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International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom
Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON EXPOSURE DRAFT ON *INCOME TAX*

In response to your request for comments on the IASB's exposure draft on *Income Tax*, 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 bring to your attention that the Long Term Insurance Project Group of SAICA has submitted a separate comment letter on this exposure draft that contains the views of the long term insurance industry of South Africa.

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

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Project Director – Accounting

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

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SAICA SUBMISSION ON EXPOSURE DRAFT ON *INCOME TAX*

GENERAL COMMENTS

We are generally supportive of the Board's decision to accelerate the project on Income Tax as part of its convergence project with the US Financial Accounting Standards Board (FASB). We understand that the objective is to eliminate discrepancies between International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (GAAP) and to simplify the accounting for deferred taxes. However, we are not convinced that the proposals have achieved the simplification objective. In our view, some of the proposals appear to be more complex to apply in practice and more difficult to understand than the current income tax standard.

The Exposure Draft does not clearly establish the principles underlying deferred tax.
It appears that it could be the intention of the Board that the deferred tax balance represents the tax consequences of realising assets or settling liabilities for their carrying value at the reporting date. However, there is some ambiguity in the Exposure Draft that we have highlighted in our answer to Question 1.

Contributors to this comment letter have different understandings of what is, and what should be, the basic principle underpinning the proposed calculations of the deferred tax balance. Consequently, two alternate views have been presented to the answer to Question 1. The impact of the different views flows through to other questions, in particular Question 9.

In light of the difficulties encountered in understanding the proposals in the Exposure Draft, we are not convinced that issuing a revised standard based on the Exposure Draft would be appropriate given the inability to provide meaningful feedback.

SPECIFIC COMMENTS

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?

VIEW 1

We agree with the proposals that the tax basis should always reflect the tax consequences of realising an asset by sale or settling a liability at the reporting date for its carrying value. We are of the view that the deferred tax balance (similar to all statement of financial position balances) represents the tax position at the reporting date and should not take into account events that may occur after the reporting date. Further, where the tax consequences of using the assets are different from those arising from selling the asset, these should not be factored into the measurement of the deferred tax balance as that relates to events that have not yet occurred at the reporting date. Whilst we acknowledge that this method measures the deferred tax balance at the amount that would be payable or recoverable if the entity were to be liquidated on the reporting date, we believe that this basis better reflects the tax related obligations or rights that exist at the reporting date.

To illustrate, assuming a depreciable asset with a revalued carrying value of CU1,5m, original cost of CU1m and a tax basis of CU0,7m, at the reporting date there would be a temporary difference of CU0,8m (CU1,5m – CU0,7m). (The tax basis is the original cost less the tax deductions already granted). If the asset were to be sold at the reporting date for its carrying value of CU1,5m, tax would be payable at 28% on the recoupment of tax allowances granted and at 14% on the proceeds above cost i.e. CU0,084 (CU1,m – CU0,7m) x 28% + CU0,07m (CU1,5m – CU1m) x 14%.= CU0,154m.

A deferred tax balance of CU0,154m would reflect the tax consequences of realising (selling) the asset for its carrying value at the reporting date. This should be the deferred tax balance irrespective of whether the intention was to use or sell the asset. However, it is noted, that because of B29, given that the tax deductions on sale and usage are the same, the entity is required to use the rate that reflects the expected manner of recovery. Therefore, if that is usage, the resulting deferred tax would be CU0.8m x 28% = CU0.224m.

Refer to our comments below relating to the limitation of the definition of tax basis in situations where there may be more than one type of tax implication as highlighted in the example.

VIEW 2

An alternative view is that the tax basis of an asset or liability should reflect the future tax consequences of the manner in which management expects to recover the assets or settle the liability. This argument is based on the assumption that, at the reporting date, the financial statements are prepared on a going concern basis and thus the deferred tax balance should be measured on this basis as opposed to the amount that would be payable if the company were to cease operating at the reporting date. On this basis, the deferred tax balance should reflect the intentions of management both in respect of the measurement of the tax basis as well as the tax rate used.

Conceptually we are not convinced that it is appropriate to consider the intention when selecting the appropriate tax rate to use, but not when selecting the appropriate tax basis to use. Where there is a difference between the tax basis on a sale or usage basis, there does not appear to be a strong conceptual argument for ignoring the usage basis in determining the tax basis, which would then also imply that the sale rate is required to be used in determining the deferred tax balance in terms of B29 (although it is noted that this does address some of the difficulties currently encountered in applying IAS 12 for assets for which there are no tax allowances relating to the usage of the asset). In that case, despite the fact that the asset is expected to be realised through use, both the tax basis and the rate used would be that applicable to the sale of the asset. On that basis, we would not support the principle that measuring the tax basis is independent of the expected manner of recovery under the second view proposed.

The effect of view 2 on the deferred tax balance would be illustrated by expanding the example used above in view 1. (To recap – carrying value CU1,5m, cost CU1m, tax basis CU0,7m)

Assumption 1 – Management intends to sell the asset at a future date
Assuming the residual value is in excess of CU 1.5m, the deferred tax balance would be CU0,154m, calculated as above. Both the tax basis and the tax rate that is applied reflect the consequences of selling the asset.

Assumption 2 – Management intends using the asset and not to sell it
If management intend to use the asset, the carrying value will be recovered by depreciating the asset in the production of income, which will be taxed at the full rate i.e. 28%. The tax basis remains at CU 0,7m as that is the amount that remains to be deductible in the form of capital allowances as the asset is used.

The deferred tax balance would be CU0,224m (CU1,5m – CU0,7m) x 28%. That balance represents the tax consequences of recovering the carrying value of the asset through use.

In our constituency, the tax basis will almost always be the same on a use and sale basis, i.e. using the example above, CU0,7m are the remaining capital allowances that are deductible if the asset were to be used and is also the amount that would be deducted from any proceeds on sale to determine the tax consequences of selling the asset. In most cases, the tax basis would therefore be the same irrespective of the expected manner of recovery, but that does not imply that it is conceptually correct.

VIEWS 1 & 2

A simplified basis of calculating deferred tax would be calculating the deferred tax balance as the amount that would be payable to the tax authorities assuming all assets are realised for their carrying value and liabilities settled at the reporting date (View 1 as outlined above). In order to calculate the deferred tax balance, preparers would have to consider what tax deductions and taxable income would arise and what rates would be applicable to those tax consequences. This would avoid the complications arising from different tax consequences, which are not accommodated in the proposed definition of tax basis.

The definition of the tax basis does not allow for the possibility that there may be more than one type of tax consequence of selling the asset. Where a depreciable asset is sold for an amount above its original cost, in some tax jurisdictions the recoupment of prior allowances is taxed and the amount received in excess of the original cost is taxed as a capital gain. In an environment where entities are permitted to revalue assets for accounting purposes, this will have implications for the calculation of the deferred tax balance in respect of that asset.

It is not clear that a deferred tax approach that requires the determination of a tax basis is going to be a useful starting point for a simplified basis of calculating deferred tax in an environment where the carrying value of many assets may be above the original cost and there are tax consequences relating to disposal of the asset for an amount greater than cost.

In terms of South African Income Tax legislation, when an asset is sold above its original cost, a single capital gain after consideration of the base cost of the asset is included in taxable income, i.e. there is not a deductible amount. We propose that paragraph 15(a) be reworded as follows *"the tax basis of an asset equals the amount that would have been <u>allowed as a reduction</u> ~~deductible~~ ~~against~~ of taxable income in arriving at taxable profit if the carrying amount of the asset had been recovered through sale at the end of the reporting period."* (words added have been underlined and suggested wording to be deleted has been struck through). This will avoid any possible misinterpretation in determining the tax basis of the asset.

We also request clarification on the definition of a tax basis. In a South African context, most assets are subject to capital gains tax. However, the capital gains tax is not determined as the capital gain measured at a capital gains tax rate. Instead, on sale of the asset, 50 per cent capital gain is included in taxable income. Using the example in View 1 above, an asset has a cost of CU 1m, has previous usage tax deductions of CU 0,7m and could be sold for its revalued carrying amount of CU 1,5m at the reporting date. If the entity realises the carrying value of the asset through use, further deductions of R0,3m will be allowed. If the entity realises the asset through sale at the reporting date, the entity will have a capital gain of CU 0.25m included in taxable income (50 per cent of the capital gain of CU 0.5m) and a recoupment of previous usage deductions of CU 0.3 m. Therefore, the tax deductions available on sale of the asset are CU 0.55m, while the tax deductions available on continued use of the asset are CU 0.3m. As the deductions available on sale differ from those on use of the asset, the tax basis of any asset subject to capital gains tax will therefore be based on sale. In order to accurately reflect the entity's expected future tax payments, we recommend that the tax basis on the sale of an asset should be determined as cost less deductions to date.

We have also noted some inconsistency in the exposure draft where the Board states that in certain circumstances the **temporary differences** arising from an asset sold would differ from that of an asset being used. For example, IN8(b) indicates that the basis on which the entity expects to recover the carrying value may affect the measurement of any temporary difference. Based on our understanding, temporary differences arise as a result of the differences between the balances determined in terms of IFRS and those calculated in terms of the relevant tax legislation, which in terms of the Exposure Draft will not depend on managements' intentions. It is thus not clear how a temporary difference determined in accordance with this basis would be affected by the manner of recovery.

On an editorial note, we believe that the proposed wording under paragraph 15(b) results in less prominence of the words included in brackets. We propose that the brackets are replaced with commas in order to make it clear that the tax basis of a liability can be higher than its carrying amount.

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?

We do not agree with the proposed definitions. We believe that the distinction between tax credits, investment tax credits and other tax incentives is not clear. The Board should, in our view, revise the definitions to provide clarity in the proposed standard.

In certain jurisdictions, the government would provide tax incentives to entities operating in a particular industry. For example, an entity would be entitled to a tax allowance of 150% of the cost of an asset. It is not clear from the definition provided whether the *investment tax credit* relates to the additional 50% deduction, the entire 150% deduction or none of it (i.e. this is not an investment tax credit. Example 16 has a tax allowance of 150% from usage and this does not appear to have been treated as an investment tax credit). In this example, the entity would apply the incentive in deriving its taxable income rather than reducing its income tax payable as per the definition of *tax credit.*

It is implied by the definitions that all *investment tax credits* are *tax credits.*

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?

It is understood that the Board has introduced this exception to eliminate the rule based exceptions under the existing IAS 12. However, the exposure draft proposes a revised rule in the introduction of the concept of deferred tax premiums and allowances to achieve the same outcome to the existing IAS 12. It is unclear why the Board has introduced this exception where the net effect before and after applying the proposals are the same, except where the tax rate changes. (It is our understanding that the deferred tax balance will change for a change in tax rate, but there is no indication that the allowance or premium should be adjusted if the tax rate changes.) We therefore suggest that the new standard adopt the current IAS 12 requirements, which will apply to limited assets and liabilities given the change in the tax basis to the deductions available on sale.

We believe that the guidance provided regarding “entity-specific tax effects” is not clear. For example, certain tax jurisdictions allow transfers of assets among entities within the same group to be carried at the tax basis of the entity transferring the asset.

This treatment would be available to any entity entering into this type of transaction in that jurisdiction and therefore any tax effects would not be regarded as "entity specific". We suggest that the Board clarify this principle.

Whilst we acknowledge that the current initial recognition exceptions have been difficult to apply in practice, we envisage that the proposed initial recognition principles would be more complex to apply in practice without further guidance. The proposal introduces the concept of "*entity-specific tax effects*" with limited guidance on how to measure and derive these tax effects.

Paragraph B13(c) requires the entity to "*present the allowance or premium within deferred tax in the statement of financial position.*" The wording "*…within deferred tax…*" is not clear. This could be interpreted as being in the same financial statement section but presented separately or offset against the deferred tax balance, which would imply a nil balance except where the tax rate has changed (see comment above).

Paragraph B13(c) further requires that "*the entity shall not consider the allowance or premium when determining the need for or the measurement of a valuation allowance in accordance with paragraph B16-B25.*" The application of this paragraph would effectively result in a premium which is not matched by a deferred tax asset (because the deferred tax asset is subject to the valuation allowance) resulting in the recognition of deferred tax on initial recognition or subsequently. It is unclear whether this was the intention of the Board.

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 disagree with the proposals. The motivation for excluding associates from this requirement is unclear. It appears that temporary differences relating to certain equity accounted joint ventures could be exempt from deferred tax, whereas temporary differences relating to an equity accounted associate would not be exempt. Furthermore, we note that in certain circumstances it may not be possible to measure reliably the deferred tax balance from an investment in an associate. We believe that, on this basis, it would not be appropriate to remove the exception in IAS 12 relating to investment in associates. Further, the temporary differences relating to local subsidiaries are accounted for differently to those of foreign subsidiaries where the investment is essentially permanent in duration based purely on cost versus benefit rationale.

It is unclear whether a foreign subsidiary or joint venture refers to taxes levied by a different tax jurisdiction (for example different states within a country) or a different country. We also envisage that, in some jurisdictions, it might be difficult to determine whether a subsidiary is foreign or not where it has both local and foreign branches. As a result, this could result in inconsistent accounting for similar transactions. We propose that the Board provide a definition of a foreign subsidiary in the context of the proposed standard.

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?

Conceptually, we do not agree with the proposed approach of recognising the deferred tax asset in full and offsetting the valuation allowance in respect of tax losses carried forward that are not expected to give rise to "*future economic benefits*" as this will result in the recognition of an asset that does not satisfy the definition in the *Framework*. We believe that the current approach for recognising the deferred tax asset to the extent that its realisation is probable is more appropriate and conceptually sound than the proposed exposure draft. We are also of the view that the Board has not provided clear explanations of the benefits that the proposed approach would have, as opposed to the current accounting in IAS 12, other than convergence with US GAAP.

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?

Whilst we do not agree with the proposed accounting for recognising a valuation allowance in all instances, in the instance that the Board proceeds with this method, we believe that the 'more likely than not' approach is appropriate.

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?

Whilst we do not agree with the proposed accounting for recognising a valuation allowance, in the instance that the Board proceeds with this method, we believe that this guidance will ensure that the deferred tax asset reflects the highest amount that is more likely than not to be realisable against taxable profit at each reporting date.

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 with the proposals to add a requirement on the cost of implementing a tax strategy being considered in the recognition of a deferred tax asset.

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?

Although we are supportive of the Board providing guidance in this regard, we do not believe that a probability weighted average is the appropriate measurement basis for uncertain tax positions. As such, we would suggest that uncertain tax positions be measured based on a 'more likely than not' outcome. We believe that this will result in the recognition of tax exposures that more accurately reflect the expected outcome. Furthermore, we propose that the Board needs to decide on whether the 'probability-weighted average approach' or 'more likely than not' outcome is more appropriate, in order to ensure consistency across all future IFRSs, for example lease renewal options.

We have also noted that the Exposure Draft assumes that it is feasible for an entity to estimate, on a disaggregated basis, the probable outcomes of uncertain tax positions, including those that are not in dispute. We believe that this assumption is artificial.

Secondly, the Exposure Draft proposes that the assessment of uncertain tax positions be performed on a disaggregated basis. This assumes that it is possible in all circumstances to conduct this assessment on a disaggregated basis. We are of the view that this approach could potentially result in artificial assets and liabilities being recognised at the reporting date. Performing the assessment on an aggregated basis would, in our view, produce a more accurate outcome.

Moreover, disputes about an uncertain tax position often involve a complex legal – regulated dispute resolution process between the tax payer and the tax authorities. The due process rights of the tax payer could be undermined where they are required to estimate the outcome of each individual dispute or potential dispute. This follows because this procedure allows the tax authority access to what should be the entity's legally privileged information, whether in the form of the entity's own internal working papers or audit working papers. It has been suggested that the constitutional rights may thereby be infringed in various countries, including South Africa.

Thirdly, the exposure draft proposes that an entity make certain disclosures in respect of uncertain tax positions. We believe that this accounting requirement could result in public disclosure of confidential company information, which may otherwise be legally privileged. From this would follow the same difficulties identified above, but are magnified through public disclosure.

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 with the proposals. However, we do not believe that a principles based standard should provide application guidance to a specific jurisdiction. We therefore believe that the reference to "*in the US tax jurisdictions, substantive enactment is achieved only on enactment*" should be removed.

The committee considered whether the use of a probable or most likely rate in the measurement of taxes is appropriate. It is proposed that the Board should consider this as the term "*substantive enactment*" is only utilised in the context of accounting for tax and is potentially the root of the uncertainty around its application.

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?

Those who support View 1, as explained in response to Question 1, disagree with the proposal based on the considerations included in our response to that question. If the underlying principle is that the deferred tax balance should reflect the tax consequences on sale of the asset or on settlement of the liability, this principle should, in our view, be applied consistently in measuring the tax basis and the tax rate applied to determine the deferred tax balance.

Furthermore, the arguments provided in BC69 justifying the application of the usage rate may be considered where the sale and usage rate are the same, but would not be considered in other circumstances. If the appropriate tax basis to use is the basis on sale, it is not clear why it would then be appropriate to use the usage rate. If the usage rate is appropriate, it is not clear why that is inappropriate purely because the tax basis on sale differs.

Those who support View 1 could argue that use of a rate other than the selling rate will take into account amounts that relate to events that occur after the reporting date. This would then be in conflict with paragraph 9 of ED 10, which states that an "*entity shall recognise a deferred tax asset or liability for tax recoverable or payable in future periods as a result of* ***past transactions*** *or events*" (emphasis added).

An alternate view (refer to Views 1 & 2 in response to Question 1) is that the measurement of the asset that has been recognised is based on future cash flows relating to the asset. If the future cash flows are determined on the basis of using the asset, then it is conceptually consistent to recognise the tax consequences of realising those cash flows.

Life insurers and property investment vehicles in South Africa hold investment properties as defined under IAS 40 – *Investment Properties*. In light of the fact that these investment properties support the benefit values of customer life insurance and investment policies (policyholder liabilities) and unit holders, most preparers choose the fair value model in determining the balance sheet values for the respective properties. The fair value adjustments in respect of these investment properties are accounted for in profit and loss each year in terms of paragraph 35 of IAS 40. The current interpretation of IAS 12 is that deferred tax should be provided at normal company tax rates on the revaluation surpluses/deficits to the extent they are related to the present values of future rental income (taxable income flow) applicable to the property.

The component of the revaluation surplus on the investment properties that relates to future rental streams, and not the bare dominion, is by definition a temporary difference and on application of IAS 12 gives rise to a deferred tax liability at rates applicable to recovery. In some cases the property portfolio is held for long term purposes and therefore recovery is assumed to be through use. The applicable use rate in South Africa (being the tax applicable to net rental income) is the income tax rate at

28%. The deferred tax balance would therefore reflect the tax consequences of the future rental income.

The current requirements results in double counting where the cash flows that have been used to calculate the fair value include the rental income on an after tax basis. However, it is noted that the Exposure Draft addresses some of the difficulties currently encountered in applying IAS 12 for assets for which there are no tax allowances relating to the usage of the asset.

We believe that the proposals in the Exposure Draft do not appear to solve this problem, unless one assumes that the intention is to provide deferred tax on the basis of the consequences of selling the asset. To eliminate such double taxation, we propose that the rate that would apply if the asset were sold should be applied.

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 do not agree with the proposals as we envisage potential problems in applying the proposed principle. Distributions are often discretionary and the decision to distribute can, to a large extent, be affected by profit levels and other factors. Based on this, we are of the view that the tax effects of such distributions should not be recognised before the distribution. We believe that the related tax effect of a distribution should be recognised consistently with that distribution in accordance with IAS 10 – *Events after the Reporting Period.*

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?

Yes, we agree that the exposure draft be silent on the treatment of tax deductions that do not form part of a tax basis. However, we think it should be articulated clearly when tax deductions do not form part of the tax basis. For example, in Example 16, deductions of 150% are obtained through usage, but deductions of only 100% are obtained on sale. Since the tax basis only reflects the tax deductions of 100%, are the additional tax deductions of 50% regarded as deductions that do not form part of the tax basis?

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?

Yes, we agree with the proposals that an entity consider any interaction between tax systems when measuring deferred tax assets and liabilities.

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.

We do not agree with the proposed approach in so far as it prohibits "backward tracing". If the adjustment is easily identifiable and allocated to the components of comprehensive income and equity, this should be performed. A cost versus benefit approach should, in this case, be also a determining factor. In so far as an allocation is not practicable, the adjustment should then be recognised in the profit or loss component of the statement of comprehensive income.

We also note that the proposed approach could result in counterintuitive results. For example, on the revaluation of an item of property, the initial deferred tax would be recognised in other comprehensive income. Assume the same deductions are available on use and sale and the tax rate on sale is lower than the tax rate on use. If the applicable tax rate is subsequently reduced to the sale rate due to a change of management intention, the adjustment would be recognised as a credit in profit or loss and not in other comprehensive income. (If it is assumed that the deferred tax balance has been calculated on the sale basis in the first instance, then there would be no adjustment to the deferred tax balance arising from the change in intention and therefore the issue of backward tracing would not arise.)

We suggest that the proposals be applicable only in instances where the costs to identify the specific component of comprehensive income and equity would outweigh the benefits.

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.)

Refer to our response to Question 13A above.

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?

Refer to our response to Question 13A above.

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?

Refer to our response to Question 13A above.

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 with the proposals.

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 do not support the proposal to classify the deferred tax assets and liabilities as current or non-current, particularly based on the underlying asset or liability. We believe that the existing IAS 12 treatment provides sufficient information in terms of disclosure to allow users to evaluate this information, if necessary.

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 that the adoption of an accounting policy for penalties and the disclosure thereof will provide increased comparability amongst entities.

However, we believe that the inclusion of interest charges in taxation is inconsistent with the principles in other IFRSs. For example, IAS 18 – *Revenue* requires the entity to recognise revenue at fair value resulting in separate recognition of finance income, if any. On this basis, we do not support the accounting policy choice.

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 agree with the proposal. We do not propose any further disclosures. We believe that additional disclosures that would provide decision-useful information to users, for example, disclosures about uncertainties, which would be required by IAS 1 – *Presentation of Financial Statements,* would suffice.

The intention of the disclosures under paragraph 48(d) is unclear and it is envisaged that this disclosure would be arbitrary and not useful to the users of financial statements.

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?

We agree with the proposals. We further recommend that the entities are provided with the option to early adopt the proposals and/or restate comparative amounts, particularly where the differences between the two comparative periods are significant.

OTHER COMMENTS

Foreign exchange differences

Paragraph 38 of the Exposure Draft allows for an accounting policy choice for the classification of foreign exchange differences as a tax expense. It is unclear why this election is permitted as this choice is not allowed in any other IFRS. For example, exchange differences of trade debtors are not recognised as a component of revenue. Similarly, it is unclear why exchange differences on income taxes are included in income tax.

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