International Financial Reporting Standards

GPF meeting, 5 March 2015
Agenda paper 5

Accounting for income taxes- Is there a need for change?

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Purpose of the session

- To understand how you use tax information in assessing company's performance.
- To understand your thoughts on today's requirements to account for income taxes.
  - Where you find a problem[1] in today's accounting for income tax?
- To understand the extent to which you think the Standard for income taxes should be amended?
  - Narrow-scope amendments to improve disclosures requirements?
  - Fundamental re-think of the principle to account for income taxes?

[1] Problems concerning uncertain tax position is separately discussed in Agenda Paper 2.

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Agenda

- Background information
- Survey Result
- Questions to GPF members

Background

The overall objective of income tax accounting today

- The objective of the IFRS for income taxes* is to provide information about:
  - current tax — tax payable or refundable for the current period
  - deferred tax — future tax consequences of book-tax differences on balance sheet
- ‘Temporary difference’ approach
  - deferred tax arises from
    - all timing differences; and
    - other differences such as (1) undistributed profits in subsidiaries, (2) revaluation gain on assets and (3) intangible asset acquired in business combination at fair value

* IAS 12 *Income Taxes*

Why are we doing this project?

- There are questions about the usefulness of the information provided by the current accounting requirements and their complexity.
  - Income Tax remains one of the most time-consuming topics at the IFRS Interpretation Committee
  - EFRAG's 2011 discussion paper[1] recognised deficiencies on both a conceptual and application level.
  - A number of professionals and recent academic research question the value relevance of deferred tax information.

1. http://www.efrag.org/files/ProjectDocuments/Proactive%20-%20Income%20Taxes/120127_Income_tax_DP_final.pdf

Possible approaches considered by other standards setters [1]

- Temporary difference approach (approach under IAS 12 today)
  – Deferred tax is recognised for a difference between accounting balance sheet and tax balance sheet.
- Accrual approach (timing difference approach)
  – Deferred tax is recognised for a difference between income statement and tax return
- Flow-through approach
  – Only current tax is recognised (no deferred tax)
- Partial tax allocation approach
  – Deferred tax is recognised for some but not all timing differences
- Valuation adjustment approach
  – Deferred tax is recognised as an adjustment to the value of underlying asset/liability

1. http://www.efrag.org/files/ProjectDocuments/Proactive%20-%20Income%20Taxes/120127_Income_tax_DP_final.pdf

Survey Result

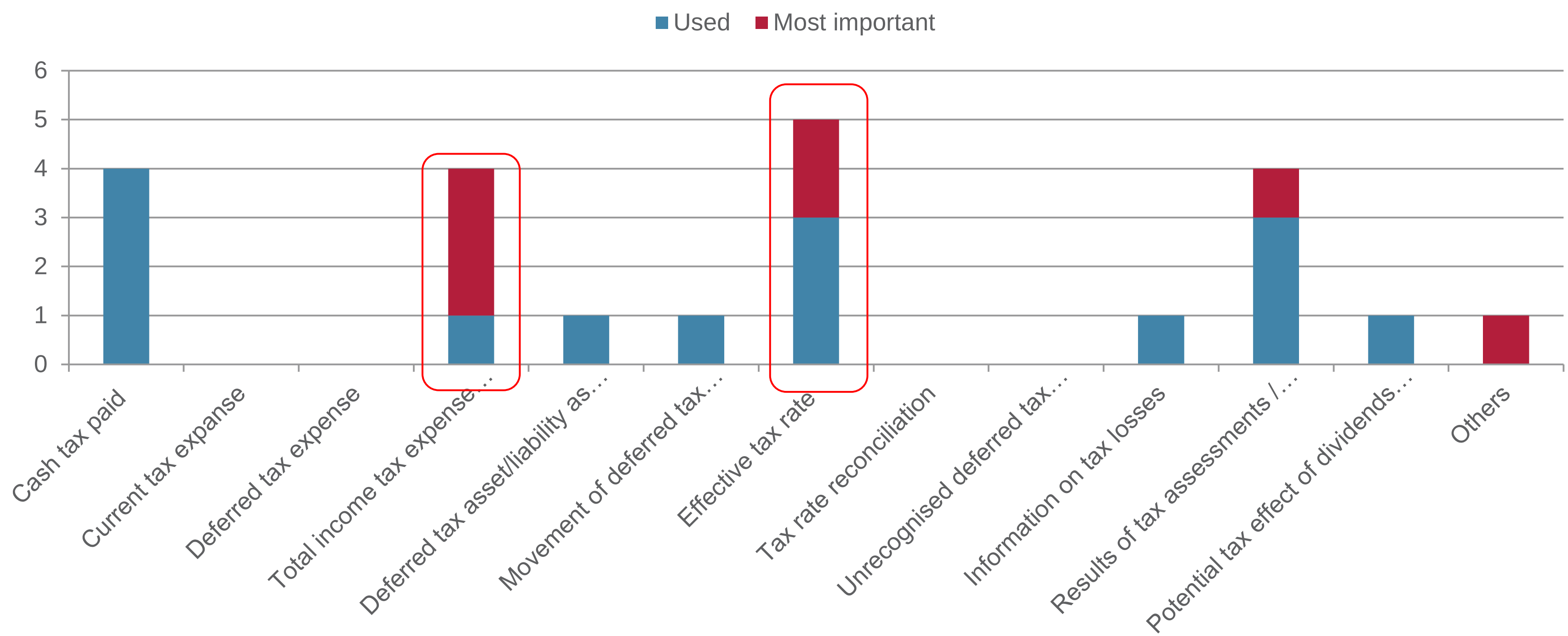
Pre-meeting survey

- A pre-meeting survey was conducted in January and some of you kindly completed the survey.
  - Is tax information disclosed being used by management?
  - What are the major problems that trouble preparers (e.g. deficiency in the fundamental principle, lack of guidance in certain areas, cost outweighs benefit etc)?

- A similar *investor* survey to CMAC was also conducted to understand users' needs and concerns.

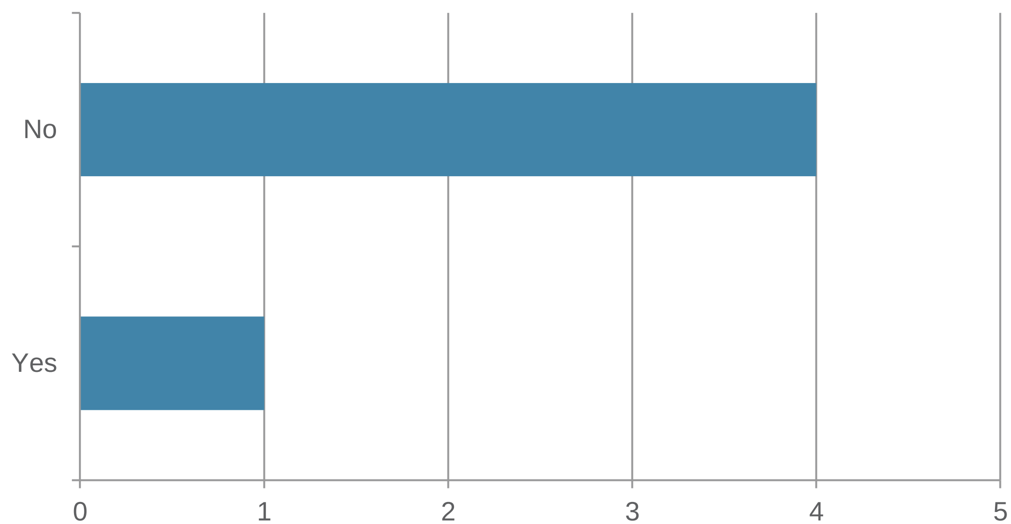
Is tax information used for internal evaluation (tax department)?

- Total income tax expenses and effective tax rate are commonly used and considered most important when evaluating performance of tax department



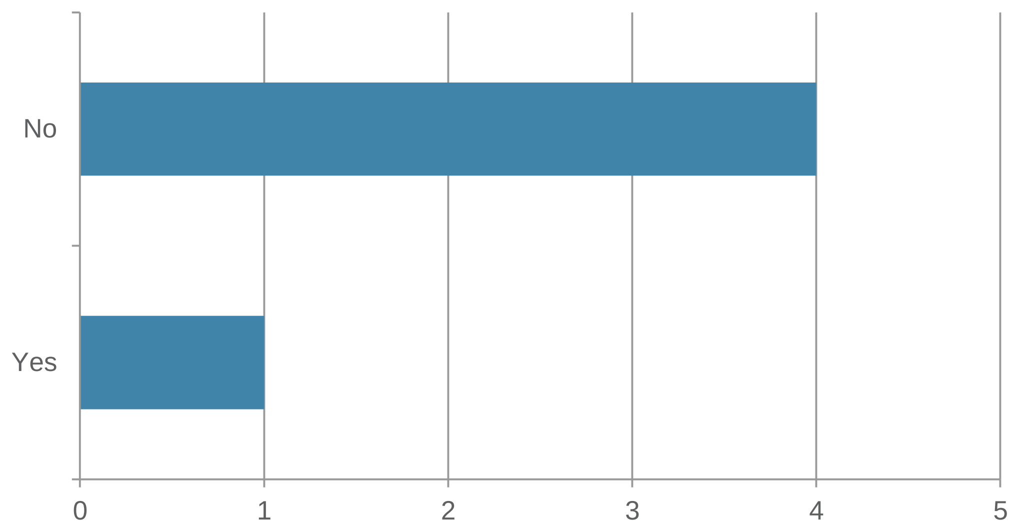
Is tax information used for internal evaluation (other than tax department)?

- The majority of respondents suggested that tax information is not used, while one company uses it to evaluate the corporate finance department
- Although income tax information is not used for evaluation of a department, its impact is estimated when making planning or business decision



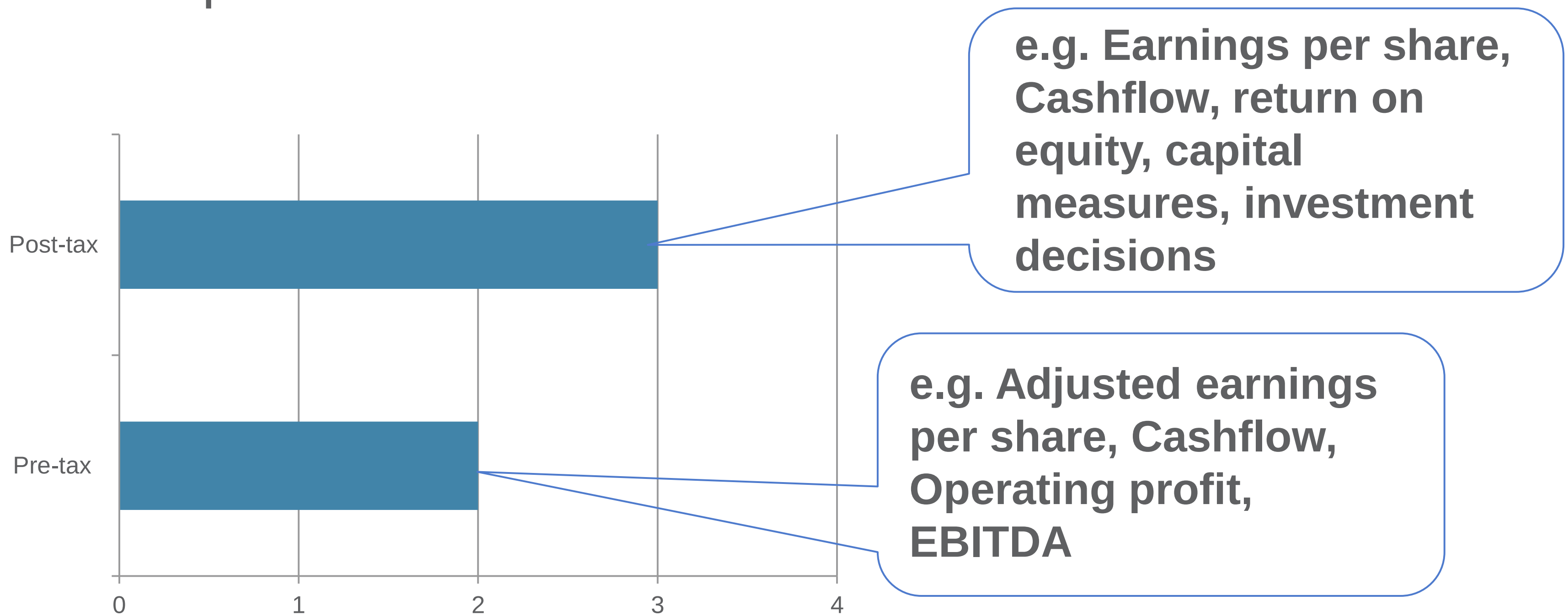
Is tax information used for internal evaluation (operational segment)?

- Only one respondent indicates that after-tax profit is used when evaluating segment performance



Is tax information used for internal evaluation (overall performance)?

- overall performance are evaluated on:



- ‘Operational performance is based on pre-tax results even though overall performance is based on post-tax result’

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Tax information used to evaluate the performance of tax department

Question 1 to GPF members

Following on from the survey result, please expand on:
- **How you use tax information today;**
- **What information about income tax you need; and**
- **How you use that information when you assess the company's performance?**

Areas where you seek more guidance

- Preparers seek more guidance on
  - Tax rate reconciliation (reflection of tax holiday; reintroduction of ‘permanent differences’; tax effect of consolidation adjustment)
  - Selection of tax rate (manner of recovery or settlement of deferred tax assets/deferred tax liabilities)
  - Uncertain tax positions (Separately discussed in Agenda Paper 2)
  - Estimation of future taxable profit (2014 ED *Income Taxes*: Recognition of Deferred Tax Assets for Unrealised Losses)
- Preparers support disclosure improvement on:
  - Valuation allowance (2009 ED *Income Tax*)

Disclosures which you think users are not using

Some of you believed that the following disclosures are not used by users while a lot of effort is needed to prepared them:

- Temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures

- Change in the deferred tax asset/liability balance in respect of each type of temporary difference and in respect of each type of unused tax losses and unused tax credits

- Disclosure of the deferred tax asset in respect of unused tax losses if a loss has been suffered in the current or preceding year.

Areas where users seek enhanced disclosure

- However, from the investor survey to CMAC members, we heard that investors need enhanced disclosures on the following:
  - Disclosures about the tax consequences of remitting cash from subsidiaries; as well as other items that affect availability of resources;
  - Detailed disclosure of the breakdown of deferred tax liability/deferred tax asset (recurring/non-recurring)
  - Introduction of ‘valuation allowance’ and clear picture of unused tax losses

Areas which may require a fundamental change

- Preparers also seek for improvements in following areas where the staff think that it may require a fundamental change in principle
  - Unrealized Intercompany Profits in Inventory
    - it is questionable whether this presentation provides the user of the financial statements a true and fair view
    - deferred tax on unrealized intercompany profits "at the supplier's tax rate" would represent a much truer impact of the actual tax paid by the Group
  - Tax impact related to valuing intangible assets in a business combination
    - tax effect is discounted for purchase price allocation purpose but not for financial reporting purpose.
    - Does the goodwill reported give a true and fair view?

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Areas to improve tax accounting

Question 2 to GPF members

- Are the indicated areas for improvement a fair reflection?
- Are we missing any important points?

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Areas to improve tax accounting

Question 3 to GPF members

- To what extent do you think the Standard should be amended? Enhanced disclosure through limited amendment or fundamental change in principle?

Thank you


individual comments
questions
expressions of
individual views
comments
feedback
questions
feedback
questions or comments
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