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Global Mindset, Asian Insights

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International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

RESPONSE TO DRAFT IFRIC INTERPRETATION (DI) – UNCERTAINTY OVER INCOME TAX TREATMENTS

ISCA sought views from its members on the above DI through a one-month public consultation and from the ISCA Financial Reporting Committee which includes experienced technical accounting professionals from large accounting firms.

We welcome the guidance proposed by IASB's IFRS Interpretation Committee (IFRIC) to reduce diversity in practice when addressing the recognition, measurement and disclosure of uncertain tax positions in financial statements. Other than on the scope of the DI, we agree with the proposals in the DI. We have highlighted some matters which we believe will further enhance the proposals in the DI. These have been included in our responses to questions 2 and 5 below.

We believe that this is a good opportunity for IFRIC to address the main issue on the project titled "IAS 12 Income Taxes – Deferred taxation arising from un-remitted overseas earnings (Agenda Paper 11(viii))", which was discussed during the IFRIC meeting held in May 2007. In our view, this issue can be addressed via the expansion of the DI's scope of uncertain tax treatments to include one arising from an uncertain future event. The uncertain future event here is whether or not an entity's direct (that is, not through foreign subsidiaries, branches, associates or joint arrangements) earnings (that is either tax free or otherwise) in another jurisdiction will eventually be remitted to the entity's home jurisdiction, thereby giving rise to an incremental tax payable. This will provide the very much needed guidance to the 2007 IFRIC request. The details of our proposed scope expansion are included in our comments to question 1 below.

Question 1—Scope of the draft Interpretation

The draft Interpretation provides guidance on accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments. Such uncertain tax treatments may affect taxable profit (tax loss), tax bases, tax credits or tax rates that are used to recognise and measure current or deferred tax liabilities or assets in accordance with IAS 12 Income Taxes.

Do you agree with the proposed scope of the draft Interpretation? If not, why and what alternative do you propose?

Paragraph 8 of the DI states that the DI applies to the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, in circumstances in which there is uncertainty over income tax treatments that affects the application of IAS 12. Paragraph 6 of the DI explains that a tax treatment is an "uncertain tax treatment" when there is uncertainty over whether the taxation authority will accept a specific tax treatment.

We are of the view that the proposed scope of the uncertain tax treatments could be expanded to include one arising from an uncertain future event such as whether or not an entity's direct (that is, not through foreign subsidiaries, branches, associates or joint arrangements) earnings (that is either tax free or otherwise) in another jurisdiction will eventually be remitted to the entity's home jurisdiction, thereby giving rise to an incremental tax payable.

At the IFRIC meeting held in May 2007 with the project title "IAS 12 Income Taxes – Deferred taxation arising from un-remitted overseas earnings (Agenda Paper 11(viii))", IFRIC was asked to provide guidance on whether entities should recognise a deferred tax liability in respect of temporary differences arising because foreign income is not taxable unless remitted to the entity's home jurisdiction. The foreign income in question did not arise in foreign subsidiaries, branches, associates or joint arrangements covered by IAS 12.39 as it is worded.

We note that there were differing views on whether a deferred tax liability should be recognised. Supporters for the no deferred tax view believe that, whether an entity operates a branch with its own bank account in a foreign country or holds directly a bank account in the foreign country should make no difference to the accounting for deferred tax arising on earnings from that bank account when the two conditions in IAS 12.39(a) and (b) are met. The two conditions are (a) the ability to control the timing of the reversal of the temporary difference and (b) it is probable that the temporary difference will not reverse in the foreseeable future. We support this view.

The IFRIC decided in July 2007 to not include the above issue to its agenda because the issue was being addressed by a Board project that was expected to be completed in the near future. We note from the IASB's workplan that the Board project on income tax was

moved from current project to research project in 2012, and is currently still at the research stage.

The DI has clarified a key principle in IAS 12 that deferred tax liabilities are recognised for amounts of income taxes payable in future periods in respect of taxable temporary differences. Paragraph 15 of the DI states that if an entity concludes that it is probable that the taxation authority will accept an uncertain tax treatment, or a group of uncertain tax treatments, it shall determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings.

The carrying amount of unremitted earnings in another jurisdiction is nil and whether there is a taxable temporary difference depends on whether the same earnings has a tax base other than zero with respect to the entity's home jurisdiction.

If remittance is highly likely, the tax base is the amount taxable in the home jurisdiction upon remittance and the resulting taxable temporary difference is the amount of that tax base.

On the other hand, if remittance is not intended, highly unlikely or impossible (as the amount has already been reinvested abroad), the tax base and the resulting taxable temporary difference converges to zero and based on the same rationale in paragraph 15 of the DI, the entity shall determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings.

The nature of the uncertainty here is not whether the taxation authority will accept a specific tax treatment but whether the entity will remit the foreign earnings to its home jurisdiction, thereby giving rise to an incremental tax payable.

Paragraph 15 interprets the key principle in IAS 12 in a way that has come close to resolving the long-standing issue since the 2007 IFRIC request and we think this interpretation should be enhanced to provide the much needed and awaited guidance. It is our recommendation that the scope in the DI be expanded such that "uncertain tax treatments" include uncertainty over whether there will be a future event giving rise to an incremental tax payable.

Question 2—When and how the effect of uncertainty over income tax treatments should be included in determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates

The draft Interpretation requires an entity to consider whether it is probable that a taxation authority will accept an uncertain tax treatment, or group of uncertain tax treatments, that it used or plans to use in its income tax filings.

If the entity concludes that it is probable that the taxation authority will accept an uncertain tax treatment, the draft Interpretation requires the entity to determine taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment included in its income tax filings.

If the entity concludes that it is not probable that the taxation authority will accept an uncertain tax treatment, the draft Interpretation requires the entity to use the most likely amount or the expected value in determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates. The method used should be the method that the entity concludes will provide the better prediction of the resolution of uncertainty.

Do you agree with the proposal in the draft Interpretation on when and how the effect of uncertainty should be included in the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates? If not, why and what alternative do you propose?

We agree with the proposal in the DI that the "probable" criterion of "whether a taxation authority will accept an uncertain tax treatment" be used to determine the accounting effect of uncertain tax treatments. This is also consistent with the recognition criteria for assets and liabilities in the *Conceptual Framework for Financial Reporting,* which uses a probability threshold for the recognition of assets and liabilities.

However, we note that the term "probable" is not explicitly defined in IAS 12, although generally defined in IFRS as "more likely than not". Considering the significance of the term "probable" in paragraphs 14, 15 and 16 of the DI, we recommend that the DI provides a definition of "probable" and also clarifies how "probable" is to be applied in measuring current tax liabilities/assets within the context of paragraph 46 of IAS 12.

Question 5—Other proposals

Disclosure

The draft Interpretation does not introduce any new disclosure requirements, but highlights the relevance of the existing disclosure requirements in paragraphs 122 and 125–129 of IAS 1 Presentation of Financial Statements, paragraph 88 of IAS 12 and IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

Transition

The draft Interpretation requires an entity to apply its requirements by recognising the cumulative effect of initially applying them in retained earnings, or in other appropriate components of equity, at the start of the reporting period in which an entity first applies them, without adjusting comparative information. Full retrospective application is permitted, if an entity can do that without using hindsight.

Do you agree with the proposals in the draft Interpretation on the disclosure and the transition requirements? If not, why and what alternative do you propose?

We agree that no additional disclosures are required for the DI. However, we question the need to highlight existing disclosure requirements in paragraphs 122 and 125-129 of IAS 1, paragraph 88 of IAS 12 and IAS 37. We are concerned that this may create some confusion over the interpretation of these disclosure requirements, in particular references made to IAS 37. In addition, we believe that the clarification in paragraph BC 31 of the DI will assist entities in understanding that IAS 37 should only be referred to for the determination of what disclosure should be given and that IAS 37 does not apply to the recognition of income taxes.

We recommend that if disclosure references to IAS 37 is to be retained, there should be clarifications on the different threshold used in IAS 12 and IAS 37 for the disclosure of contingent tax assets with possible (and not probable) inflows of economic benefits.

Should you require any further clarification, please feel free to contact Lim Ju May, Deputy Director, Technical Advisory and Professional Standards, or Jezz Chew, Manager, Technical Advisory and Professional Standards, from ISCA via email at jumay.lim@isca.org.sg or jezz.chew@isca.org.sg respectively.

Yours faithfully,

Titus Kuan
Director
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