Exposure Draft Income Tax

Dear Sir / Madam,

Mazars welcomes the opportunity to comment on the Exposure Draft Income Tax. Our general comments are given below. Detailed responses to the specific questions included in the Exposure Draft are attached to this letter.

We appreciate the efforts made by the IASB to address some tax accounting issues that have arisen during the last decade. We also support the project’s objective to “achieve a clearer, more principle-based standard that will make the accounting requirements on income tax easier to understand and apply and will also result in more consistent reporting” (Sir David Tweedie).

Nevertheless, it appears to us that the Board has failed to achieve this objective. We believe that the proposals, as drafted, do not represent an improvement to existing IFRSs. Worse, we believe it makes income tax accounting more complex and rule-based.

Our main concerns are the following:

- We feel that the needs of the financial statements users and preparers have not been taken into account. Once again, the issue seems to have been reduced to the need to remove exceptions from IFRSs in order to achieve convergence with US GAAP, without any cost / benefit analysis.
For example, the removal of the initial recognition exception leads to complex accounting, while, in most cases, the result is the same as in IAS 12.

Regarding intraperiod tax allocation, the proposed method is rule-based, can be difficult to use and can give counter-intuitive results. Moreover, the Exposure Draft lacks of guidance. We fear that the costs of implementing such an approach will outweigh the benefits for users of financial statements.

The conclusion is the same on deferred taxes for permanently reinvested earnings of domestic subsidiaries. The proposed approach requires complex computations. Worse, the different accounting treatment between foreign subsidiaries and domestic ones will undermine comparability and deteriorate financial information.

- The Board proposes to determine the tax basis of an asset on a sale assumption. First, this definition disregards management’s intent. Thus, the entity will report deferred tax assets and liabilities that will not necessarily reflect its expected cash flows. Second, this definition is inconsistent with other parts of the Exposure Draft regarding the use of management’s intent (for instance, in determining tax rates).

- The proposed requirements will not allow the users of accounts to evaluate the expected cash flows of an uncertain tax position. Indeed, the way an uncertain tax position would be measured under the Exposure Draft, taking into account the probability as a measurement criterion rather than a recognition one, would lead to the recognition of liabilities measured at an amount which, by definition, would never represent the actual outflow of resources to settle the obligation. Therefore, the proposals could lead to deterioration in the quality of financial statements.

- The Board failed to cover certain controversial issues such as discounting or accounting for investment tax credit.

As a consequence, we recommend that the Board reconsiders its approach and splits the 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. The project would have to consider an income tax financial reporting based on principles, rather than being bound by existing requirements.

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

Yours sincerely,

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Head of Financial Reporting Technical Support
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?

We disagree with the proposed definition of a tax basis for the following reasons. First, we consider that the Board arguments are not sufficient to justify this change to IAS 12. Besides, there are inconsistencies in the Exposure Draft regarding the use of management’s expectations. But above all, this proposal fails to improve financial information.

Lack of justification of the new definition of a tax basis
The Board has decided to retain the definition used in US GAAP for the sake of convergence and to simplify problems arising in practice in determining the tax basis of an asset when there are different tax consequences of selling the asset and using the asset. We support the convergence efforts as long as they lead to the improvement of both sets of standards. But we consider that convergence should not, by itself, justify a change to the tax basis definition. Moreover, there is no explicit definition of a tax basis in FAS 109. Therefore, it seems odd to retain a definition that is only a practice. We also fear that the proposals may not be fully convergent with US GAAP.
The Board has also decided that the tax basis should not depend on management’s expectations in order to solve problems arising in practice in determining the tax basis of an asset when there are different tax consequences of selling the asset and using the asset. As a consequence, the Board proposes that the tax basis shall be determined on a sale assumption. Except for simplification purposes, we do not see any reasons to choose the sale assumption. In particular, we do not understand why the Board has decided to disregard the going concern principle in determining the tax basis.

Inconsistent use of management’s expectations
We are also concerned with the inconsistent use of management’s expectations in the Exposure Draft.
Management’s intent is taken into account in the following cases:
* In determining the assets and liabilities for which the recovery or settlement is not expected to affect taxable profit; in this initial step, there is no sale assumption to determine if the asset will affect taxable profit.
* In assessing whether a deferred tax asset or liability should be recognised for temporary differences arising from an investment in a foreign subsidiary or a foreign joint venture; in that case, no deferred tax should be recognised if the investment is essentially permanent in duration and if it is apparent that the temporary difference will not reverse in the foreseeable future.

* In determining tax effects on distributions; the Exposure Draft requires that the entity uses the rate it expects to apply when the tax asset or liability is realised or settled, including the effect of the entity’s expectation of future distributions.

* In determining the tax rate applicable if there is a difference between the deductions available on the sale of the asset and the use of the asset; in that case, the entity shall use the tax rate that is applicable to the sale.

* In determining the tax rate applicable if the same deduction is available on the sale or use of the asset; in that case, the entity shall use the tax rate that is applicable depending on how the entity expects to recover or settle the carrying amount of its asset or liability.

However, management’s intent is not taken into account in the following cases:

* In determining tax basis.

* In assessing whether a deferred tax asset or liability should be recognised for temporary differences arising from an investment in a domestic subsidiary or joint venture; in that case, a deferred tax asset or liability should be recognised for all temporary differences, disregarding management’s intention on the investment duration or on the reversal of temporary difference.

* In determining the tax rate applicable if there is a difference between the deductions available on the sale of the asset and the use of the asset; in that case, the entity shall use the tax rate that is applicable to the sale.

As illustrated, the proposal is not consistent with other requirements of the Exposure Draft with respect to management’s intent.

No improvement of the financial information

Paragraph 1 of the Exposure Draft defines the core principle of income tax accounting: “an entity shall also recognise tax liabilities, tax assets and tax expense for deferred tax, which is tax payable or recoverable on taxable profit for future periods as a result of past transactions or events.” The key principle is to provide information on future cash flows, i.e. the payable or recoverable. In our view, taking into account the management’s intent enables the entity to report deferred tax assets and liabilities that reflect the expected cash flows of the entity. Not reflecting such information will give less useful information for users of financial statements.
Recommendation
We urge the Board to develop a definition of a tax basis that would conceptually reflect the expected cash flows. We believe that using management's intent will achieve this objective.
We also recommend the Board to clarify the accounting for deferred tax arising from equity instruments that give rise to an asset or a liability from a tax standpoint.
- For example, how to apply the proposals on the specific case of treasury shares? When applying the ED, should an entity book a deferred tax asset when acquiring treasury shares? Besides, in some countries, tax benefit is obtained on the loss in value of treasury shares. Should the entity book in that case a deferred tax liability in order to cancel this impact on income tax result?
- Besides, how to account for tax effects arising from financial instruments considered as debt from a tax standpoint but recorded in equity in accordance with IAS 32?

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 believe that the proposed definitions need to be clarified. In our view, the definition of a tax credit is open to interpretation, especially as the term “tax benefit” has not been defined. Besides, the notion of “directly related” needs to be clarified in the definition of an investment tax credit. Moreover, we regret that the Board did not take the opportunity to address accounting for investment tax credit. Therefore, investment tax credit will still be out of the scope of IAS 12 and IAS 20.
We recommend that the Board addresses this issue and clarifies the definitions of tax credit and investment tax credit.
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 are concerned with the proposed requirements on initial recognition since they are complex and they will not significantly improve the financial information. Worse, one of the main issues addressed by the Board, i.e. “single asset entity transactions” is not resolved because of lack of clarity in the ED.

IAS 12 prohibits recognition of a deferred tax liability or deferred tax asset for temporary differences that arise from the initial recognition of an asset or liability in a transaction that:

(a) is not a business combination, and
(b) at the time of the transaction affects neither accounting nor taxable profit.

The Board proposes to eliminate this exception and to account for temporary differences arising from the initial recognition of an asset or liability as follows:
(a) disaggregate assets or liability into:
   (i) an asset or liability excluding entity-specific tax effects
   (ii) any entity-specific tax advantage or disadvantage
(b) recognise the asset or the liability in accordance with IFRSs
(c) recognise any resulting deferred tax asset or liability in accordance with the new IFRS
(d) recognise any difference between the consideration paid or received and the total amount of the asset / liability acquired as a premium or discount of the deferred tax asset and deferred tax liability.
Complexity of the requirements
These requirements proposed by the Board are complex in practice; in particular, it will be
difficult to follow up the premium in the subsequent periods.
Besides, this complexity appears to be useless: in most cases, the result is the same in
accordance with the ED and with IAS 12.

For example, take an acquisition of an asset of 100. The maximum tax deduction available on sale for
all market participants amounts to 80. The tax rate is 40%. In that example, the tax base amounts to
80. As a consequence, there is a temporary difference of 20 at initial recognition.
According to IAS 12 requirements, no deferred tax liability is accounted for. According to the ED
proposals, a deferred tax liability of 8 is booked but is offset by a premium of the same amount.
As a consequence, if there is no entity specific tax effect, the deferred tax balance would be
zero. The proposed method also creates a premium that is an anomaly under the
temporary approach, not justified by the Framework.

Lack of clarity
We understand that one of the objectives of the elimination of the exception on initial
recognition is to solve issues related to "single asset entity transactions" that are not part of
a business combination. But the proposal does not address the issue in practice because of
lack of clarity. The Board uses the notion of "entity specific tax advantage" but does not
provide much guidance on it. It is not clear whether it includes single asset entity
transaction or unique tax status of the entity. If this proposal does not address this issue,
our concern will be that, under revised IFRS 3, the difference between a business
combination and an asset purchase might be very slight and the difference in accounting
for tax effects might be huge.
It is also not clear whether it includes only specific advantage negotiated with the tax
authorities.

Recommendation
We recommend that the Board keeps the IAS 12 general exception to account for
temporary differences arising from the initial recognition of an asset or liability. But
we propose that the Board deals specifically with "single assets entity transactions" to
define an adequate accounting that will be consistent with the Framework and other
IFRSs.
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 BC59–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 proposed requirements removing the exception to the temporary difference approach on investments in associates and on investments in domestic subsidiaries, branches and joint ventures. We believe that this proposal is not consistent between domestic and foreign entities and between subsidiaries and associates.

Complexity of the proposal
In practice, the calculation of the amount of deferred taxes for permanently reinvested unremitted earnings of foreign subsidiaries, branches, joint ventures and associates is often complex.

Inconsistency of the proposal
The Board has retained this argument but only for foreign subsidiaries and joint ventures. We believe that calculation of the amount of such deferred taxes may also be complex for domestic subsidiaries and joint ventures. We also find the proposal inconsistent between subsidiaries, joint ventures and associates. There is no conceptual justification for a different approach. In practice, groups often calculate such deferred tax but there are cases where the entity can control the reversal of
the temporary difference of an associate. For example, if the entity has a right of veto on distribution of earnings of the associate, it controls the reversal of a difference. In that case, the temporary differences on unremitting earning should be the same as for controlled subsidiaries.

Recommendation
We recommend that the Board keeps the exception to the temporary difference approach for associates and domestic investments in subsidiaries, branches and joint ventures.

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 agree with the proposal which will improve traceability on unrecognised deferred tax assets and will provide better information for financial statements users. However, the Framework requires the following recognition criteria to be met prior to the initial recognition of an element (including an asset) in the financial statements: “[...] it is probable that any future economic benefit associated with the item will flow to or from the entity [...]” (paragraph 83 of the Framework). We believe that a deferred tax asset that needs a valuation allowance on initial recognition will not meet this definition. We nevertheless encourage the Board to give priority on improving financial reporting rather than articulating the valuation allowance approach with the recognition criteria established within the Framework.
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 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. We believe that this approach is similar to the existing requirements of IAS 12.

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**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?*

We agree with the proposed guidance.

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**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 proposed guidance. We find it useful, even if further clarification is needed. We are nevertheless concerned that this approach may be inconsistent with other IFRSs or IFRICs.

Indeed, we are concerned with the following contradictions or inconsistencies with other IFRSs/IFRICs:
- Voluntary change in tax status is only recognised either on the approval date or the filing date. The effect of a tax strategy, on the other hand, may be anticipated for the
purposes of determining a valuation allowance (see B17 and 18). The ED seems to maintain this inconsistency which already exists between SIC 25 and the current version of IAS 12.

- The concept in paragraph B18 of the ED appears to contradict similar concepts contained elsewhere in the IFRS. For example, in IAS 36 paragraph 44 prohibits to include a future restructuring to which an entity is not yet committed to estimate future cash flows of an asset.

Recommendation
We advise the Board to resolve the above-mentioned inconsistencies. We also recommend the Board to clearly state that expected costs should be deducted from the amount of the deferred tax asset that would be realised by the tax strategy. We also ask the Board to define the costs that can be taken into account.

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 there is a need for guidance on uncertain tax position since IAS 12 is silent on the issue. We also agree with the need of consistency between IAS 37 project and the ED. However, consistently with our comment letter on the IAS 37 project, we disagree with the proposed measurement of tax uncertainties because the financial information produced would be irrelevant and unreliable.

Irrelevant information
The proposed approach seems to be in contradiction with the definition of a liability given by the Framework: “a present obligation [...] arising from past events, the settlement of which is expected to result in an outflow [...] of resources [...]” which, in our opinion, presumes that an outflow of resources will be probable.

The proposed approach would lead to the recognition of an important number of liabilities that are not likely to result in an outflow of resources for the entity. Thus, the financial information produced would be useless and irrelevant. For instance, an
obligation for which there is 90% of chances to pay nothing and 10% to pay 100 would give place to a liability of 10, although the entity does not expect to pay anything.

The way a liability would be measured under the ED, as drafted, taking into account the probability as a measurement criterion rather than a recognition one, would lead to the recognition of liabilities measured at an amount which, by definition, would never represent the actual outflow of resources to settle the obligation. This situation would result in the first objective of financial statements described in the Framework being missed. Indeed, it would not allow the users of the accounts to evaluate the ability of the entity to generate future cash flows.

**Unreliable information**
Moreover, we believe that an approach in which multiple cash flow scenarios are weighted by their respective probabilities would be unable to give reliable and relevant information:

- It is difficult to obtain from a lawyer an estimate of the most likely risk. Therefore, how will it be possible to get external evidence of weighted expected cash flows?
- How will it be possible to reach the objective of both reliable and verifiable information?

**Recommendation**
We are therefore in favour of recognising and measuring uncertain tax position with the existing rules of IAS 37, which have proven to provide efficient reporting for non-tax risks.

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**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. Nevertheless, the Board provides guidance in the BC on how to apply this principle in the US context. We consider that this reference is not appropriate in an International Financial Reporting Standard.
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, i.e. 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 do not agree with the proposals. Please refer to our comments in Question 1. We believe that both the tax rates and tax basis used to determine a deferred tax asset or liability relating to a specific item should be consistent with the expected way of recovering that item. This proposal in the ED further confirms our statement in Question 1: the financial information produced through the proposed approach will be neither accurate nor useful to users of financial statements.

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 agree with the proposals which take into account management’s expectations. Please also to refer to our comments in question 1.
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 have not identified any issue related to tax deductions that do not form part of a tax basis. However, the ED does not provide us with enough guidance on defining those special deductions.

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 proposal that an entity should consider any interaction between tax systems when measuring deferred tax assets and liabilities. It is necessary to take into account this interaction to address specific issues related to alternative minimum taxation. Applying this requirement is a question of judgement, because of the various tax systems that may interact.
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 adapting 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?

We consider that there are two different issues: the allocation of tax expense in respect of current year operations and the allocation of tax in respect of prior year operations.

A) Allocation of tax expense in respect of current year operations

We disagree with the proposals on the allocation of tax expense in respect of current year operations because it is a very rule-based and complex method.

Rule-based method
A goal of the IASB—a goal shared by their constituents—is for their standards to be clearly based on consistent principles. We support this goal. Therefore, we consider that introducing some rule-based method to allocate deferred tax is not consistent with this objective.

Moreover, the Board does not justify the method adopted, except by US GAAP convergence. The key principle of the proposed method is not explained. As a consequence, preparers of financial statements will have to apply a rule that they do not understand from a conceptual standpoint. This makes the proposal even more complex.
**Complex method**
The Board admits that SFAS 109 requirements are complex, can be difficult to use and can give counter-intuitive results. Our experience on application of the US GAAP allocation method confirms this analysis. Moreover, the Exposure Draft lacks of guidance. For instance, the example 20 does not illustrate the paragraph 34 (c) in case there are both loss components and gains components. The Board should provide additional examples in order to cover all critical cases an entity can encounter.

Regarding the complexity of this method, we believe that the costs of this proposal may outweigh its expected benefits.

**Recommendation**
As a consequence, we propose that the Board adopts one of the following approaches:
- Either not to require a single allocation method, but to require the allocation method to be systematic, rational and consistent with the Board principles established by the standard. An example of such method is the US method but other methods can be used
- Or to develop principles of allocating the tax expense.

Should the Board decide to maintain its proposal, we recommend developing additional guidance and examples to apply this method.

**B) Allocation of tax in respect of prior year operations**

We disagree with the proposals on the allocation of tax expense in respect of prior year operations because it is not justified conceptually.

The reasons for prohibiting the backwards tracing method are the following:
- Applying this method is very difficult
- Prohibiting it will enable convergence with US GAAP.

We do not agree with these arguments. In most cases, the backwards tracing is possible and can be done without increasing costs.

Besides, even in the US, the prohibition of this method is controversial. In 1997, the FASB developed a draft approach for allocating the tax effects of change in tax rate, etc. to all equity items. In response to circulation of the draft approach, the FASB received 28 comment letters, with 21 respondents indicating they believed the draft approach was a workable approach.

Moreover, we believe that, in some cases, prohibiting backwards tracing will lead to counter-intuitive results.

For example, at the end of the previous period, the entity considered that the acceptance by the tax authorities of a tax benefit of 100 related to a transaction recognised in equity was highly uncertain. It did not therefore recognise the tax benefit. In the current year, the entity believes that, in line with new regulation, the tax authorities may accept the tax benefit. Under the current IAS 12 standard,
the tax benefit is recognised in the current year directly in equity. According to the exposure-draft, the tax benefit must be recognised in the current period in the income from continuing operations.

The most compelling proof is that the Board provides for two exceptions:
- In the case of transactions with equity holders recognised in equity, the valuation allowance related to deferred tax assets is recognised in equity.
- If income in the current year causes a reduction in the valuation allowance, the tax effect is allocated to the component in which the income is recognised.

**Recommendation**
Therefore, we recommend that the Board performs an in-depth analysis of the situations where backwards tracing should be maintained. In particular, we encourage the Board to distinguish the change in valuation allowance or in tax uncertainty from a change in tax rate.

**Question 13B**

*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.*

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 lacks of guidance on the proposed intraperiod tax allocation method. Moreover, the example 20 does not illustrate the paragraph 34 (c) in case there are both loss components and gains components. As a consequence, we are not able to conclude on whether those paragraphs produce results that are materially different from those produced under SFAS 109 requirements.
Question 13C

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.)

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?

Please refer to our answer to question 13A.

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?

Please refer to our answer to question 13A.

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 do not agree with the proposal 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.

This requirement mainly addresses issues related to separate financial statements. We consider that any allocation should be consistent with the legal obligation of each entity in
a group that files a consolidated tax return. In practice, tax consolidation agreements are often signed between the entity and its mother to define obligations of each party, e.g.:
- Which entity has to pay the income tax to the state?
- Which entity can use the tax losses?
As a consequence, applying the proposals may not be consistent with legal documentation and provide inaccurate separate financial information on the entity.

**Recommendation**
We recommend that the Board proposes a methodology consistent with legal or contractual obligations of entities in a group that files a consolidated tax return.

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**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 agree with the proposal to classify deferred tax assets and liabilities as current or non-current, based on the financial statements classification of the related non-tax asset or liability. We consider that this proposal is not consistent with the definition of current / non-current in IAS 1 or with the proposal of the DP Financial statements presentation.

On one side, IAS 1 provides a current/non-current distinction based on when the asset or liability will be recovered or settled. This principle is not retained in the ED. For example, according to the ED, any deferred tax liability of a fixed asset will be classified as non current even if the temporary difference is expected to reverse in no more than twelve month. On the other side, the DP financial statements presentation proposes to present all tax assets and liabilities in a single section of the statement of financial position.

**Recommendation**
We recommend that the Board maintains the existing requirement and waits for the end of the financial statements project in order to propose a consistent approach.
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 do not agree with the proposals. We believe that entities should classify their interest and penalty payments based on how the payments arose, which will result in presentation of the payments based on their substance, rather than on their legal form.

For example, if an entity was overdue in paying their income taxes either intentionally or due to a lack of funds, we suggest that the interest and penalties should be reflected as finance charges in the income statement, as the entity has effectively utilised the Tax Authority in its financing strategy. However, if these fees were incurred negligently, or in a dispute with the Tax Authority, the fees are, in substance, a taxation charge and we think that they should be included in the taxation line item. Furthermore, we believe that the allowance of choices undermines the principle of comparability contained in the Framework.

Recommendation
We recommend that the Board proposes that entities should classify their interest and penalty payments based on how the payments arose.
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 proposals except on the following:
- Eliminating the option available under IAS 12 of aggregating separate reconciliations using the domestic rate in each individual jurisdiction.
- Information on uncertain tax positions

1. Eliminating the option available under IAS 12 of aggregating separate reconciliations using the domestic rate in each individual jurisdiction.

The Board proposes to amend the requirement for an explanation of the relationship between tax expense and accounting profit. It suggests eliminating the option of aggregating separate reconciliations using the domestic rate in each individual jurisdiction. Instead, the ED proposes to use the domestic rate in the parent company jurisdiction in all cases. We do not agree with the elimination of this option. We believe that in some cases, especially when the mother of a group is located in a different entity from all other subsidiaries, the tax rate used in the tax proof will not be useful. As a consequence, we recommend that the Board keeps the existing disclosure requirement.

2. Information on uncertain tax positions

The ED proposes to add disclosure requirements on the separate effect of the possible outcomes of a review by the tax authorities, i.e. the uncertain tax positions. We agree that some disclosures may be necessary on uncertain tax positions. But we recommend that the Board includes the same limitation as in IAS 37 paragraph 92 in order to exempt entities to provide this information in case this information can be expected to prejudice seriously the position of the entity vis-à-vis the tax authorities.
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 understand that the Board proposes a limited retrospective application of the new standard. We agree with this proposal.