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Fédération des Experts comptables Européens

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Ref.: ACC/PRJ/TSI/IDS

Dear Ms. Flores,

Re: FEE Comments on EFRAG's Discussion Paper Improving the Financial Reporting of Income Tax

(1) FEE (the Federation of European Accountants) is pleased to comment on the EFRAG's Discussion Paper Improving the Financial Reporting of Income Tax (the "DP").

(2) EFRAG's proactive work is a useful way of evaluating different methods of accounting for income tax and provides helpful considerations to IASB about potential improvements to the current accounting standards.

(3) We welcome the work that EFRAG has done to date in attempting to assess the needs of the users and preparers. However, we do not believe that a final conclusion can be drawn at this stage based on the analysis and findings included in the DP regarding the most appropriate method for accounting for income tax.

(4) At this point, it would be difficult to conclude that there is only one method, which would address all the criticisms about the usefulness of the information provided by the existing tax standard, without introducing exceptions to the key principles applied.

(5) Therefore, it is important for EFRAG to continue with its efforts and undertake more extensive field testing such that the future development of the standard can be based upon a definitive assessment of what the users are looking for and which can be justified on a cost benefit basis.

(6) The evidence gathered by the field tests would provide a useful foundation to determine whether the development of an alternative approach to the existing accounting model for income tax is warranted. If necessary, limited improvements may be made to the current standard in the meantime.

(7) In our view, the current standard is not fundamentally flawed and, therefore, there appears to be no need for developing an alternative tax accounting method unless further field tests were to demonstrate that the current method does not meet users' and preparers' needs.

(8) The DP suggests a number of disclosures in addition to what is already required by IAS 12. As the disclosures required by IAS 12 are already detailed, we believe that it is necessary to clearly understand users' needs and whether additional disclosure is justified before proceeding further. Also, some of the disclosures proposed in the DP appear better suited for sections of the management report than the financial statements.

(9) The DP appears to focus on numerical tax disclosures. Although it correctly identifies that numerical analyses can be difficult because of the bespoke conditions relevant to each entity, in our opinion a solution could be that the numerical disclosures are combined with enhanced narrative (qualitative) information. This would give entities the flexibility to explain tax matters that are relevant to their particular circumstances.

(10) We also recommend EFRAG to take into account the various other ongoing projects, in particular its own project on the Disclosure Framework, while considering changes in the disclosure requirements for tax reporting.

Our detailed comments on DP are contained in the Appendix to this letter.

For further information on this letter, please contact Tibor Siska, Project Manager, at the FEE Secretariat on +32 2 285 40 74 or via email at tibor.siska@fee.be.

Yours sincerely,

Philip Johnson

President

Appendix

Question to constituents - General

Q0.1 Do you consider that there are deficiencies in IAS 12 that should be addressed? If so, should they be addressed through limited amendments to the standard or by developing a new standard based on different principles?

(11) We welcome the research work that EFRAG has done in this area. We also recognise that IAS 12 can be criticised, in part because of the many exceptions to the principles.

(12) Criticisms that we have noted with respect to IAS 12 relate to

- its "mechanical" approach that results in recognition of deferred tax liabilities that will never result in additional taxes being paid and are never expected to reverse (for example, due to the recognition of deferred tax liabilities on intangible assets that are not expected to be sold),
- the lack of discounting, in particular with respect to deferred tax liabilities that will only reverse in the very long-term (excluding liabilities which have been already discounted such as pension liabilities),
- the difference in treatment with respect to the initial recognition of deferred tax assets and liabilities arising on business combination compared to acquisition of a group of assets that does not represent a business.

(13) Despite these criticisms of IAS 12, there is no sufficient evidence to conclude that the current standard is fundamentally flawed and therefore needs to be completely rewritten. In our view, improvement to tax accounting can be achieved through targeted amendments to IAS 12. However, we would not wish to exclude any of the alternative solutions without further research.

(14) We recommend that EFRAG undertakes more extensive field testing before proceeding further with this project. This would provide the necessary foundation to determine what course of action is warranted: development of a new accounting approach based on different principles or (limited or substantive) improvements to the existing accounting model.

(15) A limited improvement to the existing accounting model would be clarification of what constitutes income tax within the scope of IAS 12. We address this point in our response to Question 1.9.

Questions to constituents - Part 1: Possible amendments to IAS 12

Q1.1 Under current IAS 12 a difference between the tax paid and the current tax expense reported in the income statement leads to misunderstandings of these relationships. Do you agree that additional disclosure that would provide a reconciliation of the taxes paid and current tax expense will help in understanding this relationship? (Paragraphs 1.15 to 1.18)

(16) We do not believe that the proposed disclosure about the relationship between the current tax expense as reported in the income statement and the cash paid for taxes for the current period would in itself provide additional useful information to what is already required by IAS 12. In our view, the cost to prepare such reconciliation would

probably outweigh the benefits of disclosing such information since we are not convinced that the reconciliation would meet the needs of those who call for greater transparency with respect to tax paid. Accordingly, we suggest that, should it decide to perform further field testing, EFRAG seeks to better understand the information needs of users with respect to cash tax paid.

(17) An alternative to the proposal of the DP (that focuses on the current tax expense) may be to provide information on the maturity of the cash flows expected from the tax liability recognised on the balance sheet. We think that the balance sheet position is a more appropriate starting point to provide meaningful information to the users; although more extensive research would be needed before a final conclusion can be drawn.

Q1.2 Do you agree that additional more detailed disclosures regarding deferred tax assets, especially unused tax losses and unused tax credits are necessary and useful? (Paragraphs 1.23 to 1.24)

(18) IAS 12 already requires information about deferred tax assets and the nature of the evidence supporting their recognition. However, we think it could be beneficial to provide enhanced narrative information, for example, about the utilisation of deferred tax assets and the specific restrictions attached to them in the different jurisdictions. Such narrative has the advantage that it could be accommodated within the existing framework and therefore instead of necessitating changes to IAS 12 improvements could be implemented through the promotion of best practice.

Q1.3 Do you agree with the identified users' information needs in Chapter 1 of Part 1? Do you have any suggestion for additional information requirements regarding reporting of income taxes? (Paragraphs 1.8 to 1.24)

(19) The users' needs as identified in the DP appear generally reasonable with the exception of the proposed additional disclosure requirements related to tax strategies, and contingent tax liabilities and assets/uncertain tax positions as described later in this letter. In addition, we believe that current tax liabilities for current and prior periods should be recognised and measured in accordance with the current version of IAS 12.

(20) Nevertheless, the research in this area appears incomplete. In our view, it is important for EFRAG to continue with its efforts and undertake proper field testing such that the future development of the standard can be based upon a definitive assessment of what the users are looking for and can be justified on a cost benefit basis. Furthermore, any significant changes in disclosure should be considered as part of a wider project on the disclosures in financial statements as a whole.

Q1.4 Do you agree that tax strategies to accommodate user information needs should be disclosed in the management commentary and not in the financial statements? Why or why not? (Paragraphs 1.8 to 1.9)

(21) Even if we cannot deny the interest of users in obtaining information about the various strategies developed by entities, we are sceptical that the disclosure provided by entities in that respect will result in meaningful information to users. Meaningful information should concern matters that are necessary to comply with the true and fair view and not confidential information. Therefore, we believe that this requirement would very likely result in boilerplate information.

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(22) Furthermore, if further field tests were to demonstrate that entities would produce meaningful information with respect to their tax strategies, we would suggest that the information be disclosed in sections of the management report other than the financial statements.

Q1.5 The reconciliation of the actual tax charge to the charge on profit at the statutory tax rate (tax rate reconciliation) is quite complicated and leads to some misunderstandings.
Do you agree that the suggestions made in the paper are helpful by clarifying the explanation why the current tax charge is not equivalent to the standard rate of tax applied to the accounting profit? Why or why not? (Paragraphs 1.19 to 1.20 and 2.21 to 2.34)

(23) We agree that it might be useful to further consider ways of how the tax rate reconciliation can be improved. Establishing a segregation of reconciling items into standard categories as proposed in the DP (income exempt from taxation, non-deductible items, etc) could be helpful to users and be supplemented by the details relevant to a company's particular circumstances. The numerical disclosures could be combined with enhanced narrative information, which would provide for more flexibility to explain tax matters that are relevant to a company's own circumstances.

(24) While some may be reluctant to impose such a reconciliation format, as mandatory we believe that it might be useful as a model of best practice in order to help the preparer to perform his reconciliation task.

(25) The DP suggests disclosure of individual items that are more than 5% of the income before tax multiplied by the statutory tax rate. We do not support this proposal, in our view, it would create a rule-based measure for determining the materiality of individual items. It is undesirable to establish such an absolute quantitative measure given that an established system for assessing materiality already exists within IFRS.

Q1.6 The amounts currently disclosed provide limited information about future tax cash flows.
How would you suggest the disclosures in IAS 12 be improved to provide better information about future cash flows?
(Paragraphs 1.13 to 1.14 and 2.35 to 2.40)

(26) Users are likely to welcome disclosures about future tax cash flows related to the current taxes recognised on the balance sheet to the extent these can be reliably assembled. However, at this stage, there is no clear evidence demonstrating that users need information beyond that. Further, except with respect to the reversal of current taxes, estimating future cash flow with an adequate level of certainty may sometime be very difficult due to the number of assumptions to be made and therefore should be limited to reasonably measurable amounts with predictable maturity.

(27) Nevertheless, we believe that further outreach is necessary to clearly establish users' needs in that respect and also to determine the ability of entities to provide information that would be sufficiently reliable.

Q1.7 The possibility of discounting deferred tax balances is discussed in paragraphs 2.44 to 2.50. In your view, should discounting deferred tax amounts be required? Please explain.

(28) Conceptually, discounting deferred taxes is desirable, in particular for deferred tax liabilities, since it would provide more meaningful information especially with respect to the amounts that will only result in a cash flow in the distant future (if at all). Discounting would also be consistent with the treatment of many other assets and liabilities in IFRS.

(29) Nevertheless, the complexity of discounting deferred tax should not be underestimated. It would require establishing a reliable schedule of the reversal of existing deferred tax assets and liabilities.

(30) To the extent that the carrying amount of assets and liabilities are discounted (for example, provisions within the scope of IAS 37) the related deferred tax assets/liabilities already reflect time value. Hence, introducing a requirement to discount deferred tax would require entities to distinguish temporary differences based on whether they relate to items that are already discounted.

(31) Despite the practical challenges, the possibility to introducing discounting within a revised standard should not be disregarded but further explored since companies may be willing to overcome the complexity of such calculation in order to provide more meaningful information.

(32) As an alternative to full discounting, we recommend that EFRAG also explores the possibility of providing additional information with respect to deferred tax liabilities that are expected to reverse only in the very long term (if ever) such as those related to certain intangible assets (e.g. trademarks).

Q1.8 Currently IAS 12 neither provides explicit guidance for accounting for uncertain tax positions nor contains any specific disclosure requirements regarding the tax risk position.

(a) Do you agree required information regarding uncertain tax positions should be disclosed? If so, which of the following do you prefer:

Alternative 1: Disclosure requirements should be included in management commentary.

Alternative 2: Disclosure requirements should be split in two parts. Part 1 would include disclosure of all positions for which the tax payer must establish a tax provision under IFRS and will be disclosed in notes to the financial statements. Part 2 would include all other uncertainties regarding income taxes for which no provision is recognised. (Paragraphs 1.10 to 1.12)

(b) Do you agree that IAS 12 should address the recognition and measurement of uncertain tax position? Why or why not? If you agree, should the measurement be based on the most likely outcome or a probability weighted method? Should measurement include the likelihood the tax position will be reviewed by the tax authorities or should that review be assumed? (Paragraph 2.51 to 2.59)

(33) We agree that disclosure of uncertain tax positions may be useful.

(34) We prefer Alternative 2, reflecting disclosure requirements in IAS 37. If the information is considered necessary to comply with the true and fair view, it should be included within the financial statements rather than in the management commentary.

(35) Further, we believe that it would be desirable to clarify the accounting for uncertain tax positions. We believe that IAS 37 should be the applicable standard.

(36) Conceptually, potential tax assets or liabilities are no different from other contingent assets or liabilities and, therefore, it would be reasonable that such amounts be accounted for in accordance with IAS 37, including the relevant disclosures. Accordingly, it may be sufficient to clarify that the scope of IAS 37 includes uncertain tax positions.

(37) Our response to the proposed revision of IAS 37 opposed the weighted average model. Accordingly, we do not support the use of this method for tax balances.

(38) The probability weighted average method can be appropriate for large and heterogeneous populations, but this is unlikely to be the case in instances of tax uncertainty. In our view, it is better to use the most probable outcome approach; this has the virtue of predicting an outcome that could actually occur.

(39) We do not consider the FASB issued guidance (FIN 48 Accounting for Uncertainty in Income Taxes) to be a potential solution for clarifying the accounting treatment for any uncertain tax position.

Q1.9 Are there any issues with IAS 12, which are not addressed in Part 1, that would significantly improve the standard? What amendments would address these issues?

(40) A frequent occurring difficulty is the scope of taxes that are subject to that Standard. For instance, when a national government introduces special incentives in order to stimulate local economy (e.g. R&D tax incentives), it is unclear whether this should be presented as a favourable tax income element or an operational element reducing operational cost. We believe that further work on that issue would be useful.

Q1.10 What is your view on the exemptions that currently exist in IAS 12?

(41) As a matter of principle, we believe that exemptions reduce comparability and understandability; therefore they should be avoided, to the extent possible. We prefer general principles that are applicable in various situations.

(42) However, we believe that the complexity of income taxes (including the fact that various jurisdictions have very different tax regimes) will necessarily result in exceptions and exemptions regardless of the underlying model used to recognise and measure income tax.

Questions to constituents - Part 2: Alternative approaches to accounting for income tax

Q2.1 If the development of a new standard for income tax, based on different principles from those used in IAS 12 is to be considered, which of the approaches discussed in Part 2 seem to have most merit and should be considered as a basis for further development?

(43) As already noted, we welcome the work that EFRAG has done to date in attempting to assess the needs of users. However, at this time, this research does not seem sufficient to draw definitive conclusions. Once there is a clear understanding of what the user needs are, the different alternative accounting methods and the related disclosures can be assessed. Currently, we deem it premature to identify which of the methods proposed in the DP would be the most appropriate for tax accounting.

(44) At this point, it would be difficult to conclude that there is only one method, which would address all the criticisms about the usefulness of the information provided by the existing tax standard, without introducing exceptions to the key principles applied.

(45) Although the underlying principles of IAS 12 can be questioned and the fact that there are many exceptions to the principles is a significant drawback, in our opinion this does not necessarily mean that the temporary difference model must be changed. Improvement to tax accounting could be achieved through targeted amendments made to the current accounting method in IAS 12. As noted in our response to Question 1.10, exceptions are unavoidable due to the complexity of the various income tax regimes worldwide and will arise regardless of the model chosen.

(46) Further research should be conducted before a final conclusion is drawn on whether or not another model should be used.