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Basis for Conclusions
Exposure Draft ED/2009/2

Income Tax

Comments to be received by 31 July 2009

International
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Basis for Conclusions on Exposure Draft

INCOME TAX

Comments to be received by 31 July 2009

ED/2009/2

This Basis for Conclusions accompanies the proposed International Financial Reporting Standard (IFRS) set out in the exposure draft *Income Tax* (see separate booklet). Comments on the draft IFRS and its accompanying documents should be submitted in writing so as to be received by **31 July 2009.** Respondents are asked to send their comments electronically to the IASB website (www.iasb.org), using the 'Open to Comment' page.

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Basis for Conclusions on Exposure Draft *Income Tax*

Introduction

BC1 This Basis for Conclusions summarises the considerations of the International Accounting Standards Board in reaching the conclusions in the exposure draft *Income Tax*. Individual Board members gave greater weight to some factors than to others.

BC2 The Board undertook this project for two reasons. First, the Board has received many requests to clarify various aspects of IAS 12 *Income Taxes*. Second, the Board and the US Financial Accounting Standards Board (FASB) agreed to consider the accounting for income tax as part of their convergence project.

BC3 IAS 12 and SFAS 109 *Accounting for Income Taxes* share a common approach—the temporary difference approach. Because of the limited scope of the convergence project, the boards did not discuss whether the temporary difference approach should be replaced. They have no plans to consider other approaches at this time.

BC4 However, although IAS 12 and SFAS 109 both use the temporary difference approach, there are differences in their application. These differences can result in substantial differences in the amounts recognised for income tax. The boards' aim was to achieve convergence by eliminating exceptions to the temporary difference approach, resulting in a higher quality, principle-based standard for both boards.

BC5 The boards reached common decisions on almost all issues that were within the scope of the project. The FASB had originally intended to publish proposals to amend SFAS 109 for the decisions made in the project. However, in September 2008 it announced that it would review its strategy for short-term convergence projects in the light of the possibility that some or all US public companies might be permitted or required to adopt International Financial Reporting Standards (IFRSs) at some future date. As part of that review, it will invite views from US constituents by issuing an invitation to comment containing the IASB's proposed replacement of IAS 12. After that review, it will decide whether to undertake a project to eliminate differences in the accounting for tax by adopting the replacement for IAS 12.

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BC6 Paragraphs BC130–BC134 summarise the differences between the proposals in the exposure draft and US generally accepted accounting principles (GAAP).

Overview of principles and of this Basis for Conclusions

BC7 The principles underlying the temporary difference approach and the proposals in the exposure draft are set out below, with an outline of how the issues discussed in this Basis for Conclusions relate to those principles.

Recognition principle 1 – account for income tax effects of past transactions and events

BC8 The temporary difference approach accounts for income tax effects of past transactions and events by recognising the income tax recoverable or payable in the future when the entity recovers its recognised assets and settles its recognised liabilities.

BC9 It is assumed that the recognised assets and liabilities will be recovered or settled in the future for their carrying amount at the end of the reporting period. If the carrying amount of an asset or a liability differs from its tax basis, the amount recovered or settled will differ from the amount that will be deductible or taxable. If such a difference gives rise to income tax payable or recoverable, it is a temporary difference and the resulting obligation to pay or right to recover the income tax in the future is a deferred tax liability or asset. Deferred tax assets are also recognised for income tax recoverable in the future because of unused tax losses and tax credits.

BC10 In relation to this principle, the Basis for Conclusions discusses:

(a) what is income tax? (paragraphs BC15 and BC16)

(b) the definitions needed to support the temporary difference approach, ie tax basis, temporary difference, tax credit and investment tax credit (paragraphs BC36–BC38)

(c) the following exceptions that the Board proposes to the temporary difference approach:

(i) deferred tax liabilities that arise on the initial recognition of goodwill (paragraphs BC36–BC38)

(ii) deferred tax assets and liabilities for investments in foreign subsidiaries and joint ventures (paragraphs BC39–BC44)

(d) why the Board does not propose exceptions for temporary differences arising on:

  (i) the initial recognition of assets and liabilities in specified situations (paragraphs BC25–BC35)

  (ii) intragroup transfers of non-monetary assets (paragraphs BC45–BC49)

  (iii) specified exchange differences arising on foreign non-monetary assets (paragraphs BC50 and BC51).

Recognition principle 2 – recognise a valuation allowance to reduce deferred tax assets to the amount that is more likely than not to be recovered.

BC11 Temporary differences and unused tax losses and tax credits will give rise to recoverable income tax in the future only if there is sufficient taxable profit in the future to utilise them. Hence, a valuation allowance is recognised in order to reduce the carrying amount of deferred tax assets less the valuation allowance to the highest amount that is more likely than not to be realisable against taxable profit (paragraphs BC52–BC56).

Measurement requirements

BC12 The amount of tax recoverable or payable on the future recovery or settlement of assets and liabilities, and for unused tax losses and credits, depends on many factors. The Board did not set a high level measurement objective. Instead, the exposure draft proposes specifying the following requirements, which are discussed below:

(a) uncertainty about whether the tax authorities will accept the amounts reported to them by the entity is included in the measurement of tax assets and liabilities by using the probability-weighted average of expected outcomes, assuming that the tax authorities review the amounts reported to them (paragraphs BC57–BC63).

(b) tax law is that substantively enacted at the reporting date (paragraphs BC64–BC66).

(c) if the tax rate depends on the level of income of the entity, the applicable tax rate is the average rate expected to apply given the expected profit (unchanged from IAS 12).

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(d) if the tax rate depends on the manner of recovery of an asset, the applicable tax rate is the rate consistent with deductions that determine the tax basis, ie the deductions that arise on the sale of the asset. If the same deductions can also be obtained by using the asset, but different rates apply to recovery by sale and recovery by use, then both rates are consistent with the deductions that determine the tax basis. In this case, the applicable rate is determined by the entity's expected manner of recovery (paragraphs BC67–BC73).

(e) if distributions to shareholders have tax effects, tax assets and liabilities include the effect of expected future distributions (paragraphs BC74–BC81).

(f) the exposure draft is silent on the effect of expected future deductions that are not part of a tax basis or related to distributions to shareholders (paragraphs BC82–BC88).

Allocation principle

BC13 On initial recognition, tax expense is allocated to the same component (ie continuing operations, discontinued operations, other comprehensive income or equity) as the item giving rise to the tax. Subsequent changes in tax are recognised in continuing operations, with specified exceptions (paragraphs BC90–BC99).

Other requirements

BC14 The following are also discussed below:

(a) classification (paragraphs BC101–BC103)

(b) disclosures (paragraphs BC104–BC110)

(c) transition (paragraphs BC111–BC120)

(d) the costs and benefits of the proposed changes from IAS 12 (paragraphs BC121–BC129).

Scope

BC15 In 2006 the International Financial Reporting Interpretations Committee (IFRIC) received a request to clarify what tax was income tax and therefore within the scope of IAS 12. The IFRIC rejected the request because of the variety of tax that exists worldwide and the need for judgement in determining whether some tax is income tax. However, the IFRIC

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observed that IAS 12 applies to income tax, which is defined as tax that is based on taxable profit. This implies, first, that not all tax is within the scope of IAS 12 and secondly that, because *taxable profit* is not the same as accounting profit, tax does not need to be based on an amount that is exactly accounting profit for it to be within the scope of IAS 12. This second point is also implied by the requirement in IAS 12 to disclose an explanation of the relationship between tax expense and accounting profit. The IFRIC further noted that the term 'taxable profit' implies a notion of a net rather than gross amount. Lastly, the IFRIC observed that any tax that is not within the scope of IAS 12 is within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

BC16 The Board concluded that those observations would be helpful guidance to include in the proposed IFRS.

Definitions

Definitions of tax basis and temporary difference

BC17 IAS 12 and SFAS 109 use similar but different terms—*tax base* and *tax basis*—for the same notion. The Board decided to converge on *tax basis*.

BC18 IAS 12 has a definition of tax base that is based on amounts deductible for tax. If different amounts are deductible depending on the manner of recovery or settlement of the asset or liability, the tax base used depends on the expected manner of recovery or settlement. Furthermore, for assets and liabilities that will be recovered or settled without tax consequences, the tax base is defined as being equal to the carrying amount.

BC19 SFAS 109 does not have an explicit definition of tax basis. However, in practice, under US GAAP there is a notion that the tax basis is the amount that would be recognised in a statement of financial position prepared using the applicable tax rules of the relevant jurisdiction. Tax basis does not generally depend on the expected manner of recovery or settlement. Moreover, under US GAAP a difference between carrying amount and tax basis is a temporary difference only if there will be tax consequences of recovering the asset or settling the liability.

BC20 The Board understands that the notion of tax basis is well understood and applied consistently under US GAAP. The Board concluded that the definition of tax basis used in practice under US GAAP was clearer and

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less open to different interpretations than the definition of tax base in IAS 12. Therefore, the Board proposes to adopt the definition of tax basis used in US GAAP.

BC21 The Board is also aware of 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. To resolve those problems, the Board proposes to require the tax basis of an asset to be determined by tax deductions that are available if the asset is sold at the reporting date. This requirement is more specific than the definition of tax basis used in US GAAP, but in most cases will result in a tax basis consistent with that used under US GAAP. The tax basis may differ from that used under US GAAP when the deductions available on sale differ from the cost of the asset less tax deductions received so far plus any tax indexation allowance.

BC22 Under the proposals in the exposure draft, the tax basis does not depend on management's expectations of how the carrying amount of the asset will be recovered. But the Board concluded that considering whether the recovery or settlement of an asset or liability would affect taxable profit was an appropriate initial step before starting the deferred tax methodology proposed by the exposure draft. Therefore, under the proposals, management expectation does play a role in an initial threshold for the recognition of deferred tax assets and liabilities. If the entity expects to recover an asset or settle a liability without causing any effect on taxable profit, as set out in paragraphs 10 and 11 of the exposure draft, then no deferred tax asset or liability arises. This is also consistent with US GAAP.

BC23 Management's expectations can also affect the measurement of deferred tax assets and liabilities, as discussed in paragraphs BC67–BC73.

Definitions of tax credit and investment tax credit

BC24 IAS 12 does not define the terms *tax credit* or *investment tax credit*. It excludes from its scope the accounting for investment tax credits, and prescribes different accounting for tax credits and tax deductions. This has led to questions about how some tax benefits should be classified. The exposure draft proposes definitions of tax credit and investment tax credit that converge with US GAAP. The Board acknowledges that the definitions focus on the way in which the tax authorities express the benefit. Because similar economic benefits could be expressed as either tax credits or tax deductions, this means that similar economic benefits may be accounted for in different ways. The Board concluded that it was

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beyond the scope of this project to include a comprehensive reconsideration of the accounting for tax credits and tax deductions. Nonetheless, clear definitions would make the new IFRS easier to use by removing doubt over the required treatment for tax benefits.

Exceptions from the temporary difference approach

Initial recognition exception

BC25 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.

IAS 12 also prohibits an entity from recognising subsequent changes in such an unrecognised deferred tax asset or liability. SFAS 109 does not include an exception from the temporary difference approach for temporary differences that arise on the initial recognition of an asset or liability.*

BC26 The Board proposes to eliminate the exception that IAS 12 makes and so create a more principled standard and more consistent treatment of deferred tax. The resulting IFRS should also be easier to understand and apply. Many questions arise in practice on how the initial recognition exemption should be applied.

BC27 The Board considered how an entity should account for the acquisition outside a business combination of an asset with an initial tax basis different from its initial carrying amount. It first discussed the simultaneous equations method prescribed in US GAAP by EITF Issue No. 98-11 *Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combination*. In considering that approach, the Board discussed particular fact patterns in the application of EITF 98-11 that can result in the recognition of a deferred credit in the statement of financial position. The Board was troubled by the recognition of a deferred credit that does not represent a liability, but rather results from a computational requirement. It therefore rejected the approach in EITF 98-11.

* The only exception is for taxable temporary differences arising on the initial recognition of goodwill (see paragraphs BC36–BC38).

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BC28 The Board proposes that any entity-specific tax effects should not affect the carrying amount of an asset or liability. Accordingly, it proposes that an entity should separate the asset or liability that results in an initial temporary difference into:

(a) the asset or liability excluding any entity-specific tax effects, and

(b) any entity-specific tax effects.

BC29 Measuring the asset or liability in paragraph BC28(a) in accordance with applicable IFRSs results in a carrying amount for the asset or liability that is consistent with the carrying amount of other assets and liabilities, and is not affected by any entity-specific tax effects. The Board acknowledges that there may be difficulties in assessing what the amount measured in accordance with applicable IFRSs would have been had the same tax basis been available to the entity as to a market participant. The Board considered whether the carrying amount on initial recognition should be fair value, because that would give a clear measurement objective. But the Board rejected such a proposal because this project is not the place in which to consider whether to introduce new fair value measurements. The Board thinks that entities would be able to estimate how entity-specific tax effects have affected the transaction price.

BC30 Next, a deferred tax asset or liability is recognised for the temporary difference between the carrying amount of the asset or liability and the tax basis available to the entity. This establishes a deferred tax asset or liability that is consistent with the other deferred tax assets or liabilities recognised in accordance with IAS 12.

BC31 A problem arises if the sum of the carrying amounts of the recognised asset or liability and the deferred tax asset or liability does not equal the price for the transaction in which the entity acquired the asset or assumed the liability. This problem does not arise if the recognition of the asset or liability affects comprehensive income or equity, for example internally generated assets or liabilities. In those cases, the effect of the recognition of the deferred tax asset or liability is recognised in comprehensive income or equity. The problem also does not arise if the initial temporary difference arises from deductions that affect taxable profit, because the effect of the temporary difference will be offset by an effect on current tax. Lastly, a problem does not arise if the transaction is a business combination, because any difference between the transaction price and the sum of the recognised amounts affects goodwill.

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BC32 But if the transaction does not affect comprehensive income, equity or taxable profit at the time of the transaction and is not a business combination, there can be a difference between the sum of the amounts recognised as described in paragraphs BC29 and BC30 and the transaction price. This is the group of temporary differences that is covered by the initial recognition exception in IAS 12.

BC33 In such cases, a premium or allowance must be recognised to make the sum of the recognised amounts equal the transaction price. That premium or allowance is an anomaly that arises because the methodology in IAS 12 does not measure deferred tax assets and liabilities at fair value or at a price established by an exchange transaction for the tax asset or tax liability. Because that premium or allowance relates to the measurement of the tax assets and liabilities in accordance with IAS 12, the Board proposes to recognise it as part of the deferred tax asset or liability.

BC34 The Board noted that when the same tax basis is available to the entity and to market participants, the practical effect of the proposed requirements on initial recognition is the same as the existing initial recognition exception. But many of the practical problems with the initial recognition exception relate to difficulties in distinguishing between subsequent changes in an unrecognised initial difference (the effect of which is not recognised) and the creation of new temporary differences (the effect of which is recognised). Recognising the effect of the original temporary difference and an offsetting premium or allowance makes tracking subsequent changes easier.

BC35 Given that the premium or allowance is an anomaly under the temporary difference approach, the Board considered whether immediate recognition of the premium or allowance in comprehensive income would result in the most consistent approach. Doing so would remove the anomaly as quickly as possible without effects in subsequent periods. The Board rejected this approach on the grounds that the acquisition of an asset or liability in an arm's length transaction could be assumed to be an exchange of equal value and hence the recognition of tax gain or loss would be inappropriate. Instead, the Board proposes that the premium or allowance should be recognised in comprehensive income pro rata with changes in the deferred tax asset or liability to which it relates.

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Goodwill

BC36 Both IAS 12 and SFAS 109 prohibit the recognition of a deferred tax liability for a temporary difference arising on the initial recognition of goodwill when the carrying amount of goodwill exceeds its tax basis. However, both standards require the recognition of a deferred tax asset for a temporary difference arising when the tax basis of goodwill exceeds its carrying amount.

BC37 The Board noted that requiring the recognition of a deferred tax liability arising on the initial recognition of goodwill would be consistent with:

(a) the objective of removing as many exceptions from the temporary difference approach as possible;

(b) the treatment of temporary differences arising on initial recognition when the tax basis of goodwill exceeds its carrying amount; and

(c) the treatment of taxable temporary differences arising on goodwill after its initial recognition.

BC38 However, the Board also noted that the initial measurement of goodwill is a residual amount arising after measuring at fair value the identifiable assets and liabilities in a business combination. Recognising a deferred tax liability on the initial recognition of goodwill simply adjusts the amount of the residual. The Board therefore proposes not to eliminate the exception.

Investments in subsidiaries, branches, associates and joint ventures

BC39 The recovery of investments in subsidiaries, branches, associates and joint ventures may give rise to tax consequences in addition to those arising from the recovery or settlement of the individual assets or liabilities within those investments. For example, tax may be payable or refundable on the payment of distributions from a subsidiary to its parent and tax may be payable on the sale of the investment in the subsidiary. Investments in subsidiaries, branches, associates and joint ventures have a tax basis in the investor's tax jurisdiction in respect of these taxes. Temporary differences between the tax basis and the carrying amount of the investment, often called outside basis differences, may arise.

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BC40 IAS 12 includes an exception to the temporary difference approach for some investments in subsidiaries, branches, associates and joint ventures that is 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.

BC41 SFAS 109 and APB Opinion 23 *Accounting for Income Taxes—Special Areas* prohibit the recognition of a deferred tax liability or asset for the difference between carrying amount and the tax basis of an investment in a foreign subsidiary or a foreign corporate joint venture that is essentially permanent in duration.

BC42 The Board considered whether to retain an exception for investments in subsidiaries, branches, associates and joint ventures. The Board concluded that, in principle, the exceptions in IAS 12 should not be carried into the new IFRS because they have no conceptual basis. The ability to control the timing of the reversal of a temporary difference does not mean that the temporary difference does not exist or does not give rise to a deferred tax asset or liability.

BC43 However, on the basis of information given by experts, the Board concluded that the calculation of the amount of deferred taxes for permanently reinvested unremitted earnings of foreign subsidiaries and joint ventures is so complex that the costs of doing so outweigh the benefits. The Board therefore proposes to converge with the requirements in SFAS 109 and APB Opinion 23 relating to temporary difference on foreign subsidiaries and joint ventures.

BC44 As discussed in paragraph BC22, if an entity expects to recover an asset or settle a liability without affecting taxable profit, then no deferred tax asset or liability arises. The Board considered the situation in which the entity expects to recover an investment in a subsidiary or joint venture without affecting taxable profit. The Board concluded that such an expectation should result in no deferred tax arising for any temporary difference on the investment in the subsidiary or joint venture but should not affect the recognition of deferred tax for temporary differences on individual assets and liabilities in the subsidiary or joint venture. Deferred tax assets and liabilities that arise on temporary differences on individual assets and liabilities in the subsidiary should be assessed in the context of their recovery or settlement by the subsidiary, not in the context of the recovery of the investment of the subsidiary by the parent. This approach is generally consistent with US GAAP.

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Intragroup transfers of assets

BC45 An intragroup asset transfer (such as the sale of inventory, intangible assets or depreciated property) between tax jurisdictions is often a taxable event. Such a transaction may result in a taxable gain or loss in the selling jurisdiction and establish a new tax basis in the buyer's tax jurisdiction. Paragraph 9(e) of SFAS 109 requires taxes paid by the seller on intragroup profits to be deferred, and prohibits the recognition of a deferred tax asset for the difference between the tax basis of the assets in the buyer's tax jurisdiction and their carrying amounts in the consolidated financial statements. IAS 12 does not provide a similar exception.

BC46 The Board noted that the tax consequences of an intragroup sale of inventory or other assets between group entities in different tax jurisdictions involve two parties outside the group entity—the selling company's tax authority and the buying company's tax authority. Recognising the tax consequences of the transaction is a faithful representation of the economic events of the period. Additionally, not recognising the tax consequences would be an exception to the temporary difference approach.

BC47 Some argue that applying the temporary difference approach to intragroup asset transfers is inconsistent with the existing requirements to eliminate intragroup transactions on consolidation. However, the Board observed that (a) the payment of income tax and (b) the change in tax jurisdiction are events that involve the entity and an external party. It concluded that application of the temporary difference approach did not create a conflict with consolidation accounting.

BC48 Others argue that the results of recognising the tax consequences are counter-intuitive. For example, if an asset is transferred at an amount higher than its carrying amount to a jurisdiction with a higher tax rate, tax income will be recognised even though if the asset is later sold outside the group at an amount higher than the transfer amount, the entity will pay tax at a higher rate than if the transfer had not happened. However, the assumption underlying the temporary difference approach is that the entity will recover the carrying amount of the asset. If that assumption is valid, the group entity has paid tax in one jurisdiction in exchange for an expected higher tax benefit in another. The group entity has made a tax gain on the transfer that should be recognised.

BC49 The Board concluded that there should be no exception to the temporary difference approach for intragroup transfers. Additional disclosures relating to intragroup transfers are discussed in paragraph BC108.

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Foreign non-monetary assets

BC50 Paragraph 9(f) of SFAS 109 prohibits recognition of a deferred tax asset or liability for differences related to assets and liabilities that are remeasured from the local currency into the functional currency using historical exchange rates and result from (a) changes in exchange rates or (b) indexing for tax purposes. In contrast, IAS 12 requires recognition of a deferred tax liability or asset for such temporary differences.

BC51 Consistently with the objective of eliminating exceptions to the temporary difference approach, the Board proposes no exception for such differences.

Recognition of deferred tax assets

BC52 Under IAS 12, a deferred tax asset is recognised only if it is 'probable' that it will be realised. Under SFAS 109, all deferred tax assets are recognised and a valuation allowance is recognised to the extent that it is 'more likely than not' that the deferred tax assets will not be realised.

BC53 The Board proposes to adopt the valuation allowance approach in SFAS 109. The Board noted that this change would have no effect on the net amount recognised for the sum of the deferred tax asset and valuation allowance. However, separating the recognition of the asset from the process of assessing its recoverability is more consistent with the discussion of elements and recognition in the *Framework for the Preparation and Presentation of Financial Statements*.

BC54 On the meaning of the term 'probable', the Board noted that in some jurisdictions that apply IFRSs it is generally understood to denote a higher likelihood than the term 'more likely than not'. The Board considered what the term should mean in the context of the recognition and measurement of a deferred tax asset.

BC55 The Board proposes to replace the term 'probable' in IAS 12 by 'more likely than not'. That is consistent with the use of the term 'probable' in IAS 37 and IFRS 3 *Business Combinations* (as revised in 2008) and with the recognition threshold in SFAS 109.

BC56 Both IAS 12 and SFAS 109 include guidance on the realisability of deferred tax assets. The Board considers that all the guidance in the two standards is useful. Hence, the exposure draft combines the guidance. This includes guidance on accounting for significant expenses to implement a tax planning strategy. IAS 12 is silent on this topic.

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Measurement

Uncertain tax positions

BC57 In June 2006 the FASB issued an Interpretation (FIN 48 *Accounting for Uncertainty in Income Taxes—an Interpretation of FASB Statement No. 109*) on uncertain tax positions. FIN 48 requires an entity to recognise tax benefits it has claimed only if it is more likely than not that the tax authorities will accept the claim. If a tax benefit meets the recognition threshold, the amount recognised is the maximum amount that is more likely than not to be accepted by the tax authorities.

BC58 IAS 12 is silent on how to treat any uncertainty relating to amounts submitted to the tax authorities. The Board considered the Interpretation issued by the FASB but noted that it was not consistent with the Board's thinking behind the proposed amendments to IAS 37 published in June 2005. Applying that reasoning, the Board concluded that an entity has a liability to pay more tax if the tax authority does not accept the amounts submitted. Consistently with the approach taken in the proposed amendments to IAS 37, no probability-based recognition threshold is applied. Rather, the uncertainty is included in the measurement of the tax assets and liabilities. That is done by measuring current and deferred tax assets and liabilities using the probability-weighted average of all possible outcomes.

BC59 FIN 48 requires an entity to assume that the tax authorities will review the amounts submitted when recognising and measuring tax benefits. The alternative would be to require entities to include their assessment of whether the tax authorities will review the amount in the recognition and measurement of tax assets and liabilities. The Board agreed with the approach in FIN 48.

BC60 The Board's proposed measurement is not the same as fair value or the settlement value required by IAS 37. No adjustment is made for risk and deferred tax assets and liabilities are not discounted amounts. Consideration of such issues is outside the scope of the convergence project on income tax. Nonetheless, the Board believes that the use of a probability-weighted average of all possible outcomes, without any probability-based recognition threshold, provides more relevant information than an approach that uses a probability-based recognition threshold. No possible outcomes are ignored in the measurement.

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BC61 Both boards acknowledged the desirability of convergence on this issue. Divergent treatment of the uncertainty could have a significant effect on the tax amounts recognised in the financial statements. The boards observed, however, that the divergence arises from different approaches to uncertainty more generally in IFRSs and US GAAP. The boards are addressing these differences in the joint conceptual framework project and do not think they can be resolved in a convergence project on income tax.

BC62 The Board also noted that an expected outcome approach is not used in assessing the need for a valuation allowance (see paragraphs BC52–BC56). The Board does not think it is appropriate in a convergence project to extend such an approach to an established aspect of IAS 12 that is already aligned with US GAAP. In contrast, the proposed treatment of uncertainty relating to tax is a new proposal on an issue not addressed currently in IAS 12 and on which the Board does not wish to adopt a treatment inconsistent with its most recent thinking.

BC63 Some contend there are few amounts reported to the tax authorities over which there is no uncertainty. They argue that it would be unduly onerous to use a probability-weighted average of the expected outcomes in all cases, even when the possibility of an outcome different from the amount reported is remote. However, the Board does not intend entities to seek out additional information for the purposes of applying this aspect of the proposed IFRS. Rather, it proposes only that entities do not ignore any known information that would have a material effect on the amounts recognised.

Enacted and substantively enacted rates

BC64 IAS 12 requires an entity to measure its deferred taxes using the tax rates and tax laws that have been ‘enacted or substantively enacted by the end of the reporting period’. Paragraph 18 of SFAS 109 requires the use of the ‘enacted tax rate(s) expected to apply’ and paragraph 27 indicates that changes in tax laws or tax rates should be recognised ‘in the period that includes the enactment date’.

BC65 IAS 12 notes that, in some jurisdictions, announcements of tax rates and tax laws by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. The Board concluded that it would be inappropriate in such cases to wait for actual enactment. To do so would be giving undue weight to an event (the enactment) that may have a formal or ceremonial role but is extremely unlikely to affect a previously made decision. The Board proposes to clarify that ‘substantive enactment’ is achieved

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when any future steps in the enactment process will not change the outcome. By 'will not', the Board does not mean 'cannot'. That would make substantive enactment the same as enactment. Rather, it means that the future steps in the enactment process are steps that historically have not affected the outcome.

BC66 The Board noted that in the US the effect of the President's power of veto is that the point when any future steps in the enactment process will not change the outcome is always only at enactment.

Expected manner of recovery or settlement

BC67 IAS 12 requires an entity to measure deferred tax liabilities and assets using the tax rate that is consistent with the expected manner of recovery or settlement of the asset or liability. In practice there has been some diversity in the application of this requirement.

BC68 The amended definition of a tax basis means that the tax basis does not depend on the expected manner of recovery or settlement of the asset or liability (see paragraphs BC17–BC23).

BC69 That raises the question of what rate should be applied in order to measure any resulting deferred tax asset or liability. First, the Board decided that the tax rate used to measure the deferred tax asset or liability must be consistent with the tax basis. Use of an inconsistent rate would not provide a useful measure of the deferred tax asset or liability. So, if the deductions that determine the tax basis are available only on sale, the Board proposes that the tax rate applicable to sale must be used. However, the same deductions may also be available for the use of the asset. In that case, measuring the deferred tax asset or liability at the rate that is applicable to the expected manner of recovery provides the most useful information. This is consistent with the requirements in US GAAP on which rate to use.

BC70 The proposals reflect the view that the tax basis is a matter of fact that establishes whether a temporary difference, and hence a deferred tax asset or liability, exists. But the measurement of any deferred tax asset or liability may be affected by management expectations on the manner of recovery or settlement of the related asset or liability giving rise to the temporary difference.

BC71 The Board noted arguments that the proposed approach to the role of management expectations in the recognition and measurement of deferred tax assets and liabilities was inconsistent and confusing. Those holding this view note that in many jurisdictions, it is difficult to argue

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that the tax basis is any more a matter of fact than the tax rate. The tax authority does not require the creation of a tax balance sheet as such. Rather, it specifies what deductions are available in what circumstances, just as it does with the tax rate. In such jurisdictions it is difficult to justify a different approach to management expectations for the deductions (ie tax basis) and the rate.

BC72 The Board acknowledges these arguments. However, the Board noted that a balance had to be drawn between requirements that were clear and straightforward to apply in the different tax jurisdictions that exist globally and more complex requirements that have proved to be difficult to implement. The Board concluded that the proposals would be easier to apply and result in more consistent treatment across tax jurisdictions than the IAS 12 requirements. They will also usually have the same outcome as practice under US GAAP.

BC73 The Board also proposes to include in the IFRS the requirements in SIC-21 *Income Taxes—Recovery of Revalued Non-Depreciable Assets*. As SIC-21 explains, the recognition of depreciation implies that the carrying amount of a depreciable asset is expected to be recovered through use to the extent of its depreciable amount, and through sale at its residual value. Consistently with this, the carrying amount of a non-depreciable asset, such as land having an unlimited life, will be recovered only through sale. This is because the asset is not depreciated, and hence no part of its carrying amount is expected to be recovered (ie consumed) through use. Thus, deferred tax associated with non-depreciable assets reflects the tax consequences of selling the assets.

Distributed or undistributed rate

BC74 The Board discussed whether the tax effects of future distributions should be included in the measurement of tax assets and liabilities. Distributions can have tax effects because, in some jurisdictions, incremental income tax must be paid (or a benefit is received) when the income is distributed to shareholders.

BC75 IAS 12 requires the use of the tax rate applicable to undistributed profits in measuring deferred tax assets and liabilities. The tax consequences of the distribution are recognised when a liability to make the distribution is recognised.

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BC76 SFAS 109 is silent on distributed and undistributed rate issues. Two EITF Abstracts address the impact of dual rate structures outside the US:

No. 95-10 *Accounting for Tax Credits Related to Dividend Payments in Accordance with FASB Statement No. 109*

No. 95-20 *Measurement in the Consolidated Financial Statements by a Parent of the Tax Effects Related to the Operations of a Foreign Subsidiary That Receives Tax Credits Related to Dividend Payments.*

BC77 That guidance requires the use of the undistributed rate in a subsidiary's separate financial statements. In consolidated financial statements, it requires a rate consistent with the entity's application of the indefinite reversal criteria of APB Opinion 23 (ie it requires use of the tax rate applicable to distributed earnings if earnings are remitted to the parent or the tax rate applicable to undistributed earnings if they are not). Practice has developed under US GAAP of using the higher of the distributed or undistributed rate.

BC78 Some argue that an entity's financial statements should report to the shareholders the beneficial interests that are available to them, taking into account any 'gate' (in this case, a tax authority) that those beneficial interests have to pass through before the benefit can be realised by shareholders. That gate may be advantageous or disadvantageous from a shareholder's perspective.

BC79 Others argue that before the entity has a liability to make the distribution (ie before there is a present obligation to make the distribution), it cannot have a liability to pay any additional income tax relating to the distribution. There is no present obligation. The event that triggers the income tax consequence of the distribution is the distribution.

BC80 In considering the issue, the Board assessed the impact of not anticipating the effect of distributions on specific entities. These entities, eg real estate investment trusts and co-operative societies in some jurisdictions, are in effect tax-exempt because of tax rate reductions or tax deductions relating to distributions and a policy of distributing all or almost all of their available reserves. The Board concluded that useful information would not result from requiring such entities to measure their tax assets and liabilities without taking into account the effect of expected future distributions.

BC81 The Board therefore concluded that the effect of expected future distributions should be included in the measurement of tax assets and liabilities. Requiring the use of either the undistributed rate in all circumstances or the distributed rate in all circumstances would lead to

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unrealistic measures in some cases. Including the effect of expected distributions is consistent with the general approach of using the rate expected to apply in measuring deferred tax assets and liabilities. In order to ensure that the entities use realistic expectations, the Board proposes that, when determining future expectations of distributions, an entity should consider past experience and whether it expects to have the intention and ability to make distributions for the period in which the deferred tax asset or liability is expected to be realised or settled.

Special deductions

BC82 Special deductions are specific tax deductions that SFAS 109 requires to be recognised no earlier than the period in which they are deductible. Paragraph 231 of SFAS 109 states that 'The tax benefit of statutory depletion and other types of special deductions such as those for Blue Cross-Blue Shield and small life insurance companies in future years should not be anticipated for purposes of offsetting a deferred tax liability for taxable temporary differences at the end of the current year.'

BC83 IAS 12 specifies the treatment of tax deductions that form part of the tax basis of an asset or liability. It does not explicitly discuss the treatment of any other tax deductions.

BC84 The Board noted the following:

(a) Because of the global application of IFRSs the Board could not adopt an approach that listed specific items as special deductions.

(b) A deduction that relates to the amount that would be realised on the sale of an asset or on the settlement of a liability is part of the tax basis of the asset or liability. Special deductions are other deductions that do not form part of a tax basis.

(c) Special deductions could be unrelated to specific assets or liabilities and could have economic effects similar to tax rate reductions. For example, a deduction of 10 per cent of taxable profit is economically the same as a tax rate reduction of 10 per cent of the normal rate.

(d) Under both IAS 12 and SFAS 109, the tax rate used to measure deferred tax assets and liabilities is the rate expected to apply when the asset is realised or the liability is settled. For example, if different tax rates apply to different levels of taxable income (graduated rates), the expected average graduated rate is used.

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If different rates apply depending on how an asset or liability is recovered or settled, the rate that is used reflects the expected manner of recovery or settlement.

BC85 The Board considered that it was not possible in a short time to establish a clear principle to determine which possible future tax reductions (whether rate reductions or deductions) should be reflected in the rate used to measure the deferred tax assets and liabilities and which should not. A comprehensive review of special deductions would add a significant amount of time to the project. The Board therefore identified three possible approaches:

(a) Define special deductions as deductions that do not form part of a tax basis and require an entity not to anticipate special deductions.

(b) Define special deductions as deductions that do not form part of a tax basis and require an entity to include estimated special deductions in the determination of the effective tax rate used to measure deferred tax assets and liabilities.

(c) Stay silent on the issue of special deductions.

BC86 Approach (a) would achieve consistency with the treatment of the special deductions listed in US GAAP. But there are other deductions that would meet the proposed definition and whose effects are recognised in practice in the US. Approach (a) would not achieve convergence on those deductions. Furthermore, it would be inconsistent with the treatment of tax rate reductions prescribed by both IAS 12 and SFAS 109.

BC87 Approach (b) achieves consistency with the treatment of tax rate reductions. As noted above, some special deductions may be very similar to tax rate reductions. But treating all special deductions as tax rate reductions would be a substantial change in practice.

BC88 Given this, the Board proposes approach (c). IAS 12 is silent on special deductions and the Board is not aware of any problems arising in practice. That does not mean there is consistent treatment in practice or that problems will not arise in the future. However, if the IFRS is silent, entities will have the choice of being consistent with practice under existing US GAAP. Any other approach will either take considerable time to develop or cause divergence in some cases from existing US GAAP.

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Alternative minimum taxation

BC89 Some income tax jurisdictions have alternative minimum tax computations. Paragraph 19 of SFAS 109 includes requirements on the tax rate to be used when alternative tax systems exist. IAS 12 does not give any guidance on alternative tax systems. To ensure consistent treatment of such tax systems, the Board proposes to include those requirements of SFAS 109 in the IFRS.

Allocation

Allocation of tax to components of comprehensive income and equity

BC90 IAS 12 and SFAS 109 require the tax effects of items credited or charged 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 changes in 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.

BC91 The Board noted that in some situations backwards tracing seems the obvious treatment and prohibiting it seems to produce counter-intuitive results. This is particularly the case when the event that causes tax to arise in the current year is such that the only item recognised in relation to that event is the tax. For example, a change in the tax rate gives rise only to a tax amount to be recognised. No related non-tax amount is recognised in the current period. This means that the natural home for the tax seems to be the component of comprehensive income or equity in which the original item was recognised.

BC92 However, the Board also noted that in other situations, it seems intuitive to prohibit backwards tracing. If the same event causes both a tax amount and a non-tax amount to arise in the current year, the natural home for the tax amount seems to be the component of comprehensive income or equity in which the non-tax amount is recognised.

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For example, suppose a loss carryforward had arisen in a previous period and a valuation allowance for the full amount of the resulting deferred tax asset had been recognised at that time. In the current period, taxable gains beyond those previously expected reduce the valuation allowance. The tax benefit recognised because of the reduction in the valuation allowance could be regarded as belonging to the component in which the original loss had been recognised or to the component in which the taxable gain is recognised in the current period. In this case, it seems simpler to recognise the benefit in the component of comprehensive income or equity in which the taxable gain is recognised in the current period, ie not to trace backwards.

BC93 The Board also noted that in some cases backwards tracing would be difficult, or result in arbitrary allocations. For example, consider loss carryforwards that arose from losses recognised in different components of comprehensive income or equity. The tax authority does not distinguish between the different loss carryforwards. At the time the losses arose, 100 per cent valuation allowances were recognised in relation to the resulting deferred tax assets because the likelihood of their realisation was low. In a subsequent period, the assessment of the realisation of the total deferred tax assets changes and the total valuation allowance is reduced. There is no non-arbitrary way of allocating the benefit arising from the reduction in the total valuation allowance to the different components of comprehensive income or equity in which the losses were originally recognised.

BC94 Lastly the Board noted that IAS 12 does not specify how to make the required allocation to the different components of comprehensive income and equity. For example, it does not specify what should be done if the tax relating to the individual components does not add up to the total tax for the entity because of cross-cutting effects. Nor does it state whether tax benefits arising from tax losses should be allocated to the source of the loss or the source of the realisation of the benefit. IAS 12 acknowledges that difficulties can arise in making the allocation in some situations and requires a reasonable pro rata allocation, or other method that achieves a more appropriate allocation.

BC95 The Board considered whether:

(a) to continue with the existing approach in IAS 12;

(b) to converge with the requirements in SFAS 109; or

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(c) to develop a new approach to tax allocation that makes a principled distinction between those cases when backwards tracing should be required and those when it should be prohibited.

BC96 The Board concluded that a new approach to the allocation of tax to components of profit or loss and equity would take too long to develop fully to be part of this convergence project. Any new approach would also be likely to contain some arbitrary elements, simply because of the nature of allocation. Given the context of a convergence project, the Board decided to adopt the allocation approach in SFAS 109 because it is a more fully specified method than that in IAS 12.

BC97 However, the Board is aware that that the SFAS 109 requirements are complex, can be difficult to use and, as noted above, can seem to give counter-intuitive results. The Board has simplified the requirements as much as possible without changing the basic approach. In order to explore the issue fully in the exposure draft and get as much information as possible from respondents, the Board has also developed an approach based on the IAS 12 requirements with additional guidance to cover the gaps described in paragraph BC94 (see paragraphs 29A–34A and B34A–B36A). The invitation to comment asks questions on both approaches.

Allocation of changes in tax uncertainty

BC98 The draft IFRS proposes that changes in uncertainty over the amounts that the tax authorities will accept are treated as remeasurements of tax assets and liabilities (see paragraphs BC57–BC63). Consistently with the other allocation requirements, the Board therefore proposes to allocate the effects to continuing operations, regardless of the component in which the tax was originally recognised. FIN 48 and SFAS 109 do not specifically address this issue.

SIC-25 Income Taxes—Changes in the Tax Status of an Entity or its Shareholders

BC99 The Board proposes to amend the guidance in SIC-25 to be consistent with the revised allocation approach and to incorporate it into the new IFRS.

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Allocation of tax to entities within a consolidated tax group

BC100 Paragraph 40 of SFAS 109 provides guidance on allocating tax to entities within a consolidated tax group. SFAS 109 does not require a single allocation method, but requires the allocation method to be systematic, rational and consistent with the broad principles established by that standard. The Board decided that the requirements in SFAS 109 were a useful constraint on the treatment of tax in the separate financial statements of entities and proposes to include such guidance in the new IFRS.

Classification

Classification of deferred tax assets and liabilities in the statement of financial position

BC101 SFAS 109 requires deferred tax assets and liabilities to be classified as current or non-current on the basis of the classification of the underlying asset or liability. IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires deferred tax assets and liabilities to be classified as non-current, regardless of the classification of the underlying asset or liability giving rise to the temporary difference.

BC102 The Board concluded that classification of a deferred tax asset or liability consistently with the classification of the underlying asset or liability gave more useful information.

Classification of interest and penalties

BC103 FIN 48 states that the classification of interest and penalties payable to the tax authority is a matter of accounting policy choice that should be disclosed. The Board decided that this was a helpful requirement and should be included in the new IFRS. FIN 48 also requires disclosure of the amount of penalties and interest. The Board proposes not to require this disclosure. If interest and penalties are material, paragraph 97 of IAS 1 requires their disclosure. The Board noted that materiality depends on the nature of the item as well as its size.

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Disclosures

BC104 The Board considered disclosures from the standpoint of convergence, so that users would have comparable information under each standard. It considered (a) existing disclosure requirements that are in either IAS 12 or SFAS 109 but not in both and (b) new disclosure requirements that may be necessary as a result of decisions reached in the project.

Existing disclosures in one standard but not the other

BC105 The Board proposes not to include in the new IFRS the following disclosure requirements in IAS 12:

(a) the effect of changes in tax rates or laws substantively enacted after the end of the reporting period. This requirement is redundant because it is required by IAS 10 *Events after the Reporting Period*.

(b) the amount of a deferred tax asset and the nature of the evidence supporting its recognition when:

(i) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and

(ii) the entity has suffered a loss in either the current or the preceding period in the tax jurisdiction to which the deferred tax asset relates.

The Board concluded that this disclosure was something that auditors might wish to consider rather than relevant information for users of the financial statements.

BC106 The Board proposes to amend the requirement for an explanation of the relationship between tax expense and accounting profit to eliminate the option of aggregating separate reconciliations using the domestic rate in each individual jurisdiction. Instead the reconciliation must use the domestic rate in the parent company jurisdiction. This approach is consistent with that required in SFAS 109 and results in the effects of differences between the parent company's domestic rate and other rates being shown clearly as a reconciling item.

BC107 The Board decided that the following disclosures in SFAS 109 but not IAS 12 would provide relevant information that was cost-beneficial to prepare:

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(a) adjustments for a change in the tax status of an entity and tax benefits allocated directly to contributed capital or to goodwill, as examples of significant components of tax income or expense that should be disclosed.

(b) for entities not subject to income tax because their income is taxed directly to their owners, a requirement to disclose that fact and the net difference between tax basis and carrying amounts.

(c) for an entity that is a member of a group that files a consolidated tax return, disclosures in its individual or separate financial statements about the allocations of the consolidated tax effects.

New disclosures

BC108 When discussing the exception to the temporary difference approach in SFAS 109 for intragroup transfers of non-monetary assets (see paragraphs BC45–BC49), the Board noted concerns about possible perceptions of earnings management. In response to those concerns, the Board proposes to add requirements for disclosures about those transfers.

BC109 As part of the financial statement presentation project, users of financial statements informed the Board that they would find it useful to be able to reconcile total tax expense for a period to current tax payable for the period. The Board noted that the difference between the two was essentially the deferred tax expense. The Board concluded that further analysis of changes in deferred tax assets and liabilities would provide the information required. The Board therefore proposes a numerical reconciliation of the opening and closing amounts of deferred tax assets and liabilities, for each type of temporary difference and for each type of unused tax losses and tax credits.

BC110 The Board also considered possible disclosures relating to unremitted foreign earnings beyond those in either IAS 12 or SFAS 109. It does not propose to require additional disclosures because it identified no disclosures that would be both useful and practicable. The invitation to comment on the exposure draft asks respondents to supply specific suggestions for useful incremental disclosures.

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Transition

Transitional arrangements for entities that already apply IFRSs

BC111 If an IFRS does not include specific transitional arrangements, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires changes in accounting policy to be applied retrospectively unless it is impracticable to do so. In determining whether the proposals in the exposure draft would require specific transitional arrangements, the Board considered what information would be required for retrospective application and whether retrospective application would require the use of judgements that could be affected by hindsight.

BC112 Retrospective application of the proposals in general requires information at the date of the opening statement of financial position of the earliest period presented and subsequently. For the most part, no information is required for earlier dates because the deferred tax assets and liabilities depend solely on the carrying amount and tax basis of asset and liabilities at the end of the reporting period, assessments of the rates at that date and assessments of recoverability at that date. However, information is required for earlier dates in relation to two proposals as follows:

(a) The elimination of the initial recognition exception will change the carrying amount of some of the assets and liabilities that were subject to the exception. The exposure draft proposes that such assets and liabilities are recognised at an amount that excludes any entity-specific tax effects. For assets and liabilities that are not remeasured at fair value, retrospective application would require entities to determine the initial carrying amount and any subsequent depreciation. Furthermore, entities would need to determine whether a valuation allowance would have been recognised for any deferred tax assets, because that would affect the allocation of tax between profit or loss, other comprehensive income and equity (see (b) below).

(b) The proposed amendments include changes in the allocation of tax between profit or loss, other comprehensive income and equity. Retrospective application of those amendments would require information from earlier dates in order to determine the amount of tax that would have been recognised in other comprehensive income or equity. This amount needs to be known for disclosure and subsequent recognition in profit or loss of amounts previously recognised in other comprehensive income.

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BC113 The Board also identified two issues that could require judgements that could be affected by hindsight if the date of the opening statement of financial position for the earliest period presented is before the revised standard is issued. They are:

(a) the proposals relating to uncertainty over the amounts and rates underlying the tax amounts.

(b) the need to assess whether a valuation allowance is needed for any deferred tax assets that would be recognised under the proposals but are not recognised in accordance with IAS 12.

BC114 Given those factors, the Board proposes that the amendments should be applied to the assets and liabilities in the opening statement of financial position for the first period beginning after the new IFRS is issued and to all events and transactions thereafter. Any adjustment arising on the application to that first statement of financial position would be recognised in retained earnings.

BC115 Furthermore, in applying the amendments to the assets and liabilities in the opening statement of financial position:

(a) if assets and liabilities currently are subject to the initial recognition exemption and are not remeasured at fair value, they should be treated as if they had been acquired for their carrying amount at the date of the opening statement of financial position. In other words, the entity should assess whether its specific tax position would affect their initial carrying amounts measured in accordance with IFRSs, for example their cost. The entity would then apply paragraphs B10–B13 on the basis of that assessment.

(b) re-analysis of the cumulative amounts recognised in comprehensive income and equity should not be allowed.

Transitional arrangements for first-time adopters with a date of transition after the new IFRS is issued

BC116 There are no special transitional arrangements for IAS 12 in IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Retrospective application is required. As noted above, first-time adopters would not need to collect information from before the date of opening statement of financial position of the first period presented (ie the date of transition to IFRSs), except in relation to

(a) the carrying amounts of assets and liabilities that would have given rise to a temporary difference on initial recognition, and

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(b) the cumulative amounts of tax that would have been recognised directly in equity.

Other than for these items, first-time adopters whose date of transition to IFRSs is *later* than when the new IFRS is issued should have no problem in applying the amendments retrospectively.

BC117 In relation to (a) the Board concluded that the carrying amounts of such assets and liabilities should be determined as if the assets and liabilities had been acquired for their carrying amounts at the date of transition to IFRSs.

BC118 In relation to (b) the Board concluded that the requirements for the allocation of tax among components of profit or loss and equity should be applied prospectively from the date of transition to IFRSs. An entity should deem the amounts recognised outside profit or loss to be zero at the date of transition to IFRSs.

First-time adopters with a date of transition before the new IFRS is issued

BC119 For first-time adopters whose date of transition to IFRSs is before the new IFRS is issued, the same matters relating to the proposals on uncertain tax positions and valuation allowances will arise as for entities that already apply IFRSs (see paragraph BC113).

BC120 The Board therefore considered whether these first-time adopters should apply IAS 12 for any periods presented that start before the date of issue of the IFRS. However, such a requirement could require entities to apply IAS 12 for a comparative period only, before applying the new IFRS thereafter. The costs of doing this could exceed the benefits. The Board therefore proposes to allow first-time adopters the option of applying the new IFRS to all periods presented or of applying IAS 12 for any periods presented that start before the date of issue of the IFRS.

Analysis of costs and benefits of the new IFRS

BC121 The Board noted that a quantitative analysis of the costs and benefits of the new IFRS was not possible. The Board considered a qualitative analysis that compared:

(a) any new information that preparers of financial statements would need to obtain to comply with the proposed IFRS,

(b) the benefits to preparers in terms of an IFRS that is easier to understand and apply, and

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(c) the benefits to users of more useful information.

BC122 The Board noted that entities would need to generate new information to comply with the proposals that eliminate exceptions to the temporary difference approach, ie in relation to:

(a) temporary differences arising on the initial recognition of assets and liabilities outside a business combination that do not affect accounting or taxable profit at the time of initial recognition,

(b) temporary differences on domestic subsidiaries and joint ventures, and

(c) temporary differences on all associates.

BC123 As noted in paragraph BC29, the Board acknowledges that there may be difficulties assessing the proposed carrying amounts of assets and liabilities that give rise to a temporary difference on initial recognition. However, as also noted in paragraph BC29, the Board thinks that entities would be able to make such an assessment. The benefits of eliminating the exceptions are (a) an IFRS that is clear and easier to use than IAS 12 and (b) more consistent recognition of tax in financial statements.

BC124 The Board noted that when the FASB required the recognition of temporary differences for domestic subsidiaries and joint ventures, it stated that any increase in cost or complexity from requiring the prospective recognition of deferred tax liabilities arising from domestic subsidiaries and joint ventures would be minimal. Experience from the US indicates that this has been the case. The benefits of the proposed change are (a) a standard that is clear and easier to use and (b) more consistent recognition of tax in financial statements.

BC125 Regarding temporary differences arising on investments in associates (paragraph BC122(c)), the Board noted that IAS 12 already requires deferred tax to be recognised for temporary differences on associates unless the investor is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. IAS 12 also notes that an investor in an associate does not control the associate and is usually not in a position to determine its dividend policy. IAS 12 goes on to state that, in the absence of an agreement requiring the profits of the associate not to be distributed in the foreseeable future, deferred tax will be recognised. So, the proposal to recognise deferred tax arising from all temporary differences on associates will not affect many entities. Furthermore, in US GAAP there is no exception from recognising deferred tax relating to temporary differences arising on investments in associates. The Board is

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not aware of concerns about the costs of complying with this aspect of US GAAP. The benefits of the proposed change are (a) an IFRS that is clear and easier to use than IAS 12 and (b) more consistent recognition of tax in financial statements.

BC126 New information would also be required in some cases to comply with the proposals on tax allocation. Because changes in tax effects originally recognised in equity are recognised in income, the tax originally recognised in equity needs to be tracked until the item giving rise to it is recycled. Under IAS 12, a change in tax may eliminate the original tax effect in equity, obviating the need to track it in future. However, the proposed requirements on tax allocation would often require less information because changes in tax would not need to be tracked back to the source of the original tax. Indeed, the benefit of the proposed changes is that they would not require backwards tracing, which can sometimes be complex and costly.

BC127 Lastly, new calculations will be needed to comply with the proposals relating to uncertainty on tax amounts. Entities will need to determine the probability-weighted average outcome. The benefit of this approach is that none of the possible outcomes is ignored in the amounts recognised in the financial statements. The information in the financial statements is more complete.

BC128 Except in these cases, any new information required by the proposed changes is minimal. Overall, the Board takes the view that the benefits of the proposals outweigh their costs.

BC129 The Board also considered the cost and benefits of rewriting IAS 12. The rewrite does not involve any changes in the requirements beyond those analysed above. Users of the new IFRS would need time to accustom themselves to the new version, but the cost of that time should be outweighed by the benefit of using an IFRS that is clearer and more understandable.

Summary of the treatment of differences between IAS 12 and practice under US GAAP

BC130 The differences between IAS 12 and practice under US GAAP are summarised below, as follows:

(a) differences eliminated by the proposals in the exposure draft

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(b) differences that the FASB tentatively decided to eliminate before its decision not to publish proposed amendments to SFAS 109 (see paragraph BC5)

(c) differences considered in the project but not eliminated

(d) differences not considered in the project.

BC131 The following differences between IAS 12 and practice under US GAAP would be eliminated by the proposals in the exposure draft:

(a) definitions of tax basis and temporary differences, and the role of management expectations in the recognition and measurement of deferred tax. Although the proposed requirement to determine the tax basis of an asset by reference to the consequences of sale is more specific than the definition of tax basis used in US GAAP, in most cases it will result in a tax basis consistent with that used under US GAAP (see paragraphs BC17–BC23)

(b) definitions of investment tax credit (see paragraph BC24)

(c) the treatment of temporary differences on investments in subsidiaries, associates and joint ventures (see paragraphs BC39–BC44), except as noted in paragraph BC133(a)

(d) the approach to the recognition of deferred tax assets and the assessment of when it is more likely than not that there will be sufficient taxable profit to utilise the assets (see paragraphs BC52–BC56)

(e) the allocation of tax to components of comprehensive income and equity (see paragraphs BC90–BC99)

(f) the allocation of tax to entities within a consolidated tax group (see paragraph BC100)

(g) the treatment of alternative minimum tax systems (see paragraph BC89)

(h) the classification of deferred tax assets and liabilities in the statement of financial position (see paragraphs BC101 and BC102).

BC132 The following differences between IAS 12 and practice under US GAAP would have been eliminated by the FASB's tentative decisions in the project before its decision not to publish proposed amendments to SFAS 109:

(a) the treatment of temporary differences that arise on the initial recognition of acquired assets (see paragraphs BC25–BC35)

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(b) the treatment of deferred tax on intragroup transfers on non-monetary assets (see paragraphs BC45–BC49)

(c) the treatment of deferred tax on foreign non-monetary assets (see paragraphs BC50 and BC51)

(d) the effect of substantively enacted but not enacted tax laws (see paragraphs BC64–BC66)

(e) the treatment of the tax effects of future distributions (see paragraphs BC74–BC81).

BC133 The following differences between IAS 12 and practice under US GAAP were considered but not eliminated:

(a) the treatment of deferred tax assets arising on investments in domestic subsidiaries and corporate joint ventures that are essentially permanent in duration and for which it is not apparent that the temporary difference will reverse in the foreseeable future, for which there is an exception under US GAAP but for which the exposure draft proposes no exception (see paragraphs BC39–BC44)

(b) the treatment of special deductions and investment tax credits (see paragraphs BC82–BC89)

(c) the treatment of uncertain tax positions (see paragraphs BC57–BC63).

BC134 The following differences between IAS 12 and practice under US GAAP were not addressed in the project:

(a) the treatment of share-based payments

(b) the special transitional procedures in SFAS 109 for temporary differences related to deposits in statutory reserve funds by US steamship enterprises

(c) the exception in SFAS 109 for leveraged leases.

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Appendix A
[Draft] Amendments to the Basis for Conclusions on other IFRSs

This appendix notes that all references to IAS 12 in Bases for Conclusions will be footnoted to indicate that IAS 12 is superseded by IFRS X. This appendix also contains the following [draft] amendment to the Basis for Conclusions on IFRIC 7 Applying the Restatement Approach under IAS 29 *Financial Reporting in Hyperinflationary Economies in order to ensure consistency with IFRS X.*

A1 In the Basis for Conclusions on IFRIC 7 *Applying the Restatement Approach under IAS 29* Financial Reporting in Hyperinflationary Economies, a footnote is added to paragraph BC24 as follows:

IAS 12 was superseded by IFRS X in [date to be inserted]. IFRS X requires the same accounting as was described in paragraph 18 of Appendix A of IAS 12.

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Appendix B
Explanatory material from IAS 12

B1 IAS 12 was issued in 1996 by the Board's predecessor, the former IASC. IASC did not provide a basis for its conclusions. Instead, some of the paragraphs in the standard itself give the reasoning for the requirements of the standard. In this project the Board has not considered every aspect of IAS 12. It focused on eliminating differences between IAS 12 and US GAAP and on clarifying issues that were causing problems in practice. The Board's reasoning for the changes proposed are set out in the main body of the Basis for Conclusions.

B2 In revising IAS 12, the Board wishes the new IFRS to contain only requirements, like other IFRSs. However, it does not wish to lose the explanatory material that relates to matters not considered in this project. That explanatory material is therefore set out below. It has been brought forward unamended from IAS 12.

On the recognition of current tax liabilities and current tax assets

B3 When a tax loss is used to recover current tax of a previous period, an entity recognises the benefit as an asset in the period in which the tax loss occurs because it is probable that the benefit will flow to the entity and the benefit can be reliably measured.

On the recognition of deferred tax liabilities for taxable temporary differences

B4 It is inherent in the recognition of an asset that its carrying amount will be recovered in the form of economic benefits that flow to the entity in future periods. When the carrying amount of the asset exceeds its tax base, the amount of taxable economic benefits will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability. As the entity recovers the carrying amount of the asset, the taxable temporary difference will reverse and the entity will have taxable profit. This makes it probable that economic benefits will flow from the entity in the form

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of tax payments. Therefore, IAS 12 requires the recognition of all deferred tax liabilities, except in certain circumstances described in paragraphs 15 and 39.*

On the recognition of deferred tax assets for deductible temporary differences

B5 It is inherent in the recognition of a liability that the carrying amount will be settled in future periods through an outflow from the entity of resources embodying economic benefits. When resources flow from the entity, part or all of their amounts may be deductible in determining taxable profit of a period later than the period in which the liability is recognised. In such cases, a temporary difference exists between the carrying amount of the liability and its tax base. Accordingly, a deferred tax asset arises in respect of the income taxes that will be recoverable in the future periods when that part of the liability is allowed as a deduction in determining taxable profit. Similarly, if the carrying amount of an asset is less than its tax base, the difference gives rise to a deferred tax asset in respect of the income taxes that will be recoverable in future periods.

B6 The reversal of deductible temporary differences results in deductions in determining taxable profits of future periods. However, economic benefits in the form of reductions in tax payments will flow to the entity only if it earns sufficient taxable profits against which the deductions can be offset. Therefore, an entity recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised.

On the prohibition against discounting deferred tax assets and liabilities

B7 The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each temporary difference. In many cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between entities. Therefore, IAS 12 does not require or permit the discounting of deferred tax assets and liabilities.

* These references are to paragraphs in IAS 12. For the equivalent requirements in IFRS X, see the table of concordance.

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Table of Concordance

This table shows how the contents of the proposed IFRS X and IAS 12 *Income Taxes* correspond. Paragraphs are treated as corresponding if they broadly address the same matter even through the guidance may differ.

Paragraph of IAS 12	Draft IFRS X
Objective	1
1	2
2	2
4	4
5	Appendix A
6	Appendix A
7	15
8	15
9	16
10	No equivalent requirement
11	14
12	6
13	7
14	Basis for Conclusions B3
15	20 and 21
16	Basis for Conclusions B4
17	17
18	17
19	B38
20	B14 and B15
21	21
21A	21
21B	20
22	B10–B13
23	B10–B13
24	20 and 21
25	Basis for Conclusions B5
26	No equivalent requirement
27	Basis for Conclusions B6
28	B18
29	B18
30	B18
31	B23
32A	B38
33	No equivalent requirement
34	20 and 23
35	B23
36	B17
37	B19
38	B1
39	B4 and B5
40	No equivalent requirement
41	No equivalent requirement
42	No equivalent requirement
43	No equivalent requirement
44	B4 and B5
45	23
46	24
47	25
48	B26
49	B28
51	B29
52	B29
52A	B31 and B32
52B	No equivalent requirement
53	28
54	Basis for Conclusions B7

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Paragraph of IAS 12	Draft IFRS X
55	28
56	B19
57	29 and 33
58	29 and 33
59	No equivalent requirement
60	33
61A	29
62–65A	No equivalent requirement
66	B38
67	B39
68	B40
68A	B41

Paragraph of IAS 12	Draft IFRS X
68B	B42
68C	B43
71	36
72	B44
73	B45
74	37
75	No equivalent requirement
76	B46
77 and 77A	No equivalent requirement
78	38
79	41
80	41

Paragraph of IAS 12	Draft IFRS X
81	42–48
82	No equivalent requirement
82A	48(a)
84	No equivalent requirement
85 and 86	42
87	No equivalent requirement
87A	48(a)
87B	No equivalent requirement
87C	No equivalent requirement
88	49
89–95	Transitional requirements for IAS 12

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