Deutsches Rechnungslegungs Standards Committee e.V.
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60. Sitzung IFRS-FA am 27.07.2017
60_02b_IFRS-FA_Interpret_IAS33_SN

Dear Sue,

IFRS IC's tentative agenda decision re. IAS 33 in its March 2017 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the tentative agenda decision in respect of the IAS 33 issue that was taken by the IFRS Interpretations Committee (IFRS IC) and published in the March 2017 *IFRIC Update*.

We consider that the IFRS IC answered our main question and agree with the tentative conclusion. As the IFRS IC has concluded that the adjustment of profit or loss (when calculating EPS) depends on which "portion of any tax benefit [is] attributable to ordinary shareholders", and since the IFRS IC intends to continue its discussion by considering a multi-period example, we understand that the IFRS IC will follow up on the potential effects from tax benefits on profit or loss, or on EPS, in subsequent periods.

Therefore, our view as described in more detail in the appendix to this letter shall be considered a preliminary response. We also suggest some aspects that we suggest the Committee consider further when developing its final answer. If you would like to discuss our current views further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow
President

Appendix – Comments on the tentative agenda decision on the IAS 33 issue

In its tentative agenda decision, the IFRS IC clarifies that any tax benefits have to be considered in the EPS calculation, regardless of whether they are recognised in profit or loss or in equity. In addition, the IFRS IC concluded that, when calculating basic EPS, the entity has to adjust the profit or loss attributable to ordinary shareholders for the portion of any tax benefit attributable to those ordinary shareholders. Hence, if only the ordinary shareholders enjoy the tax benefit (and not any participating equity holders), the tax benefit is fully allocated to ordinary shareholders. Conversely, if ordinary shareholders and participating equity holders were to share the tax benefit, an entity would allocate the tax benefit using the relevant ratio to calculate the amount of the tax benefit attributable to ordinary shareholders (as outlined in IFRS IC March Agenda Paper 04, footnote 2).

While this clearly answers our submission, which explicitly assumed that the tax benefit is fully attributable to ordinary shareholders, the discussion at the IFRS IC made clear that additional guidance is needed about how the allocation would work in a case where the tax benefit, <u>if and when it is actually distributed</u>, is shared between ordinary shareholders and other participating equity holders.

If we consider the actual pattern of how and when tax benefits arise and are allocated and distributed eventually, it should be noted, that very often the tax benefit resulting from an actual distribution of the profit or loss for a particular period is not distributed in that same period as part of the dividends. In other words, the participating shareholders only participate in the tax benefit in the period when it is distributed as part of the dividends. When calculating EPS, the profit or loss attributable to ordinary shareholders is defined as the profit or loss <u>of the (current) period</u> including all items of income and expense as well as certain equity effects (IAS 33.12 et seq.). In particular, the EPS calculation (and the relevant profit or loss amount) is based on a hypothetical distribution of all amounts (IAS 33.A14(b)).

We feel that clarity is needed as concerns the terms “attributable to” and “for the period” and whether EPS shall be calculated solely on the assumption of a distribution of the profit or loss available for the period, or by also anticipating any hypothetical distribution of the tax benefit arising on the ‘real’ distribution, such that a potential distribution of tax benefits in a later period is anticipated in the calculation of EPS for the current period.

In the light of the above, we suggest the IFRS IC look into the following questions:

1. When calculating EPS for a period, does one need to anticipate future distributions?

As stated in the March 2017 IFRIC Update, the objective of basic EPS is to provide a measure of the interests of each ordinary share in the performance of the entity over the reporting period (IAS 33.11). When calculating EPS for a period, only the profit or loss amount of that period shall be considered (IAS 33.9). As the IFRS IC Staff correctly noted, it follows that the tax benefit does not increase the profit or loss of the (current) period.

In this context, it seems unclear how the term “after-tax amount” in IAS 33.14 should be interpreted and how it should be allocated. According to the wording of IAS 33.14, the “after-tax amount” is deducted from the profit or loss of the year. The remaining profit or loss is then attributed to ordinary shareholders (IAS 33.12). From this wording, it seems that the tax effect resulting from the (assumed) distribution of the profit or loss of the respective period is fully allocated to ordinary shareholders. There is no indication in IAS 33, especially not in IAS 33.14, that the tax benefit itself, if it will not be distributed in the current period, would have to be allocated to ordinary shareholders and other parties, based on an assumed *future* distribution.

On the other hand, one could argue that when calculating EPS for the current period, the tax benefit should partially be allocated to (other) participating equity holders, if they participate in any dividend distribution (including the tax benefit), even if the tax benefit is not distributed in that period. This would be based on the view that future profits or losses and the effect of future distributions equally need to be considered when allocating the tax benefit of the period. Since the part of the tax benefit distributed to participating equity holders subsequently results in further tax benefits, an iterative calculation would have to be applied.

From the wording of IAS 33 (as described above), and especially from the fact that EPS numbers are to be based on the distribution and its effects of the current period**, it appears that such future effects should not be taken into consideration.** We would appreciate confirmation that our understanding is correct.

2. ***When deciding to whom the tax benefit is attributable to, does one need to take into consideration which party controls the rights to those tax benefits?***

Any decision to pay dividends, including any distribution of tax benefits, is under the control of the ordinary shareholders. In situations where, as assumed in the fact pattern submitted, only the ordinary shareholders participate in a liquidation, they can exclude other parties (such as participating equity instrument holders) from participating in the tax benefits up until the period in which those tax benefits are distributed as part of dividends.

In this respect, we note that IAS 33.A14 prescribes that the allocation should be "in accordance with their dividend rights or other rights to participate in undistributed earnings", and further under lit. (b), that those rights must exist in relation to "profit or loss for the period". It is unclear to us what those <u>other rights</u> might refer to. In para. 15(b) of Agenda Paper 4 of the March 2017 meeting, the IFRS IC staff states that the right to the tax benefit is such an "other right". The right of the participating equity shareholders in the fact pattern, however, is solely a dividend right (to participate 10 to 1), especially they do not participate in a liquidation. Given this, it appears that participating equity shareholders do not have rights to any tax benefits that result from the distribution of the profit or loss of the period, up until the ordinary shareholders have decided to distribute the tax benefit as part of a dividend distribution.
Consequently, we assume that, for the period under consideration, the tax benefit must be fully allocated to ordinary shareholders, but, given a dividend distribution decision, in future periods it is partially allocated to other participating equity holders. Do you agree?