MAZARS

Proposed Amendments to IAS 12 – Comment Letter
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

9 November 2010

Exposure Draft *Deferred Tax: Recovery of Underlying Assets – Proposed amendments to IAS 12*

Dear Sir / Madam,

Mazars welcomes the opportunity to comment on the Exposure Draft *Deferred Tax: Recovery of Underlying Assets – Proposed amendments to IAS 12*. Our general comments are given below. Detailed responses to the specific questions included in the Exposure Draft are attached to this letter.

In our comment letter to the ED Income Tax published in 2009 (ED/2009/02), we recommended that the Board should reconsider its approach and split the income tax project in two separate phases:

- The first phase would amend IAS 12 only on issues that need an urgent answer such as uncertain tax position, investment tax accounting and *"single asset entity transactions"*.

- The second phase would be an opportunity to develop jointly with the Proactive Accounting Activities in Europe (PAAinE) an improved standard on accounting for tax.

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As a consequence, we are very pleased with the Board's decision to address in the short term some practical tax accounting issues that have arisen during the last decade. We also agree that IAS 12 lacks guidance in measuring deferred tax when the manner in which an entity expects to recover the carrying amount of an asset is dual (i.e. through use and sale).

We acknowledge that this ED might resolve a few issues identified in some tax jurisdictions. Nevertheless, we believe that the proposals will make income tax accounting more rule-based and will not improve the quality of financial statements.

In particular, we disagree with the following aspects of this exposure draft:

- For some assets that are remeasured at fair value, 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 the carrying amount of its assets. We believe that this issue is more in a nature of application guidance and does not justify overriding IAS 12 principles.

- According to the ED proposals, the measurement of deferred tax will depend on the measurement method used by the entity (fair value model, revaluation model or cost model) and not upon the manner in which the entity expects to recover the carrying amount of its assets. We believe that an accounting method does not prejudge the intent of the entity. For example, measuring a PPE using the revaluation model does not mean that the entity expects to recover this asset through its sale. Reciprocally, measuring an investment property using the cost model does not preclude an entity from recovering this asset through its sale.

- In many cases, the proposed approach will not reflect the tax consequences expected by an entity (e.g. when an entity intends to use the asset throughout majority of its economic life and to sell it afterwards).

We believe that the following alternative approach would be more consistent with the principles in IAS 12. This proposed approach can be summarized in five points:

1. To keep the principle in IAS 12 of taking into account management intent when measuring the deferred tax asset or liability.

2. To specify as application guidance that, in case of dual intent for recovering the carrying amount of an asset, the entity should determine and measure deferred tax based on the <u>principal</u> manner in which the entity intends to recover the carrying value of the asset.

3. To specify as application guidance that, for non depreciable assets, the entity should retain a presumption that the carrying amount will be recovered through sale.

4. To apply this application guidance to each asset, regardless of the measurement method used to account for these assets.

5. To illustrate these points through detailed examples.

We believe that this project should also address the "single asset entity" issue since we feel the two topics are linked.

We would be pleased to discuss our comments with you and stay at your disposal should you need further clarification or additional information.

Yours sincerely,

Michel Barbet-Massin
Head of Financial Reporting Technical Support

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?

We disagree with the proposed exception since we consider that IFRS are principle-based standards. Moreover, we believe that the Board has not justified enough why this exception should apply only when the specified underlying assets are remeasured or revalued at fair value. We also believe that the proposed amendment will undermine comparability of financial statements.

Need for principle-based approach

We strongly support the current approach in IAS 12 (paragraph 51 of IAS 12) that takes into account the management's intent to determine the tax base and the tax rate of an asset. In case of practical issues, these principles should be maintained and some application guidance should be provided to the preparers of financial statements on how to apply these principles.

We understand that the proposal aims at solving some practical issues encountered in a few tax jurisdictions. Therefore, there is no sufficient reason that would justify overriding these principles in IAS 12.

Besides, we perceive this exemption as very rule-based since it covers only some assets that are remeasured or revalued at fair value. Scoping out other assets only emphasises the rule-based approach of this proposal.

Scope of exception

Thus, we disagree with the proposed approach to restrict this accounting method to assets remeasured or revalued at fair value. The proposal assumes that using fair value indicates that the asset will be recovered through its sale.

We strongly believe that an accounting method should not prejudge the intent of the entity. For example, measuring a PPE using the revaluation model does not mean that the entity expects to recover this asset through its sale. Reciprocally, measuring an investment property using the cost model does not preclude an entity to recover the value of the asset through sale.

Since the fair value model in IAS 40 and the revaluation model in IAS 16 and IAS 38 are optional accounting policies that apply to all investment property or all class of assets, adopting the evolution model can not represent the entity's systematic intent to use or sale a specified asset.

Lack of comparability
In addition, in the case of a business combination, the proposal will undermine comparability of financial statements. Let's take the following example.

> Entity A uses the fair value model for measuring its investment properties. Entity B uses the cost model. They plan to acquire a business for CU 100. This business includes investment property for a cost of CU 30. Cumulative depreciation for tax purpose is CU 10. During the purchase accounting, either entity A or B revalues the asset at CU 50. Either entity A or B intends to hold this asset both for rental revenues and capital appreciation. If the asset is sold for more than cost, the cumulative tax depreciation of 10 will be included in taxable income but sale proceeds in excess of cost will not be taxable. The tax rate is 40%.
>
> If A acquires this business, the deferred tax liability, in accordance with this ED, will amount to 10*40%= 4
>
> If B acquires this business, the deferred tax liability will amount to 30*20%= 6
>
> (20% is a blended tax that incorporates both the tax rate applicable during the depreciable period and the rate applicable when property is sold)

Since the two entities expect to use the asset in the same way, we can not find any rationale to justify a different measurement of this deferred tax liability. We believe this example shows that the proposals will not improve comparability.

Recommendation

We recommend that the Board should not amend the core principles in IAS 12. Rather, we would welcome additional application guidance. Moreover, the Board should not make the deferred tax measurement depend on any accounting method chosen by the entity to measure its assets.

We also suggest the Board to analyse the following alternative approach. It can be summarised in five points:

1. **To keep the principle in IAS 12 of taking into account management intent when measuring the deferred tax asset or liability.**

2. **To specify as application guidance that, in case of dual intent for recovering the carrying amount of an asset, the entity should determine and measure deferred tax based on the principal manner in which the entity intends to recover the carrying value of the asset.**

3. **To specify as application guidance that, for non depreciable assets, the entity should retain a presumption that the carrying amount will be recovered through sale.**

4. **To apply this application guidance to each asset, regardless of the measurement method used to account for these assets.**

5. **To illustrate these points through detailed examples.**

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?

For the reasons discussed above, we disagree with the scope of the proposed exception. In particular, we strongly believe that an accounting method should not be seen as a presumption of the intent of an entity.

Should the Board decide to pursue introducing an exception to principles in IAS 12, we recommend that this exception should be restricted only to investment property in order to answer practical issues encountered in some jurisdictions.

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 do not agree with the rebuttable presumption that the carrying amount of the underlying asset will be recovered entirely through sale when the exception applies. As currently drafted, we believe that this exception will have the two following drawbacks: an unbalanced cost/benefit ratio and a lower relevance of financial statements.

Unbalanced cost/benefit ratio

To our knowledge, some preparers of financial statements facing different tax consequences depending on the manner of recovering an asset have not encountered any significant issue on the application of the paragraph 51 of IAS 12 in case of dual intent. For these entities, the application of the proposals will increase the documentation requirements and the related costs for income tax accounting. In particular, we fear that the wording of the proposed paragraph 51B ("if an entity has clear evidence...") will reverse the onus of proof to entities that have no significant issue on this area. As a consequence, we believe that for these entities, the burden of preparing financial statements will be increased with no foreseen benefits.

Lower relevance of financial statements

In addition, we find it will be impossible for these entities to rebut the proposed presumption when they expect to recover an asset mainly (but not entirely) through use. In this case, an entity will have to measure deferred tax assets or liabilities by applying the presumption that its carrying value will be recovered entirely through sale. Not only will this approach provide irrelevant information to users, but it will deteriorate the quality of financial information.

<u>Recommendation</u>
We suggest that the Board should consider the alternative approach detailed in our answer to question 1. Should the Board decide to keep introducing its exception to the principles in IAS 12, we recommend that the proposed paragraph 51B should be re-drafted in order to let more autonomy for preparers of financial statements to rebut this presumption.

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?

Should the Board decide to introduce this exception to the principles in IAS 12, we agree with its application to be retrospective.

Question 5 – Other comments

Do you have any other comments on the proposals?

We believe that this project should address the "single asset entity" issues since we feel that the two topics are linked.