9 November 2010

International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

Email: CommentLetters@ifrs.org

Dear Sir/Madam

**SAICA SUBMISSION ON EXPOSURE DRAFT ON *DEFERRED TAX: RECOVERY OF UNDERLYING ASSETS* –PROPOSED AMENDMENTS TO IAS 12**

In response to your request for comments on the IASB's exposure draft on *Deferred Tax: Recovery of Underlying Assets* **–** Proposed amendments to IAS 12*,* attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

**Sue Ludolph**
**Project Director – Accounting**

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)


Integritas, 7 Zulberg Close, Bruma Lake, 2198 POSTAL ADDRESS PO Box 59875, Kengray, 2100, Johannesburg
TEL +27 11 621 6600 FAX +27 11 621 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za WEB saica.co.za | accountancysa.org.za

**SAICA SUBMISSION ON EXPOSURE DRAFT ON *DEFERRED TAX: RECOVERY OF UNDERLYING ASSETS* – PROPOSED AMENDMENTS TO IAS 12**

## GENERAL COMMENTS

Whilst we have some concerns that the measurement exception only partially addresses constituents' concerns under the existing IAS 12 – *Income Taxes*, we welcome the focus of the Board in dealing with this matter. On balance, we believe that the amendment will result in deferred tax being measured in a more consistent manner than presently occurs under IAS 12, where different approaches have been taken where the manner of recovery of assets has been unclear.

## SPECIFIC COMMENTS

**Question 1 – Exception to the measurement principle**

*The Board proposes an exception to the principle in IAS 12 that the measurement of deferred tax liabilities and deferred tax assets should reflect the tax consequences that would follow from the manner in which the entity expects to recover or settle the carrying amount of its assets and liabilities. The proposed exception would apply when specified underlying assets are remeasured or revalued at fair value.*

*Do you agree that this exception should apply when the specified underlying assets are remeasured or revalued at fair value?*

*Why or why not?*

Yes, we agree with the proposals, subject to our concerns regarding the scope of the exception dealt with below.

**Question 2 – Scope of the exception**

*The Board identified that the expected manner of recovery of some underlying assets that are remeasured or revalued at fair value may be difficult and subjective to determine when deferred tax liabilities or deferred tax assets arise from:*

*(a) investment property that is measured using the fair value model in IAS 40;*

*(b) property, plant and equipment or intangible assets measured using the revaluation model in IAS 16 or IAS 38;*

*(c) investment property, property, plant and equipment or intangible assets initially measured at fair value in a business combination if the entity uses the fair value or revaluation model when subsequently measuring the underlying asset; and*

*(d) other underlying assets or liabilities that are measured at fair value or on a revaluation basis.*

*The Board proposes that the scope of the exception should include the underlying assets described in (a), (b) and (c), but not those assets or liabilities described in (d).*

*Do you agree with the underlying assets included within the scope of the proposed exception?*

*Why or why not? If not, what changes to the scope do you propose and why?*

We agree that the scope of the amendment should apply to investment property measured at fair value, and to investment property acquired in a business combination which is subsequently measured at fair value.

We note that a similar issue arises in the measurement of deferred tax on equity instruments measured at fair value under IAS 39 – *Financial Instruments: Recognition and Measurement* (and IFRS 9 – *Financial Instruments*), specifically where the dividend tax rate differs from the sale tax rate. We therefore request the Board to consider including these instruments in the scope of the amendment.

We do not believe that the scope of the amendment should include property, plant and equipment measured using the revaluation model. The Basis for Conclusions of the exposure draft identifies one of the reasons for the measurement exception as the difficulty in determining how much of an asset will be recovered through use and how much will be recovered through sale. This is the case particularly for investment properties measured at fair value as the entity does not determine a residual value. BC12 notes that this determination is less difficult and less subjective for investment property measured at cost as the entity is required to determine a residual value, which is presumed to be recovered through sale. Property, plant and equipment measured using the revaluation model is subsequently depreciated. The entity is therefore required to determine a residual value, which would form the basis for estimating the amount of the asset's carrying value that will be recovered through sale and therefore the amount to be recovered through use can also be estimated. Therefore, we believe that property, plant and equipment should be excluded from the scope of the amendment.

The same argument applies to intangible assets measured using the revaluation model. We believe the focus should be on assets where the manner of recovery is uncertain, but in the case of property, plant and equipment and intangible assets, this is already dealt with by requiring a residual value to be determined.

Furthermore, the Basis of Conclusion seems to make an implicit assumption that if an asset is carried at valuation that it is likely to be recovered by way of sale. We would not agree that that assumption is correct as there is no evidence that revalued assets have higher residual values and thus lower depreciation expenses as a percentage of the carrying value than similar assets accounted for using the cost model. We believe that there are many reasons for revaluing asset that are not related to the intention to sell the asset e.g. the desire to have a depreciation charge that is not influenced by the timing of the acquisition of the depreciable asset and therefore more fairly reflects the profitability of the business.

**Question 3 – Measurement basis used in the exception**

*The Board proposes that, when the exception applies, deferred tax liabilities and deferred tax assets should be measured by applying a rebuttable presumption that the carrying amount of the underlying asset will be recovered entirely through sale. This presumption would be rebutted only when an entity has clear evidence that it will consume the asset's economic benefits throughout its economic life.*

*Do you agree with the rebuttable presumption that the carrying amount of the underlying asset will be recovered entirely by sale when the exception applies?*

*Why or why not? If not, what measurement basis do you propose and why?*

We agree with the proposals.

We believe that the presumption of recovery through sale should only be rebutted if there is clear evidence that the entire carrying amount at the reporting date would be recovered through use. We therefore suggest that paragraph 51B be reworded as follows:
"*However, if an entity has clear evidence that it will consume **all of** the asset's **remaining** economic benefits throughout its **remaining** economic life, this presumption is rebutted.*"

Some, however, are concerned that the proposed requirement could be interpreted as meaning that even if an immaterial amount was likely to be received at the end of an asset's economic life, say from the sale of scrap, then that would mean that the presumption could not be rebutted and accordingly the deferred tax would have to be recorded on the basis of the sale rate. These commentators are of the view that in this case it would not be appropriate for the sale rate to be used when it is expected that almost all of the economic benefits associated with an asset would be recovered during the asset's economic life. Accordingly these members suggest the above change to paragraph 51B be amended as follows: "*... its economic life except for an immaterial residual value, this presumption is rebutted.*"

An entity may hold investment property at fair value that comprises both land and building elements. If the presumption of recovery through sale is rebutted for the building element, it is our belief that the land and building elements should be separated - resulting in deferred tax on the land being measured at the sale rate, while deferred tax on the building would be measured at the use rate. It would be useful if the Board included guidance to this effect in the final amendment.

**Question 4 – Transition**

*The Board proposes that the amendments should apply retrospectively. This requirement includes retrospective restatement of all deferred tax liabilities or deferred tax assets within the scope of the proposed amendments, including those that were initially recognised in a business combination.*

*Do you agree with the retrospective application of the proposed amendments to IAS 12 to all deferred tax liabilities or deferred tax assets, including those that were recognised in a business combination?*

*Why or why not? If not, what transition method do you propose and why?*

We agree with the proposals.

**Question 5 – Other comments**

*Do you have any other comments on the proposals?*

SIC Interpretation 21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets*

As a consequence of the proposed amendments to IAS 12, the Board proposes to withdraw SIC-21.

Some members were concerned about this proposal as the concepts in SIC-21 have been used as guidance for other assets, specifically intangible assets with an indefinite useful life. It is suggested that the Board include the concepts of SIC-21 in the final amendment to IAS 12.

Double counting of the tax effect

The current requirements in IAS 12 result in a double counting effect where the after-tax cash flows have been used to calculate the fair value of the asset, which is then used to measure the deferred tax liability. This is acknowledged in BC21(a) of the exposure draft. This situation also arises when certain assets are acquired in a business combination. For example, an entity acquires a customer list in a business combination. The fair value is measured using the expected after-tax cash flows associated with the customer list. In this instance, assuming that the resulting intangible asset is measured subsequently using the cost model, deferred tax would be measured at the use rate under the current requirements of IAS 12 and the proposed amendments. We urge the Board to take this into consideration on any future projects on Income Taxes.

*#323925*