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www.drsc.de - info@drsc.de

DSR – öffentliche SITZUNGSUNTERLAGE

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TOP:	**132_02 – ED Income Tax**
Thema:	**Erster Entwurf der Stellungnahme**
Papier:	**132_02a_ED_Income Tax_Stellungnahme_Draft**

DRSC e. V. • Zimmerstr. 30 • 10969 Berlin

Telefon +49 (0)30 206412-12
Telefax +49 (0)30 206412-15
E-Mail info@drsc.de

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

United Kingdom

Berlin, 31. July 2009

Dear David,

Exposure Draft ED/2009/02 'Income Tax'

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the IASB Exposure Draft ED/2009/02 'Income Tax' (herein referred to as 'the ED'). We appreciate the opportunity to comment on the Exposure Draft.

The GASB welcomes the completion of the short-term convergence project on 'income taxes'. Although we have different views in some points, we believe that the new regulations of ED/2009/2 are a considerable improvement of IAS 12 in terms of the criteria we took into account in our commentary of the individual questions. The significantly extended guidance on accounting for income taxes compared to the present IAS 12 will ease the application of ED/2009/2 for IFRS preparers.

Besides eliminating exceptions, the objective of the short-term convergence project on income taxes was to adapt IAS 12 and FAS 109 in a way that the regulations correspond as far as possible. During the course of the convergence project it became clear that regulations on income taxes are dependent on the developments of a number of other standards which should be in line with the accounting treatment of income taxes (e.g. IAS 37 R). As long as these standards are not convergent, complete convergence will not be possible in the area of income taxes

Due to the FASB not intending to pursue the idea of a separate standard on accounting for income taxes in the USA, convergence is no longer the primary objective for issuing ED/2009/2. Our understanding is that the IASB and the FASB intended to create a new principle-based regulation by issuing ED/2009/2. In our opinion, further aims of the new standard's draft are feasibility, simplification and the reduction of complexity.

That is why we took in particular the following criteria into account in our commentary of the individual questions:

- Elimination of exceptions
- Reduction of complexity and simplification in comparison to present regulations in IAS 12
- Consistency in two aspects:
    1) Consistency in regards to other accounting standards
    2) Consistency in regards to the assumptions within ED/2009/2 (e.g. the definition of the tax basis)
- Investors' decision usefulness of disclosures

Please find our detailed comments on the questions raised in the ED in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

Appendix 1

GASB comments on the questions set out on the IASB's Exposure Draft ED/2009/02
'Income Tax'

> **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.)
>
> Do you agree with the proposals? Why or why not?

We basically support the Board's attempt in paragraph 14 to remove management's intention from the calculation of the tax basis, once the initial threshold for recognising deferred tax assets and liabilities in paragraphs 5(b), 10 had been established, because the rule is clearer and more specific than the existing guidance. We basically agree with the proposals, but we see the necessity to allow for other ways of recovering an asset in limited circumstances.

We support the Board's proposal in paragraph 14 to remove management's intention from the calculation of the tax basis, once the initial threshold for recognising deferred tax assets and liabilities in paragraphs 5(b), 10 had been established, because the rule is clearer and more specific than the existing guidance.

It may however occasionally not faithfully represent the financial position as 'recovery' by sale or use is not consistently used throughout the exposure draft in paragraphs 10-13, 15, 19 and B29. We feel that the current proposal should be a starting point for determining the tax basis, and in order to keep the deferred tax balances relevant and reliable, it might be helpful if the Board would consider some element of flexibility in the standard if the result of the determination, in particular in accordance with paragraph 15(a), would give rise to an amount that does not faithfully represent the financial position. It may be useful to add a sentence to paragraph 15(a) which could read as follows: 'If the determination of the tax basis gives rise to an amount that does not faithfully represent the financial position in limited circumstances it might be appropriate to determine the tax basis of an asset if recovered through use rather than through sale.'

Further, we would like the Board to consider removing the word 'present' from paragraph 5(b). This implies settlement at the balance sheet date which slightly contradicts the expected manner of recovery. Tax consequences of the recovery or settlement of assets and liabilities at the balance sheet date could be different to the tax consequences of recovering or settling the asset or liability in a future period.

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.)

Do you agree with the proposed definitions? Why or why not?

We support the definition of a tax credit and an investment tax credit, as both were not in the scope of any standard. But we would welcome a consideration of the accounting for tax credits and tax deductions. This would eliminate some divergence that currently exists in practice.

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.)

Do you agree with the proposals? Why or why not?

Basically we support the attempt to eliminate exception rules. Nevertheless we would like to point out the fact that so far no definition of entity-specific tax advantage or disadvantage exists. This may lead to difficulties concerning practical application and to different interpretations by the preparers.

Besides, the proposed new rule does not achieve convergence between IFRS and US GAAP, due to the fact, that EITF Issue 98-11 Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combinations still has to be applied. Therefore, we would propose to take over the rules laid down in EITF Issue 98-11 into IFRS, preferably with additional rules for specific issues like leasing where classification may lead to disparities between IFRS and taxes. In cases with a substantive difference between the carrying amount and the tax basis, we would suggest that for simplification purposes the deferred tax liability is dissolved directly into the P&L. Thus, the Board's concerns about the recognition of a deferred credit that does not represent a liability, but results from a computational requirement, can be mitigated.

Furthermore, we agree with the retention of the exception for the initial recognition of goodwill. Nevertheless, we do not understand the reason for the omission of deferred tax assets in this exemption rule. Therefore, we suggest that an entity shall neither recognise a deferred tax liability nor a deferred tax asset that arises on the initial recognition of goodwill.

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 do not agree with the proposals of the Board. We do so as we acknowledge that an exception in the case of outside basis differences lacks an underlying conceptual basis. Thus, we consider the omission of the existing exception to be reasonable and in line with the Board's objective to eliminate exceptions.

In our opinion a revision limited to foreign subsidiaries and joint ventures cannot be sustained conceptually. This is based on the complexity of a reliable computation of tax effects in certain countries. Moreover, these effects often differ in regards to their taxability, tax type and tax rates, depending on how a reversal is achieved (disposal, distribution, liquidation or merger). We agree that the measurement of these tax effects is complex in any case (domestic and foreign) and cannot be justified from an economic viewpoint. Thus, we regard an exception that comprises domestic as well as foreign entities and corresponds to the current standard IAS 12 to be reasonable.

We would like to address our concerns regarding the revised criteria of the exception stated in paragraph B5, as the adoption of the term ‘essentially permanent in duration’ introduces an undefined time concept from FAS 109 that will lead to arguments in practice. On the other hand, IAS 12.39's phrasing, ‘is able to control

[…]', applies a criterion already known from IAS 27, whose existence needs to be verified within the preparation of consolidated financial statements anyhow. Thus, the proposed revision will presumably result in increased complexity and extended room for interpretations.

Furthermore, we consider an editorial clarification that outside basis differences can be partially permanent and partially temporary to be reasonable (e.g. current gains are distributed; the remaining difference remains essentially permanent in duration).

In this context the following question arises: According to section 15, the tax basis of an investment shall be determined based on the assumed sale of the asset. If the expected manner in which the asset will be recovered does not result in an increase of taxable income, section 11 prescribes that deferred taxes are not to be recognized. How does an entity need to prove the intended manner in which the asset will be recovered? Do the general requirements of the proposal to determine temporary differences (section 10-13) apply or the more demanding criteria of section B6 (specific plans, definitive future programmes)?

Regarding the second criteria in section B5 b) the wording 'it is apparent […]' introduces a term that has not been included in the IAS framework so far. From our point of view it remains unclear if 'apparent' requires a higher level of certainty than the previously used term 'probable' in IAS 12.39 b). Generally the question arises if it can possibly occur that the first criterion of B5 is met, but not the second. In IAS 12, however, both criteria complemented one another.

Yet we appreciate that the criteria shall apply for taxable temporary differences as well as deductible temporary differences in the future.

Regarding measurement we agree to remove IAS 12.42 which prescribes that in the presence of difficulties determining the amount of tax payable, the minimum amount it will equal or exceed is to be recognised. This measurement criterion does not correspond to IAS 12 or to any other IAS, especially IAS 37.

In addition to this we would welcome more detailed guidance regarding the definition of the term 'carrying value'. On the one hand this pertains to goodwill, which unquestionably forms part of the carrying value. In practice it tends to be difficult to reliably allocate goodwill to a corresponding tax basis as soon as a cash generating unit comprises more than one independent legal entity. A modified allocation that might arise if a rearrangement of segments is required in accordance with IAS 36, however, can have significant tax consequences.

Furthermore, it remains questionable if all consolidation activities have to be considered in order to determine the carrying value. This particularly relates to the elimination of liabilities and intercompany profits that decrease the carrying value of a subsidiary, but (except in the case of consolidated tax returns) do not affect the tax basis. Thus, they fulfil the criteria of assets and liabilities that are not recognized within a financial statement but have a tax basis and therefore give rise to deferred taxes in accordance with section 16. However, if the subsidiary was disposed, these items would not be eliminated by a third party and thus would have an impact on the selling price. Consequently, there is no justifiable reason to recognise deferred taxes.

Finally, we do not consider it to be necessary that entities have to disclose the amount of temporary differences in accordance with section 48 within the notes even if they fulfil the exception. Ultimately, this would not only require entities to determine an amount that can be estimated at best, but it would also not convey the uncertainties attached to this amount to the readers of financial statements. Instead of disclosing a single amount of temporary difference, we would welcome and regard the disclosure of the gross amount of retained earnings (and other triggers of OBD) to be more reasonable. This should be combined with a qualitative assertion of the extent of actual taxation arising from repatriation.

Question 5 - Valuation allowances

The exposure draft proposes a change to the approach to the recognition of deferred tax assets. IAS 12 requires a one-step recognition approach of recognising a deferred tax asset to the extent that its realisation is probable. The exposure draft proposes instead that deferred tax assets should be recognised in full and an offsetting valuation allowance recognised so that the net carrying amount equals the highest amount that is more likely than not to be realisable against taxable profit. (See paragraphs BC52–BC55 of the Basis for Conclusions.)

Question 5A

Do you agree with the recognition of a deferred tax asset in full and an offsetting valuation allowance? Why or why not?

We support the two-step impairment approach for the recognition of deferred tax assets as included in current SFAS 109, i.e. recognition of all deferred tax assets and recognition of a valuation allowance (impairment) to the extent that the deferred tax assets will not be realisable against taxable profit. This procedure would also be consistent with the recognition and measurement requirements in other existing IFRSs/IASs, e.g. IAS 16 regarding accounting for property, plant and equipment or IFRS 3/IAS 36 regarding accounting for goodwill.

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 recognized should be the highest amount that is more likely than not to be realizable against future taxable profit. In our view, the criterion ‘more likely than not’ is more precise than the term ‘probable” used in current IAS 12 and therefore reduces existing judgement and improves comparability of IFRS financial statements.

BC 54 mentions that in some jurisdictions that currently apply IFRSs, the term ‘probable’ is currently understood to denote a higher likelihood than the term ‘more likely than not’. The final IFRS should clarify in its transitional provisions, whether necessary adjustments due to the first-time adoption of the ‘more likely than not’ criterion should be treated in accordance with the requirements in IAS 8 as a change in accounting policies, as a change in accounting estimates or as a correction of an error.

Regarding a current/non-current classification of valuation allowances, please also refer to our answer to Question 15.

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 support the incorporation of guidance from SFAS 109 on assessing the need for a valuation allowance. The guidance on the realisability of deferred tax assets included in B16 to B19 of ED/2009/2 is comprehensive and appropriate.

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 support the described addition. However, we recommend clarifying whether or to what extent internal cost of implementing a tax strategy to realise a deferred tax asset should be included.

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.)

Do you agree with the proposals? Why or why not?

We disagree with the proposals as explained further below. However, IAS 12 is silent on the treatment of uncertainty of tax positions wherefore. Therefore, we appreciate that the Board focuses on this issue and proposes rules in the ED concerning the accounting for tax uncertainties. Nevertheless, we disagree with proposed amendments regarding the measurement and explicate our reasons in the following sections.

According to the measurement requirements in paragraph 26 of the ED, tax uncertainties should be taken into account if the respective criteria are met. In contrary, no specific recognition criteria have to be met. As there is no clear distinction between recognition and measurement, the proposed rules can lead to misleading information presented in the financial statements. For example, missing recognition criteria would result in the necessity that all tax risks have to be taken into account for measurement purposes and the impact on the financials statement might be significant even if the risk is remote in case of a large assessment basis. This effect can be demonstrated if the probability of an additional economic outflow is low but the potential effect very high. In this case, it is inappropriate to recognize a liability by assigning the low probability to the high potential outflow. Assume, the probability is 5% and the possible outflow amounts to 1.000m€, what relevance has the recognition of a liability of 50 m€? The real outflow would never meet the recognised liability because it is either 0 € (more likely) or 1.000m€ (not likely). Moreover, a slight change in the probabilities has a much greater effect than if the cash flows were probable. Referring to the example above, a change of the assumed probability from 5% to 10% would lead to an increase of the recognized tax liability from 50m€ to 100 m€ and therefore results in a doubling of the tax liability. Further, it should be noted that contingencies are currently not recognised, but information in the notes are to This aspect conflicts with the fact, that contingencies are not to be recognised, but information in the notes should be disclosed. To avoid inconsistency between the ED and other standards and the framework, we suggest unambiguous recognition criteria (e.g. based on a recognition threshold).To avoid disproportionate efforts spend on items with low probability it may be helpful if the board would consider an initial recognition threshold.

In terms of the measurement of current and deferred taxes, the proposed rule requires that all possible outcomes of a tax audit should be taken into account. As described in the ED, the measurement shall be based on a probability-weighted average approach. In theory, such a measurement method can be preferable as if it is based on a sufficiently large population of outcomes which inherently assumes that the normal (Gaussian) distribution applies. Without an appropriate population the probability weighted average approach could result in a misleading amount. For tax uncertainties a large population of different outcomes might be unusual in practice. To avoid a practice of ‘working back’ from a single best estimate to a full probability-weighted calculation as required by the ED from developing in practice, it might be helpful if the standard acknowledges that in some circumstances there may only be a single best outcome which the uncertainty should be recognised at.

It considers all possible outcomes exactly and takes also into account the associated probabilities. In our view, such an approach is appropriate only to measure liabilities involving a large population of similar obligations. For single obligations, a reliable measurement will not regularly be possible when small probabilities are involved or the exposure has a binary risk structure. In these cases, the proposed measurement method can lead to misleading information. This effect can be demonstrated if the probability of an additional outflow is low but the potential effect very high. In this case, it is inappropriate to recognize a liability by assigning the low probability to the high potential outflow. Assume, the probability is 5% and the possible outflow amounts to 1.000 m€, what relevance has the recognition of a liability of 50 m€? The real outflow would never meet the recognised liability because it is either 0 € (more likely) or 1.000 m€ (not likely). Moreover, a slight change in the probabilities has a much greater effect than if the cash flows were probable. Referring to the example above, a change of the assumed probability from 5% to 10% would lead to an increase of the recognized tax liability from 50 m€ to 100 m€ and therefore results in a doubling of the tax liability.

The measurement of possible outcomes of a tax audit is very complex and the proposed probability-weighted average approach is not appropriate. As illustrated, the value measurements may be inherently unreliable and possibly highly subjective. We doubt that the information provided would be decision useful.

Instead, recognised liabilities concerning uncertainties for not finished tax audits should be measured used the best estimate of the expenditure required to settle the present obligation at the balance sheet day. We are convinced that this measurement is the most appropriate way to measure the economic substance of the underlying uncertainty of tax issues that have to be reported in the financial statements. Moreover, it is necessary to bring the tax uncertainty measurement in line with the measurement requirements concerning provisions, contingent liabilities and contingent assets proposed in the Exposure draft of proposed amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits.

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.)

Do you agree with the proposals? Why or why not?

We support the requirement for an entity to measure deferred tax assets and liabilities using the tax rates substantively enacted by the reporting date.

Nevertheless we like to stress out that we do not support the implementation of lex specialis like in B26 or BC66 of the ED. We believe that the general principle like in BC65 of the ED covers the US procedure even though.

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.)

Do you agree with the proposals? Why or why not?

We welcome the proposal in the exposure draft that the rate should be consistent with the deductions that determine the tax basis, as well as the exception to use the rate consistent with the expected manner of recovery of the asset, if the same deductions are available on sale are also available on using the asset.

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 entities past practices and expectations of future distributions. (See paragraphs BC74–BC81.)

Do you agree with the proposals? Why or why not?

We disagree with the proposal and suggest changing paragraphs B31 and B32 ED from a practical point of view as follows:

- Basic principle/regular case: The income tax effects of distributions should not be recognised before the distribution has to be shown in the financial statements as a liability.
- Option: If there is a detailed documentation and history for distribution income tax effects for current and deferred taxes should be recognised under the assumption of a distribution to the shareholders.

Especially in cases of an expected partial distribution to shareholders practical computation problems will be triggered. The application guidelines (paragraphs B31 and B32) are not clear enough and add more complexity to the process. Due to this there will be no consistent treatment.

The impact of not anticipating the effect of distributions cannot be determined for sure when taking into account <u>all</u> entities. Obviously, the situation is different for specific entities like e.g. real estate investment trusts which pursue a policy of distributing almost all of their available reserves. Nevertheless these specific entities do not represent the vast majority of preparers. Therefore from a cost-benefit view, it is not appropriate to derive a general rule from minority requirements and thus to compel all entities to provide complex documentations.

In some jurisdictions dividends will trigger refundable or payable current tax. Paragraph B31 ED requires that current tax assets and liabilities shall include the expectation of future distributions. This is not consistent with the definition of current tax assets and liabilities (paragraphs 1, 6, 7 and appendix A ED: 'Current tax: Income tax payable (refundable) in respect of the taxable profit (tax loss) for the current period or past reporting periods)'.

We are not in full agreement to disclose the entity's estimates relating to future distributions (paragraph 48(a) ED). To disclose such a sensitive planning-detail is not appropriate. Disclosure 48(a) should be deleted and the mentioned tax effects should be shown in the reconciliation (paragraph 42(a) and (b) ED). Disclosures should be similar to the existing IAS12 requirements (potential effects of distributions).

Question 11 – Deductions that do not form part of a tax basis

An entity may expect to receive tax deductions in the future that do not form part of a tax basis. SFAS 109 gives examples of 'special deductions' available in the US and requires that 'the tax benefit of special deductions ordinarily is recognized no earlier than the year in which those special deductions are deductible on the tax return'. SFAS 109 is silent on the treatment of other deductions that do not form part of a tax basis.

IAS 12 is silent on the treatment of tax deductions that do not form part of a tax basis and the exposure draft proposes no change. (See paragraphs BC82–BC88 of the Basis for Conclusions.)

Do you agree that the exposure draft should be silent on the treatment of tax deductions that do not form part of a tax basis? If not, what requirements do you propose, and why?

We agree that the exposure draft should be silent on the treatment of tax deductions that do not form part of a tax basis. There is no need for a certain rule for 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 that an entity should 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.)

13A: Do you agree with the proposed approach? Why or why not?

We do not agree with the proposed approach over all. Although we support the Board’s initiative and welcome the convergence, as articulated in our previous correspondence to the Chairman of the IASB dated October 20, 2005 (Appendix 3), we would like to confirm our serious concerns with respect to the IASB and FASB’s decision to amend IAS 12 to adopt the FAS 109 requirements for purposes of accounting for the allocation of tax to components of comprehensive income and equity.

We continue to consider the current IAS 12 guidance of recognising the effects of tax changes in the income statement except to the extent that they relate to items previously recorded in equity to be both conceptually superior to the FAS 109 approach and, all aspects considered, easier to apply. We therefore strongly recommend adopting the alternative approach of allocation of tax to comprehensive income and equity that the Board proposes not to adopt.

As discussed further in question 13C below, the application of the proposed accounting requirement produces misleading and illogical results in the financial statements, especially as it relates to securities available for sale.

Our discussions below also detail the accounting treatment currently followed by constituents. Hopefully this will remove uncertainty as to how constituents are applying the existing IAS 12 guidance.

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.

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.)

Following our proposal set out in the previous paragraph, a detailed assessment of any potential differences has not been performed.

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?

In our view, the alternative approach will provide more useful information. It complies with the temporary approach not only as on the first time recognition but also in subsequent periods. Therefore, it leads to more intuitive results. The alternative approach, similar to the proposed approach, does not completely eliminate arbitrary results. Nevertheless, we consider applying a pro rata or other appropriate method in cases where ‘backwards tracing’ is not practicable, a reasonable approach which makes it possible to allocate tax expense in a way consistent with the applicable tax jurisdiction.

Similar to the Board’s acknowledgement in the basis for conclusions that in some situations backwards tracing seems the obvious treatment and prohibiting it seems to produce counter-intuitive results, in support of our request we provide the following arguments and comments that supports the alternative approach suggested in the exposure draft:

(1) The proposed approach distorts, in the period of the tax change, the income tax expense reported in the income statement for changes in other comprehensive income (OCI) deferred taxes on gains and losses that were never recognised in net income, which produces an illogical result in both net income for the period of the tax change and retained earnings. This does not appropriately reflect the economic substance of a tax change;

(2) Consequently, this approach leaves the tranche of OCI deferred taxes accrued immediately preceding the tax change fixed until the securities are sold, at which point the underlying gains or losses may or may not exist anymore;

(3) The proposed approach results in an economic misstatement of OCI from the date of the tax change;

(4) The allocation of tax changes to income and equity as provided by IAS 12 does not impose additional record keeping requirements. This allocation merely requires an entity to collect and keep track of information that it is already required to disclose under FAS 130.25 and IAS 1.90; allocation should therefore not pose any practical problems. In contrast with the alternative approach, the proposed approach requires additional

recordkeeping in a separate tranche for OCI deferred taxes on the unrealized gains and losses subsequent to the tax change;

(5) The proposed approach misstates income statements for the subsequent periods when the gain or loss on the underlying transaction is realised by including income tax expense different from the actual tax expense on the gain or loss recognized in net income for the period; in some cases, recording income tax expense when there is none in reality.

(6) The distortions and misstatements mentioned above have a direct impact on the effective tax rate in the period of the tax change and in subsequent periods when the gain or loss on the underlying transaction is realised. The effective tax rate, among other ratios, is a measure used by analysts to forecast future post tax returns.

(7) To overcome the income statement effect of the release of the tax change in subsequent periods, diversity has developed in practice due to a lack of specific guidance under FAS 109. OCI deferred taxes are released using either the 'specific identification' or the 'portfolio' approach. The latter approach defers the release until the whole portfolio is sold.

(8) The proposed approach is a rule based approach whereas the proposed alternative is more principle based.

(9) The Board does acknowledge in BC92 that it seems simpler to allocate a change in the valuation allowance relating to an item recognised outside continuing operation in a prior period, to the component of comprehensive income or equity in which the taxable gain is recognised in the current period, but this process requires detailed calculations and is considered more onerous than the efforts required under the proposed alternative. Although this may appear to be simpler to do, the often counter-intuitive results that the proposed method produces, makes analytical review of these numbers more difficult and the information about the aggregated tax effect needs to be kept for the recognition of the reversal through continuing operations. We do acknowledge that this can happen under the alternative approach, but the occurrence thereof is expected to be less frequent

(10) Under the alternative, the accounting for subsequent changes in the amounts previously recognised is simplified because it follows the original recording of the deferred taxes: for example, if the original income taxes were recorded in OCI, the change in those deferred taxes in respect of unrealized OCI gains and losses is recorded as an adjustment of the original OCI deferred taxes. The effect of the subsequent changes is not reflected in the income statement until the underlying items are realised in the income statement. When the underlying items affected by the subsequent change are realised, the gain or loss is tax effected in the income statement at the then current tax rate.

(11) The Board noted in BC93 that in some cases, backwards tracing would be difficult, or result in arbitrary allocations. The following examples illustrate that the current IAS 12 requirement of a pro rata allocation or another method that achieves a more appropriate allocation in the circumstances, used to allocate

taxes among categories within comprehensive income and equity achieves relatively consistent results.

(12) In support of our proposal, we've included examples of how constituents are currently accounting for the allocation of tax related to an item that was recognised outside continuing operations in a prior year, under IFRS. These are supplemented with numerical examples in Appendix 2. We have illustrated the following examples that the Board identified as being the major difference between IAS 12 and SFAS 109 in BC90:

1. Changes in tax rates
2. Changes in the taxable status
3. Changes in assessments of recovery of deferred tax assets
4. Changes in the effect of uncertainty over the amounts reported to the tax authorities

Changes in tax rates

IAS 12 requires the allocation of a rate change outside continuing operations, which related to an item that was previously recognised outside continuing operations. IAS 1 already requires the disclosure of items recognised outside continuing operations together with their tax consequences [IAS 1.90]. The 'backward tracing' comes at no additional effort and the deferred taxes recognised on items outside continuing operations is easy to keep track of.

The rate change is allocated to deferred taxes in each component of comprehensive income and equity where the pre-tax item is recognised. These are one-time events and will be accounted as such. Recognition through continuing operations in current year, as currently proposed, requires an entity to track the amount for the recognition of the reversal in subsequent year.

Changes in the taxable status

Similarly to the accounting for changes in tax rates, the effect of the change in an entity's tax status, which relates to an item that was previously recognised outside continuing operations, is also recognised in the component of comprehensive income or equity, where the pre-tax item is recognised. Similarly to changes in tax rates, 'backward tracing' comes at no additional effort because change in tax status is a one-time event.

Changes in assessments of recovery of deferred tax assets

A valuation allowance could relate to temporary differences, operating losses carried forward or tax credits. An entity would recognise the effect of a change in the valuation allowance, in the category within comprehensive income or equity, where the pre-tax item is recognised. As mentioned in 1 above, IAS 1 already requires the disclosure of items recognised outside continuing operations together with their tax consequences and the 'backward tracing' comes at no additional effort.

If it's difficult to determine the amount of current and deferred tax that relates to items recognised outside profit and loss, a pro rata allocation or another method that achieves a more appropriate allocation in the circumstances is used to allocate taxes among categories within comprehensive income and equity.

Although the Board is of the view that there is no non-arbitrary way of allocating the benefit arising from a change in the valuation allowance, the numerical example provided in Appendix 1 example 3 illustrates an acceptable method which produces results that achieves an appropriate allocation.

Changes in the effect of uncertainty over the amounts reported to the tax authorities

Similarly to the accounting for changes in tax rates, the effect of the change in an uncertainty over an amount previously reported recognised outside continuing operations, is also recognised in the component of comprehensive income or equity, where the pre-tax item is recognised.
Regularly, tax uncertainties are under separate review by the companies. Therefore, 'backward tracing" is not expected to lead to major additional effort.

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?

The current IAS 12 acknowledges that in exceptional circumstances it may be difficult to allocate the current and deferred taxes among the categories, but allows for a pro rata or other method that achieves a more appropriate allocation in the circumstances. This requirement allows one to make an appropriate allocation when faced with that problem. This was found not to be a significant area of concern. We believe the additional guidance given will improve the consistency of the application in practice.

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 both, the accounting method and disclosures, as proposed in the exposure draft. From our perspective financial statements become more comparable as under the existing IAS 12.

But, anyway we would like to point out that push down accounting is not a general accounting principle within IFRS.

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 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 proposed current / non-current classification of deferred taxes especially due to the fact that such a classification causes, if any, only minor informational value e.g. for analysts or investors. In our view such a classification could only be justified from a conceptual point of view. Assuming that the boards approve the proposed current / non-current classification, we appreciate the simplification rule, i.e. a current / non-current classification based on the financial statement classification of related non-tax assets or liabilities.

In substance, the proposal is comprehensible by eliminating an existing inconsistency in IAS 1. Based on current IAS 1 paragraph 56 deferred tax assets and deferred tax liabilities shall be classified in total as non-current 'on the face' of the statement of financial position even if the general criteria for a non-current classification (see IAS 1 paragraphs 66 and 69) are not met; at the same time existing IAS 1 paragraph 61 indirectly stipulates a current/non-current distinction of deferred tax assets and liabilities by requiring corresponding notes disclosures.

But it should also be considered that in some cases a direct or traceable current/non-current allocation of deferred tax assets/liabilities is not possible or only possible based on specific assumptions. Difficulties arise e.g. regarding the allocation of deferred tax assets resulting from tax loss carry-forwards or due to offsetting of deferred tax assets and deferred tax liabilities. In those cases the allocation can only be made on an artificial or lump-sum basis e.g. by using a pro rata approach. Such an artificial allocation affects adversely decision usefulness of the information. Regarding offsetting of deferred tax assets and liabilities we do not agree with the detailed scheduling as a result of proposed paragraph 37(a), (b).

Assuming that the boards approve the proposed classification requirement, we agree to allocate the valuation allowance for deferred tax assets (please refer also to our answers to Question 5) to the current and the non-current portion of deferred tax assets as well. For practical reasons, this allocation should be performed in general on a pro rata basis in accordance with the guidance included in current SFAS 109, i.e. based on the actual ratio of the recognized current and non-current underlying assets or liabilities. But, in contrast to a mandatory allocation on a pro rata basis as included in SFAS 109, we prefer a direct allocation to the current or non-current portion of deferred tax assets to the extent that the valuation allowance definitely affects certain identifiable underlying assets and liabilities classified as current or non-current.

Additionally, we seek clarification regarding the offset of deferred tax assets and liabilities at entities which do not present a classified balance sheet and, therefore, would neither classify deferred tax assets and liabilities. Our understanding is that, in such a case, all deferred tax assets and liabilities which meet the requirements of paragraph 37(c) and (d) shall be offset (i.e., paragraph 37(a) and (b) do not apply.)

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 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.

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 disagree with some of the proposals. Although we greatly appreciate that the Board critically reviewed the disclosure requirements, we propose to reconsider the following issues:

<u>Tax Uncertainties (Paragraphs 41(b); 41(e); 49)</u>

We do not support the requirement for a separate disclosure of prior period tax expense resulting from tax uncertainties and disclosure requirements of paragraph 49.

(Or, as an alternative: We propose to require separate disclosures of current tax of prior periods and deferred tax of prior periods but no additional ‘thereof’-disclosures resulting from tax uncertainties.)

The exposure draft requires a separate disclosure of the effect of tax uncertainties on current tax of prior periods (par. 41(b)) and on deferred tax of prior periods (par. 41(e)). Paragraph 41 also requires further disclosures of the components of tax expense recognized in profit and loss. We agree that a disclosure of main components of tax expense is useful information which enables the users of financial statements to better understand the tax situation of an entity. Nevertheless, we consider the specific disclosures of paragraph 41 sufficiently comprehensive even without an even deeper breakdown into 'thereof'-components resulting from tax uncertainties for the following reasons: (i) We believe that such disclosures lead to non congruence information rather than to increased decision usefulness. Furthermore, in case of material effects, a separate disclosure of material single effects is already required by IAS 1.97 and (ii) any additional disclosure related to tax uncertainties may influence settlement negations with tax auditors because the tax auditors become informed about the settlement results and may become progressively aggressive in their stance.

Paragraph 49 requires for major sources of estimation uncertainties relating to tax a description of the uncertainty, an indication of its possible financial effects on taxes and the timing of those effects.

Having considered the expected improved quality of accounting for tax uncertainties, we do not see an urgent necessity for the disclosing requirements of paragraph 49, because for major effects, separate disclosures are already required by IAS 1.125 ff. In our view, the disclosures required by IAS 1.125 ff. satisfy the information needs in respect of tax uncertainties. We also considered the timing aspects and believe that the limitation on the next financial year in IAS 1.125 should also be applied to tax uncertainties. Apart from the fact, that in many tax jurisdictions it would be difficult to estimate the timing in distant future, this limitation would improve the quality of disclosures and would be consistent with the general requirements of IFRSs.

Further, any additional tax uncertainty related disclosure may further increase the level of information about the tax uncertainties in favour of the tax auditor. That could turn a provision for uncertainties into a liability as 'self-fulfilling prophecy' which might not be in the interest of the shareholder. We question the interest of users of the financial statements in disclosing information which could increase the probability of materializing of tax risks, which, without that disclosure, are considered as less likely than not to arise. Therefore, As stated in our comment regarding question 7, we highly appreciate the fact that guidance on tax uncertainties has been included in the standard. It will increase the security of preparers of financial statements in making their judgement and will provide a more comparable accounting for tax uncertainties. we are believe that the disclosure requirement in paragraph 49 is more relevant information to that auditors of the financial statements and tax auditors might wish to consider rather than to relevant information other users of the financial statements. Furthermore, we question the interest of users of the financial statements in disclosing information which could increase the probability of materializing of tax risks, which, without that disclosure, are considered as less likely than not to arise.

Having considered the expected improved quality of accounting for tax uncertainties, we do not see an urgent necessity for the disclosing requirements of paragraph 49, because, for major effects, separate disclosures are already required by IAS 1.125 ff. In our view, the disclosures required by IAS 1.125 ff. satisfy the information needs in respect of tax uncertainties. We also considered the timing aspects and believe that the limitation on the next financial year in IAS 1.125 should also be applied to tax uncertainties. Apart from the fact, that in many tax jurisdictions it would be difficult to estimate the timing in farer future, this limitation would improve the quality of disclosures and would be consistent with the general requirements of IFRSs.

<u>'Roll Forward' of deferred tax assets and deferred tax liabilities (Paragraph 46 (b))</u>

We disagree with the disclosure requirement of paragraph 46 (b).

Paragraph 46(b) requires a detailed 'roll-forward' of deferred tax liabilities and deferred tax assets for each type of temporary difference and for each type of unused tax losses and tax credits.

Basically, main components of this information are already included in other disclosure requirements, even if on a higher level of aggregation. So, paragraph 41 requires a separate disclosure of deferred taxes recognized in the income statement and, according to paragraph 46(a), deferred tax liabilities and deferred tax assets for each type of temporary difference, unused tax losses and tax credits must be disclosed. Eventually, paragraph 45 results in a disclosure of taxes recognized in other comprehensive income and equity.

Hence, in our view, a further disclosure of a detailed 'roll-forward" of deferred tax liabilities and deferred tax assets would provide a very limited additional value to the user of the financial statements or, due to an increased flood of information, even decrease the benefit of the users. Moreover, this requirement would increase the administrative cost at the preparers.

Therefore we believe that the costs of generating this information would not be commensurate with the resulting benefit for users of the financial statements.

<u>Analysis of valuation allowance (Paragraphs 47)</u>

We do not support the disclosure requirement to describe the events or changes in circumstances causing a change of a valuation allowance.

(Or, as an alternative: We propose to require separate disclosures only for single material effects.)

Paragraph 47 requires a disclosure of the amount of any valuation allowance, any change in the valuation allowance, and a description of any event or change in circumstances that causes that change.

We agree that a disclosure of the amount and the change of valuation allowance is useful information (which reasonably complements the disclosure required in paragraph 41(g)).

Nevertheless, we believe that such disclosure, limited on single material effects, would provide more benefit to the users of financial statements. Apart from that, entities have to provide information of substantial development of assets and liabilities in any case as required under IAS 1.112c.

<u>Intercompany Sales (Paragraph 48(d))</u>

We do not endorse the disclosure requirement of paragraph 48(d).

Paragraph 48(d) requires for all transfers of assets and liabilities within a consolidated group between taxing jurisdictions with different tax rates a disclosure of

(i) Deferred tax assets and deferred tax liabilities arising from such transfers

(ii) The net effect of such transfers on tax expense, either for all transfers or for only those transfers whose timing or terms are not customary

(iii) The tax effects of any modifications since the end of the reporting period.

In BC108 the Board notes that this disclosure is a response to concerns about possible perceptions of earnings management.

In BC45 – 49 the Board provides reasons for not introducing an exception from the temporary concept in connection with intercompany transfers. We agree with these reasons and, in connection with the disclosure requirement of paragraph 48 (d), refer especially to the following:

- In BC46 the Board explains that the tax effect resulting from a transfer of an asset or liability between two tax jurisdictions is based on the fact that two parties outside the group entity are involved (the selling company's tax authority and the buying company's tax authority). The recognition of this effect is consistent with the temporary difference approach.
- In BC47 the Board reasons that the recognition of this effect does not create a conflict with consolidation accounting.
- In BC48 the Board concludes that a tax gain (or loss) realized by paying tax in one jurisdiction in exchange for an expected higher (lower) tax benefit in another tax jurisdiction should be recognized.

In our view, it is a free decision of every entity to realize gains (or losses) in transactions in which third parties are involved. The fact that, in this case, these third parties are tax authorities can not lead to an earnings management. Therefore, we do not see any need for a separate disclosure based on such concerns.

In addition, this requirement would lay a major administrative burden especially on globally active entities which often have world-wide processes of value creation leading to cross-border deliveries. In such cases, the costs of generating this disclosure would not be commensurate with the resulting benefit for users of the financial statements.

(Should the Board not accept our proposal, we alternatively propose to constrain the whole disclosure of paragraph 48(d), and not only the disclosure of 48(d) (ii), to non customary transfers. In that case, we propose to clarify the term 'non customary" in a manner that would take into account the specific business / industry sector of the entity.)

<u>Aggregate amount of temporary differences with respect to Outside Basis Differences (Paragraph 48(c))</u>

We propose that the disclosures for Outside Basis Differences should be changed to the FAS 109 disclosures. Even if we propose that the existing exemptions in IAS 12 for the recognition of deferred taxes should be kept, we think that the disclosures under FAS 109 consider certain situations in which temporary difference could not be calculated.

FAS 109.44c states that 'the amount of the unrecognized deferred tax liability for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of

that liability is practicable' should be disclosed 'or a statement that determination is not practicable'.
As a matter of fact the company should disclose that fact if the determination is not practicable.

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.

Appendix 2

GASB examples on the questions 13C

Example 1 - Changes in the tax rates

An entity recognises a loss of CU100 relating to a security classified as available for sale in other comprehensive income (OCI). The security is not considered to be impaired. The tax rate is 30 per cent. The loss of CU100 is taxed on a realised basis and consequently cannot be taken into account in determining taxable profit. The entity assesses that it is more likely than not that there will be sufficient taxable profits in the future and does not recognise a valuation allowance against the deferred tax asset. In the next year, the entity recognises no further gains or losses in continuing operations or OCI. The entity now reassesses the need for a valuation allowance and concludes that it is not needed because the entity still expects further future taxable gains. At the end of the second year a statutory rate change to 20% for the following years is substantively enacted. The entity therefore recognises a tax benefit of the tax rate reduction of CU10 in OCI.

In the third year the entity sells the asset, for which losses of CU100 had been recognised in OCI for fair value. The cumulative loss on the available-for-sale financial asset, previously recognised directly in equity, through the statement of changes in equity, is recognised in profit or loss upon derecognition in accordance with IAS 39.55(b) and derecognises the deferred tax expense arising at the time of disposal from the same component of OCI in accordance with ED.29A. The realised loss is deductible in determining taxable profit. The entity recognises deferred tax arising from carry forward losses in continuing operations.

	Year 1	**Year 2**	**Year 3**
Continuing operations	**0**	**0**	**(100)**
Tax	**0**	**(0)**	**20**
Current	0	0	0
Deferred – gross	0	0	20
– change in rate	0	0	0
Other comprehensive income	**(100)**	**0**	**100**
Tax in OCI	**30**	**(10)**	**(20)**
Current	0	0	0
Deferred – gross	30	0	(20)
– change in rate	0	(10)	0
Memo: carry forward losses	0	0	(100)
Balance sheet	**30**	**20**	**20**
Deferred tax asset – gross	30	20	20
– valuation allowance	0	0	0
Effective tax rate for continuing operations	0%	0%	20%

Example 2 - Changes in the taxable status

An entity recognises a loss of CU100 relating to a security classified as available for sale in OCI. The security is not considered to be impaired. The tax rate is 30 per cent. The loss of CU100 is taxed on a realised basis and consequently cannot be taken into account in determining taxable profit. The entity assesses that it is more likely than not that there will be sufficient taxable profits in the future and does not recognise a valuation allowance against the deferred tax asset. In the next year, the tax status of the entity is changed from fully taxable at the statutory rate to a non-taxable entity. In the year the entity recognises no further gains or losses in continuing operations or OCI. The entity therefore derecognises a tax benefit of CU30 previously recognised in OCI.

In the third year entity sells the asset, for which losses of CU100 had been recognised in OCI for fair value. The cumulative loss on the available-for-sale financial asset, previously recognised directly in equity, through the statement of changes in equity, is recognised in profit or loss upon derecognition in accordance with IAS39.55(b). No further tax consequences are recognised.

	Year 1	**Year 2**	**Year 3**
Continuing operations	**0**	**0**	**(100)**
Tax	**0**	**0**	**0**
Current	0	0	0
Deferred – gross	0	0	0
Other comprehensive income	**(100)**	**0**	**100**
Tax in OCI	**30**	**(30)**	**0**
Current	0	0	0
Deferred – gross	30	(30)	0
Memo: carry forward losses	0	0	0
Balance sheet	**30**	**0**	**0**
Deferred tax asset – gross	30	0	0
– valuation allowance	0	0	0
Effective tax rate for continuing operations	0%	0%	0%

Example 3 - Allocation of tax benefits – allocation of change in valuation allowance between elements of comprehensive income

An entity recognises a loss of CU100 from continuing operations which includes a loss on disposal of an asset it previously classified as available for sale of CU210 and a loss relating to another security classified as available for sale, of CU150 in OCI. The tax rate is 30 per cent. The loss of CU150 recognised in OCI is taxed on a realised basis and consequently cannot be offset against any profit from continuing operations in determining taxable profit. The losses from continuing operations and OCI give rise to a deferred tax asset of CU75. The entity assesses that it is more likely than not that there will not be sufficient taxable profits in the future to support the whole deferred tax asset and recognises a valuation allowance of CU25.

The entity allocates the valuation allowance to transactions and events on a last-in-first-out basis as trades giving rise to incremental losses contribute to the increase in the valuation allowance. The loss created by the undisposed security was generated after the loss generated on disposal. Consequently, the change in the valuation allowance is firstly allocated to OCI.

In year two, no further gains or losses are recognised in continuing operations or OCI and the entity assesses that it is more likely than not that there will not be sufficient taxable profits in the future to support the whole deferred tax asset and recognises a valuation allowance of CU60. The loss created by the undisposed security was generated after the loss generated on disposal and the increase is firstly allocated to OCI until the whole deferred tax asset is reduced to zero. The residual of CU15 is then allocated to continuing operations.

In year three, the entity recognises a gain of CU70 from continuing operations and a gain of CU60 in OCI. The entity expects similar future profits and assesses that it is more likely than not that there will be sufficient taxable profits in the future and no longer requires a valuation allowance against the deferred tax asset. The reversal of the valuation allowance is also applied on a last-in-first-out basis and in this example would reverse firstly against continuing operations and secondly against OCI until the balance on the valuation allowance account is zero.

In the fourth, year the entity recognises a profit of CU310 from continuing operations and sells the asset, for which losses of CU90 had been recognised in OCI for fair value. The cumulative loss of CU90 previously recognised directly in equity, is recognised in profit or loss upon derecognition in accordance with IAS 39.55(b) and the entity derecognises the cumulative deferred tax benefit of CU27 arising at the time of disposal from the same component of OCI in accordance with ED.29A. Concurrently the entity recognises current tax of CU57 arising from the loss on disposal of the available for sale security and the profit from other continuing operations in continuing operations where both events are recognised and reverses the deferred tax asset of CU9 relating to the utilisation of the carry forward losses which related to items previously recognised in continuing operations.

Example 3 – (continued)

	Year 1	Year 2	Year 3	Year 4
Continuing operations	**(100)**	**0**	**70**	**220**
Tax	**30**	**(15)**	**(6)**	**(66)**
Current	0	0	0	(57)
Deferred – gross	30	0	(21)	(9)
– valuation allowance	0	(15)	15	0
Other comprehensive income	**(150)**	**0**	**60**	**90**
Tax in OCI	**20**	**(20)**	**27**	**(27)**
Current	0	0	0	0
Deferred – gross	45	0	(18)	(27)
– valuation allowance	(25)	(20)	45	0
Memo: carry forward losses	(100)	(100)	(30)	0
Balance sheet	**50**	**15**	**36**	**0**
Deferred tax asset – gross	75	75	36	0
– valuation allowance	(25)	(60)	0	0
Effective tax rate for continuing operations	30%	0%	9%	30%

Example 4 - Changes in the effect of uncertainty over the amounts reported to the tax authorities

An entity recognises a gain of CU100 relating to a security classified as available for sale in OCI. The security is not considered to be impaired. The tax rate is 30 per cent. Gains of this nature are taxed on a realised basis and consequently taken into account in determining taxable profit however, the entity believes that this gain will be deemed non-taxable and does not recognise the gain as a taxable profit reported to the tax authority. There is some doubt over this treatment and the entity assesses the possible outcomes of the uncertainty and calculates a liability of CU3.

Following the outcome of a court case in the following year, the uncertainty is removed as the ruling determined that the gain would not be taxable. The entity therefore derecognises the tax accrual of CU3 previously recognised in OCI. The gain is recognised in profit or loss upon derecognition in the third year in accordance with IAS 39.55(b) without any tax consequences.

	Year 1	**Year 2**	**Year 3**
Continuing operations	**0**	**0**	**100**
Tax	**0**	**0**	**0**
Current	0	0	0
Deferred – gross	0	0	0
Other comprehensive income	**100**	**0**	**(100)**
Tax in OCI	**3**	**(3)**	**0**
Current	3	(3)	0
Deferred – gross	0	0	0
Memo: carry forward losses	0	0	0
Balance sheet			
Current tax liability	**3**	**0**	**0**
Effective tax rate for continuing operations	0%	0%	0%

Appendix 3

Letter to IASB:

Short-term convergence – Income taxes – Adoption of the FAS 109 allocation requirements for a change in tax laws or rates

Sir David Tweedie
International Accounting Standards Board
30 Cannon Street,
London
EC4M 6XH
United Kingdom

Telefon +49 (0)30 206412-13
Telefax +49 (0)30 206412-15
E-Mail klaus.pohle@drsc.de

Berlin, 10 October 2005

Dear Sir David,

Comments on the proposed 'Draft Technical Correction 1: Proposed Amend-ments to IAS 21'

We appreciate the opportunity to comment on the proposed 'Draft Technical Correction 1: Proposed Amendments to IAS 21 The effects of Changes in foreign Exchange Rates: Net Investment in a foreign operation'.

General Remarks:

We support the change in IAS 21, as we think that the currency in which an item for which settlement is neither planned nor likely to occur in the forseeable future is denominated does not affect its character of being in substance part of the net investment.

Question 1: Do you agree with the proposals in this Technical Correction? If not, why not? What changes do you propose and why?

We are supportive of the amendment and agree with the proposals. However, to maintain consistency with other standards, we suggest that the Board considers amending the definitions in IAS 21 as well. As far as we understand the draft, neither the definitions in IAS 21 are to be amended nor a cross-reference to IAS 27 and IAS 28 will be added to the text.

We therefore propose to

- either include the terms “subsidiary” and “associate” in the definitions of IAS 21.8; or
- to redraft par 15 to: “A reporting entity or any of its subsidiaries (as defined in IAS 27: Consolidated and Separate Financial Statements) may have a monetary item …” and par. 15b to: “An associate (as defined in IAS 28: In-vestments in Associates) may be a foreign operation …”

Question 2: Do you have any other comments on the proposals?

Although we are supportive of the amendment of IAS 21 in itself, we are not sure whether this amendment is appropriately addressed as a technical correction. However, since we believe that IAS 21 should be amended at short notice, we do not think that this concern should delay the proposed amendment.

If you would like any clarification of these comments, please contact me.

Yours sincerely,

Prof. Dr. Klaus Pohle
President