do you agree with the proposed requirement? Why or why not?**

We agree.

**Question 7 – Uncertain tax positions**

**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. (See paragraphs BC57–BC63 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?**

We agree that guidance on uncertain tax positions is important.

The approach proposed involves measuring all tax assets and liabilities (both current and deferred) at the probability-weighted average of all possible outcomes, assuming detection. In effect, this seems to take as the unit of account the entity's total tax position in dealing with uncertainty. This approach therefore differs markedly from the equivalent US GAAP guidance, which to our understanding addresses discrete 'positions' rather than the entity's entire tax situation. Moreover, US GAAP includes a filter to the effect that, in order for a tax benefit arising from a tax position to be recognised, it must have a more likely than not chance of being accepted.

We believe that the ED's proposed approach is sound in principle. However, we have a concern that a strict application of a 'probability-weighted average of all possible outcomes' model could be very burdensome. This is especially the case in view of the unit of account approach referred to above, which seems to require consideration of every aspect of uncertainty affecting tax. We also note that this requirement is more specific and stricter than the proposed guidance in other areas of tax uncertainty (such as recoverability of deferred tax assets and incorporating the effects of expected future distributions).

We acknowledge that the practical effect and workload will be driven by the extent and nature of the uncertainties affecting each entity, but nonetheless suggest that specific field-testing should be considered in this area.

We also note that, although the presumption of detection is consistent with our interpretation of IAS 12, it could be argued to lead to systematic overstatement of tax liabilities (ie tax in excess of settlement). This may not provide the most useful information.

**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. (See paragraphs BC64–BC66 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?***

We agree. We believe the proposed guidance is useful and is an improvement on IAS 12 (at least as IAS 12 has sometime been interpreted). The ED's proposals 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.

**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. (See paragraphs BC67–BC73 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?***

We disagree and prefer IAS 12's existing approach. This proposal further illustrates the ED's inconsistent approach to dealing with the effects of management intent for deferred tax purposes. It also demonstrates the problems that stem from this inconsistency.

In particular, we see no justification for determining the tax rate on the basis of the circumstances in which tax deductions are available. We believe the tax rate should be determined on the basis of how the economic benefits inherent within an asset are expected to be taxed. Moreover, the ED proposes that the tax basis is always derived from the deductions on sale (a proposal we do not support - see our response to Question 1). It therefore seems inconsistent to revert to a 'use' notion for the tax rate in some cases.

The concept of the 'same deductions' also needs to be clarified. In some common scenarios the amount of deductions may be the same for sale or use, but the rate at which they are deductible may differ. In other cases some deductions may be available in both scenarios but the amounts may differ.

These proposals also fail to address two problems that already exist in IAS 12:

- for investments, whether receipt of 'returns' such as dividends on shares or rentals on an investment property, fall into the category of use.
- how to deal with assets whose intended manner of recovery is part by use and part by sale.

***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. (See paragraphs BC74–BC81 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?***

We support this proposal, noting that the existing IAS 12 rule is somewhat arbitrary and may fail to reflect economic reality.

***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. (See paragraphs BC82–BC88 of the Basis for Conclusions.) 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?***

We agree that there is no need for new guidance in this area. This is partly on the grounds that we are unclear as to how 'special deductions' and 'tax deductions that do not form part of a tax basis' would be distinguished from 'tax credits'. The latter term is defined in the ED and may give rise to deferred tax assets in accordance with paragraph 9.

***Question 12 – Tax based on two or more systems***

***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. (See paragraph BC89 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?***

We agree with the substance of the proposal (that the interaction of the systems needs to be considered) but suggest that the guidance in B33 is vague and inadequate. The most common scenario is that an entity's tax rate will vary based on its level of taxable profits. The main practical issue is then to determining the rate at which to recognise deferred tax, which in turn depends on an assumed level of earnings. For example, should this rate be determined based on past experience, the current reporting period, expectations of taxable profits in the periods that temporary differences are expected to reverse?

We also find the reference to 'two or more systems' unhelpful. There is normally only one system but with progressive tax rates, minimum tax etc.

***Question 13 – Allocation of tax to components of comprehensive income and equity***

*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, 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. (See paragraphs BC90–BC96 of the Basis for Conclusions.)*

**Question 13A - Do you agree with the proposed approach? 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.**

The difficulty with allocation of tax expense among components of comprehensive income (and equity) is that this does not or may not reflect the operation of the tax system in most jurisdictions. This leads us to question whether it is really necessary to allocate tax expense at all (or at least among components of comprehensive income). An alternative would be to present an unallocated tax expense amount at the end of the statement of comprehensive income.

We also recognise, however, that a demand may exist among users for post-tax information on continuing operations, discontinued operations and other comprehensive income. The remainder of this response assumes that any new Standard will continue to include allocation requirements.

The principle in paragraph 29 (that an entity recognizes tax in the same component in which it recognizes the transaction) is sound. Beyond that, we have various concerns on the detailed approach proposed in this area, notwithstanding that fact that it is US GAAP convergent

Paragraph 30 includes a 'rule' that is difficult to understand without reference to the guidance in B35. Taken together, these requirements have the effect that tax losses in continuing operations can give rise to a tax benefit in that component even if those losses are utilized against taxable profits in other components (such as discontinued operations). This seems reasonable although the wording of paragraph 30 could be clearer.

The prohibition on backwards tracing in paragraph 34 is more consistent with US GAAP but not identical. It is difficult to see how this prohibition will lead to an improvement in financial reporting in overall terms (BC91 - 92 acknowledge the mixed arguments). The wording of paragraph 34 also needs to be clarified. For example, consider a property reported using the IAS 16 revaluation model. On an upwards revaluation a deferred tax liability would be recognized in other comprehensive income. The tax expense would also be reported in OCI. What happens if the property is then sold which would presumably give rise to a current tax expense and a reversal of the deferred tax liability? Which items are regarded as 'subsequent changes in the amounts previously recognized as tax expense'?

Paragraph 34 is very confusing and, to the extent its meaning can be divined, appears arbitrary. What is a 'loss item' for example? How does 34 (c)(ii) work? Would it be

preferable simply to require a reasonable and consistent allocation among components when these circumstances apply?

**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. (See paragraph BC97 of the Basis for Conclusions.)***

We believe that the paragraphs in question should produce results that are generally consistent with SFAS 109.

***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?***

For the reasons set out under Question 13A, we prefer the alternative approach based on the IAS 12 requirements with some amendments.

***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?***

We agree with most of the additional guidance. However, consistent with our comments on paragraph 34, we find the requirements in paragraph 34A (on dealing with differences between total tax expense and the sum of the separate components) confusing and unnecessarily complex. Our preference would be to replace 34A with a requirement for a reasonable, pro rata allocation of any such difference.

**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 consolidated entity to the separate or individual financial statements of the group members. (See paragraph BC100 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?***

We agree.

**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. (See paragraphs BC101 and BC102 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?***

We find the arguments quite finely balanced between the existing IAS 12 approach and the proposal in the ED. We acknowledge that the IAS 12 requirement is somewhat arbitrary. The

timing of when deferred tax assets and liabilities may affect future tax payments is dependent on the operation of the tax system in the jurisdiction in question. Moreover, deferred tax assets and liabilities are not settled individually but, rather, may reverse and affect future current tax liabilities. This makes a principles-based approach to classification somewhat challenging to put into practice.

We note that the ED's proposal adds complexity. Moreover, it does not follow that the a deferred tax liability is current or non-current in accordance with IAS 1's definitions simply because the related asset or liability is classified in that manner.

On balance we prefer the existing IAS 12 requirement. This approach is simpler to apply. We also suggest that in many jurisdictions deferred tax assets and liabilities will not normally result in a cash inflow or outflow within 12 months of the reporting date.

#### ***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. (See paragraph BC103 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?***

We agree.

#### ***Question 17 – Disclosures***

***The exposure draft proposes additional disclosures to make financial statements more informative. (See paragraphs BC104–BC109 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?***

***The Board also considered possible additional disclosures relating to unremitted foreign earnings. It decided not to propose any additional disclosure requirements. (See paragraph BC110 of the Basis of Conclusions.) Do you have any specific suggestions for useful incremental disclosures on this matter? If so, please provide them.***

We support the disclosure principle in paragraph 40. Beyond that, we have a general concern that the specific disclosures (both in the ED and in IAS 12) are excessive and disproportionate. We believe the overall disclosure package should be reconsidered and suggest that the Board should consult with users and determine the specific information that is most useful in practice.

In particular, we do not support the proposed numerical analysis of the change in deferred tax assets and liabilities (paragraph 46(b)). Moreover, we also question the practical usefulness of the existing requirement to disclose a breakdown of those assets and liabilities by type of temporary difference (paragraph 46(a)).

We also have the following more specific comments:

- We suggest that, in relation to paragraph 46, the Board should clarify the meaning of 'each type of temporary difference'.
- Paragraph 48(g) seems a curious disclosure. It requires that an entity not subject to tax should disclose the difference between the tax bases of its assets and liabilities and carrying values. We are unclear as to how or why an entity not subject to tax would calculate the tax bases of its assets and liabilities or whether those assets and liabilities could even be considered to have tax bases.

***Question 18 – Effective date and transition***

***Paragraphs 50–52 of the exposure draft set out the proposed transition for entities that use IFRSs, and paragraph C2 sets out the proposed transition for first-time adopters. (See paragraphs BC111–BC120 of the Basis for Conclusions.) Do you agree with these proposals? Why or why not?***

**Entities that use IFRS**

We mainly agree with the proposal, subject to suggesting that assets and liabilities to which the existing IAS 12 initial recognition exemption has been applied should continue be exempt.

**First-time adopters**

We agree.

## Drafting suggestions

We have the following suggestions on possible improvements to the drafting of the ED:

### Paragraph B10-B13 (initial recognition)

Clarity might be improved structuring along the lines:

- the entity should first consider whether the actual tax basis is the same as a market participant would receive in a transaction to acquire or assume that individual asset or liability in the applicable jurisdiction [note: you might also need to clarify the price paid/received in this notional transaction];
- if not, the entity should adjust the initial measurement of the asset or liability. The effect of the adjustment should be to restate the initial carrying amount to the amount the entity would expect to pay if the actual tax basis were the same as a market participant would receive in a transaction to acquire or assume that individual asset or liability in the applicable jurisdiction;
- deferred tax should be recognized based on the difference between the adjusted carrying amount and the actual tax basis
- deferred tax arising on initial recognition is accounted for as follows:
  - in a business combination ....
  - outside a business combination:
    - if the transaction affects accounting or taxable profit, any deferred tax arising on initial recognition is recorded in the normal way
    - if the transaction does not affect accounting or taxable profit etc

[assuming that this is the analysis intended]

#### **Paragraphs 23 and 26 (valuation allowance and measurement)**

The ordering of these paragraphs is potentially confusing. As drafted the principles expressed appear to be in conflict with each other. Broadly, paragraph 23 requires the recognition of a deferred tax asset if it is more likely than not to be realisable. Paragraph 26 expresses a measurement notion of weighted average probability. We assume the intention is (i) calculate deferred tax assets using a probability weighted average measure, and (ii) then evaluate whether the resulting asset is recoverable. This is the sequence suggested in the flowchart contained in the IASB staff's Illustrative Guidance on the IASB website.

Accordingly, we suggest that these paragraphs should be re-ordered to better reflect the sequence of the measurement steps for deferred tax assets.

#### **Need for illustrative examples**

We note that the ED does not contain illustrative examples (and are also aware that examples developed by the staff are available on the IASB's website - we suggest that these might usefully have been included in the ED itself). We believe some examples should be included in any final IFRS. This will in our view be necessary to promote consistent interpretation and application of the proposed requirements, particularly in the following areas:

- determination of the tax basis
- assets and liabilities for which recovery or settlement does not affect taxable profit (paragraph 10)
- initial recognition (B10-13)
- allocation of tax to components of comprehensive income (paragraphs 29-34).