

July 30, 2009

International Accounting Standards Board (by e-mail to iasb@iasb.org)

First Floor, 30 Cannon Street

London EC4M 6XH

United Kingdom

Dear Sirs:

This letter comprises the response of the Canadian Accounting Standards Board (AcSB) to the IASB's Exposure Draft on *Income Tax* dated March 2009. Also attached (as an appendix) are detailed AcSB staff responses to the questions posed in the Exposure Draft.

Overall, we support the need for a converged and improved standard on accounting for income tax. We have **strong concerns**, however, with the project proceeding along its current path for a number of reasons.

First, we think that the IASB must prioritize its efforts and those of its constituents given the financial crisis and the number of active major projects already on the IASB agenda. Further, the AcSB does not believe the proposals represent a significant improvement over existing IAS 12, *Income Taxes*.

The introduction of the proposed standard will render the extensive interpretations of existing IAS 12 invalid. Consequently, accountants and tax lawyers will have to determine the appropriate interpretation of the new standard in the context of the many different tax regimes around the world. Even though the new words were not intended to change the

accounting in many instances, they will be pored over by constituents to determine whether the existing interpretations continue to be valid. The benefits of the proposals seem limited relative to the costs to constituents of understanding and applying them.

There are additional issues for entities adopting IFRSs in 2011. The AcSB does not believe the current plan to issue a final standard in the second half of 2010 will allow sufficient time for first-time adopters to review, interpret and make informed decisions pertaining to the new standard before these entities issue their first IFRS statements. As a result a first-time adopter may be forced to adopt IAS 12 initially and shortly thereafter again change the basis of accounting for income taxes – two changes in one of the most complex accounting areas. In our view, given the economic landscape and the limited benefits, this is the most inopportune time to proceed with these proposals.

Finally, the original project objective of short-term convergence with US GAAP has not been achieved. The exposure draft proposals converge with US GAAP in a number of areas, however there are also several significant departures from accepted US GAAP practice, for example with respect to the definition of the “tax basis” of an item and uncertain tax positions. While the FASB has stated that it intends to issue an Invitation to Comment containing the IASB’s proposed replacement of IAS 12, there is no commitment by the FASB to adopt the IASB’s proposals on income tax.

The AcSB does not support the project proceeding in its current form. We believe the project should either be re-scoped to include a more fundamental reconsideration of the accounting for income tax, or deferred to allow the IASB and constituents to focus on currently higher priority projects including financial instruments, consolidations and leases.

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In our view, under either of these alternatives, the IASB could make more limited changes to IAS 12 to address any critical issues in that standard. This would not involve rewriting the standard and would mean limited change for constituents, with the majority of existing guidance remaining applicable.

We would be pleased to elaborate in more detail if you require. If so, please contact Peter Martin, Director, Accounting Standards (+1 416 204-3276 or email peter.martin@cica.ca), Mark Walsh, Principal, Accounting Standards (+1 416 204-3453 or email mark.walsh@cica.ca), or Karlene Mulraine, Principal, Accounting Standards (+1 416 204-3466 or email karlene.mulraine@cica.ca).

On behalf of the Board

A handwritten signature in black ink that reads "Patricia O'Malley". The signature is written in a cursive style with a large initial 'P' and 'M'.

Patricia O'Malley
Chair, Accounting Standards Board

APPENDIX
Canadian Accounting Standards Board Staff Detailed Response
to IASB ED on Income Tax

The following is the response of the staff of the Canadian Accounting Standards Board (AcSB staff) to the detailed questions in the IASB Exposure Draft, *Income Tax*. Our responses are provided in the event the IASB decides to proceed with this project and should not be construed as in any way contradicting the overall views of the AcSB.

In developing its responses to the Exposure Draft questions, the AcSB staff held discussions with representatives from the six largest accounting firms in Canada and a number of financial statement preparers. Most of the tax and accounting practitioners we consulted found the document challenging to understand and felt there would be a number of substantive implementation issues. Although we considered all input received, the views expressed are those of the staff and do not necessarily represent those of the AcSB or other stakeholders with whom we consulted.

Question 1 – Definitions of tax basis and temporary difference

TAX BASIS

We do not agree with the proposed changes to the definition of tax basis. In our view, the proposed requirement to assume recovery through sale in determining the tax basis of an asset does not improve financial reporting and will result in less useful information being provided than under existing IAS 12. In addition, the proposed definition of the tax basis of an asset does not converge with practice under US GAAP and is inconsistent with other aspects of the Exposure Draft. We also think it would be useful to have some discussion of whether, and how, uncertainty should be taken into account when determining the tax basis of an item.

Tax basis - less useful information (if entity intends to use asset)

The requirement to determine the tax basis of an item based on expected recovery through sale will provide less useful information than existing IAS 12. For example, a taxation authority in a particular jurisdiction may provide very different deductions depending on whether an asset is sold or used – say, 25% if the asset is used and 0% if it is sold. If the entity intends to use the asset the Exposure Draft

proposal would provide a less representationally faithful presentation of the entity's tax position than existing IAS 12.

Tax basis – US practice

The proposed definition of the tax basis of an asset is also inconsistent with EITF 98-11, *Accounting for Acquired Temporary Differences in Certain Purchase Transactions that are not Accounted for as Business Combinations*, which notes, “the tax basis of an asset is the amount used for tax purposes... .” It does not specify amounts that are deductible only on sale. As a result, an IFRS/US GAAP difference will remain.

Tax basis – inconsistent with other aspects of ED, IFRSs and other tentative conclusions on accounting for long-term liabilities

The ED precludes the consideration of management's intent in determining the tax basis of an asset, but it permits the use of management's intent in determining the tax rate expected to apply and in deciding whether to recognize deferred taxes for investments in foreign subsidiaries. Management's intent or expectation is required by other IFRSs in measuring certain liabilities. For example, IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* requires the use of “best estimates” based on the “judgment of the management of an entity.” Management actions can play a significant role in determining future tax deductions. Consequently, deferred tax liabilities are unlike liabilities that are measured without reference to management's intent or expectations, such as financial liabilities measured at fair value under IAS 39, *Financial Instruments: Recognition and Measurement*.

Tax basis – non-taxable portion of a capital gain

In Canada and some other countries, the tax on capital gains is lower than on ordinary income. This is accomplished by including only a portion of any capital gain or loss in taxable income. That portion of the capital gain or loss is then taxed at the regular income tax rate. We believe the proposed definition of the tax basis of an asset is unclear regarding whether a non-taxable portion of a capital gain should be treated as a tax deduction or a rate reduction. In our view, the definition of tax basis should not be driven solely by the legal form of the tax return, but should take into account the substance of the relief. In the case of Canadian taxation of capital gains, the intent of the tax legislation is a rate reduction.

TEMPORARY DIFFERENCE

We presume the Board's intent in paragraphs 21 and BC36 is not to preclude the recognition of deferred tax amounts pertaining to tax deductible goodwill. These paragraphs should be redrafted to make that clearer. Also pertaining to goodwill, the second sentence in paragraph BC36 appears inconsistent with paragraph 9D in FAS 109. It is unclear whether the Board deliberately intended not to converge with the FASB in this regard.

Question 2 – Definitions of tax credit and investment tax credit

We are concerned that the proposed definition of an investment tax credit would limit such credits to items that are directly related to the acquisition of depreciable assets. In our view, the Board has made an arbitrary distinction that will result in economically similar items being treated differently. We consider this a fundamental scope decision that should not be made in a short-term convergence project.

In the Canadian tax context, it appears amounts received under the Scientific Research & Experimental Development program in respect of capital equipment expenditures would meet the definition of an investment tax credit. However, amounts received under the same government program for expenditures that are expensed (such as salaries, wages and benefits and materials) would not meet the definition of an investment tax credit – even though all expenditures were for the same project.

We do not believe this would produce decision-useful information and therefore recommend that the income tax standard remain silent on this issue, until the accounting for income tax and government incentive programs are both reconsidered more fundamentally.

Question 3 – Initial recognition exception

This requirement introduces significant complexity and will result in the same accounting as under existing IAS 12 in most instances. Constituents we have consulted with disagree that the proposals are easier to understand and apply (as is stated in the Basis for Conclusions). In particular there are concerns with determining entity-specific tax effects and the tax basis available to market participants (an undefined term).

In our view, there should be no change to the existing IAS 12 approach.

Question 4 – Investments in subsidiaries, branches, associates and joint ventures

This change would not improve financial reporting. Paragraph B5 identifies the principles for non-recognition of a temporary difference related to a subsidiary or joint venture. Those principles should apply to both foreign and domestic subsidiaries and joint ventures – there is no conceptual reason for inconsistent accounting for deferred taxes for subsidiaries and joint ventures based on geography. We also question the assertion that it is easier to calculate the tax basis for domestic subsidiaries than for foreign subsidiaries and think that the exception should be provided to all subsidiaries as is currently the case under existing IAS 12.

It is unclear which subsidiaries would be considered foreign and hence which subsidiaries the exceptions would apply to. For example, if a Canadian parent company has a US subsidiary A which has a Canadian subsidiary B, is B a foreign subsidiary of the Canadian parent company?

As discussed in our response to question 17 on disclosures, we are concerned that though an exception is provided for foreign subsidiaries, some of the required disclosures would necessitate making the computations for which the exception has been provided.

We are also unclear how the proposal would apply in situations in which a portion of an entity's investment in a foreign subsidiary does not meet the first criterion for exemption from the temporary difference approach. For instance, when an entity expects to sell a portion of a foreign subsidiary, that portion would not meet the "essentially permanent in duration" test. Would the foreign subsidiary as a whole fail the criteria for non-recognition of deferred tax amounts?

Question 5 – Valuation allowances

We agree with the proposed provisions pertaining to valuation allowances. These are similar to those included in SFAS 109, *Accounting for Income Taxes* and we are not aware of any significant interpretation issues with the words in SFAS 109. However, we do not see this as a significant improvement to IAS 12.

Question 6 – Assessing the need for a valuation allowance

We agree with the proposal for the reasons set out in the Basis for Conclusions.

Question 7 – Uncertain tax positions

We agree that an IFRS on income tax should address the accounting for uncertain tax positions. However, we have significant concerns with the practical aspects of the proposals and recommend that the IASB undertake field testing in this area prior to adopting the proposals.

Tax practitioners tell us that the proposed approach would be unduly onerous for preparers and would not provide more decision-useful information to the users of financial statements than other approaches. While the basis proposed for the measurement of uncertainty surrounding current and deferred tax amounts is consistent with the Board’s current thinking in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, we think that the Board should give further consideration to the costs to comply relative to the added benefit (if any) provided to a financial statement user.

While the accounting for uncertain tax positions under FIN 48, *Accounting for Uncertainty in Income Taxes*, is inconsistent with current decisions reached by the IASB in its project to amend IAS 37, some practitioners think that it provides a more reasonable approach. Many companies have a significant number of uncertainties related to income tax. However, for a number of these uncertainties the likelihood of the expected outcome may be high (and the expectation of a different outcome low). The standard as worded would require extensive effort to consider all of these “uncertainties” and the appropriate amount to record each of them at. This effort will be impacted by the number of different parties (company accountants, tax specialists, auditors) involved in making (and agreeing on) a necessarily subjective determination of the extent of each uncertainty.

Before finalizing this standard, the IASB should research the practical implications of the Exposure Draft proposals on uncertainty and the experience of applying the FIN 48 uncertainty recognition requirements.

Question 8 – Enacted or substantively enacted rate

We welcome the clarification proposed but do not feel it is sufficient. We recognize the difficulty in defining “substantively enacted” in a worldwide context. There are likely to be significant interpretation issues on this subject and the potential for inconsistencies within a jurisdiction and across jurisdictions.

The application guidance notes that tax rates are considered substantively enacted when “future events required by the enactment process historically have not affected the outcome and are unlikely to do so.”

This raises two issues. Firstly, how does this apply when there is no history of similar circumstances? Does this lack of a history preclude the conclusion that a rate is substantively enacted? Secondly, is the conclusion that tax rates or tax laws have been substantively enacted precluded if historically there have been rare cases when future events required by the enactment process have affected the outcome? The questions are about how much judgment can be used in applying paragraph B26 when determining whether a tax rate or tax law is “substantively enacted.”

We also note inconsistencies in the use of the terms “tax rates” and “tax laws” throughout the proposed standard. For instance, tax laws are not mentioned in paragraph 27(a) and inconsistently throughout paragraphs B26 and B31. Many tax changes are to aspects of tax laws other than tax rates. The word “rate” is too narrow and terminology is needed that covers both rates and other provisions of tax laws.

Question 9 – Sale rate or use rate

We do not agree with the proposals. In our view, the proposal to change from the current requirements in IAS 12, by which the tax basis and tax rate are both based on management’s expected manner of recovery, is a step backward and would introduce unwarranted inconsistency. We think that requiring an entity to use a sale rate even when it expects the asset will be recovered through use, does not provide a faithful representation of its tax position. The proposal is also inconsistent with the IASB’s convergence objective.

Question 10 – Distributed or undistributed rate

We agree with this proposal and encourage consistent use of management’s intent in the standard. In determining the tax basis of an item, an entity is required to assume an outcome – i.e., sale – regardless of management’s expectations for realizing the asset’s carrying amount. However, in determining tax rates, the Exposure Draft proposes that entities use the rate expected to apply.

We note the Exposure Draft does not address situations in which the form of the distributed rate is a deduction and not a different rate per se. For example, in determining taxable income, income and royalty trusts and mutual funds in Canada deduct amounts distributed to unit holders. This is substantively the same as a lower tax rate on amounts paid out as distributions. Paragraph 27(d) refers to “the tax effects of distributions of profit” and would seem to apply. However, the application guidance in paragraphs B31-32

refers only to the tax rate and it is unclear whether these paragraphs apply in this circumstance. A further issue is whether deductions for distributions can amount to the entity being, in substance, exempt from tax.

Question 11 – Deductions that do not form part of a tax basis

In our view, it would be useful for entities to have some guidance on this issue, but we recognize that providing it may be beyond the scope of a short-term convergence project.

Question 12 – Tax based on two or more systems

We agree that, when an entity is required to pay tax based on one of two or more alternative computations, the interaction between those computations should be considered when measuring deferred tax assets and liabilities.

Question 13 – Allocation of tax to components of comprehensive income and equity

We do not agree with the proposals. Our understanding is the equivalent requirements in SFAS 109 are considered to be complex and difficult to apply by entities in the US. We do not see this as an improvement on IAS 12 and think the existing IAS 12 approach should be retained.

Question 14 – Allocation of current and deferred taxes within a group that files a consolidated tax return

We agree that the requirements in SFAS 109 are a useful constraint on the allocation of tax to the separate financial statements of group entities and should be included in the new IFRS.

Question 15 – Classification of deferred tax assets and liabilities

We agree that classifying a deferred tax asset or liability consistently with the classification of the underlying asset or liability would provide more useful information than the current IAS 1 requirement. A temporary difference associated with a current asset or liability generally reverses in the subsequent year and should not be classified as non-current.

Question 16 – Classification of interest and penalties

We agree with the disclosure requirement. Paragraph 97 of IAS 1 currently requires the separate disclosure of items of income or expense when material. The proposed requirement for entities to disclose the accounting policy choice selected will facilitate transparency to financial statement users and encourage consistency over time.

Question 17 – Disclosures

We agree with most of the disclosure requirements proposed, but we have some concerns about the following:

- The disclosure requirements in paragraph 49 about the effects of possible outcomes of a review by tax authorities are quite onerous. Several preparers with whom we discussed the proposals shared this view. In particular, there are concerns about divulging information to taxation authorities that may jeopardize positions taken in tax filings. Several preparers were also concerned about the ability to compile such information. We also note paragraph 92 of the existing requirements in IAS 37 permits an entity to not provide specific information on provisions, contingent liabilities and contingent assets if such disclosure would be prejudicial to the entity. We think the income tax standard should have the same provision. In our view an income tax provision is similar to other provisions and liabilities.
- We also disagree with the proposal to require disclosure of temporary differences associated with investments in subsidiaries and interests in joint ventures for which deferred tax amounts have not been recognized. We are not convinced of the benefit of requiring the computation of these amounts for disclosure purposes. The required computations would be complex and would eliminate much of the benefit of the exemption from recognizing the related deferred tax.

Question 18 – Effective date and transition

We agree with the proposals, subject to the comments provided in the AcSB letter.

Other

It is not clear whether the proposed standard should be applied to certain payments to governments. For example, mineral royalties may be the greater of a percentage of revenue and an amount based on a measure of income. In some situations the royalty is paid on one basis until the entity recovers its investment and on the other basis after that. If the standard does apply to these situations, it is unclear how it applies when the royalty changes from being paid on one basis to the other basis.

The AcSB letter contemplates the possibility of making limited improvements to address critical issues in the income tax standard. In the event the IASB decides to make more limited improvements to IAS 12 in the near term, we recommend addressing issues pertaining to determining the tax basis of an item, how uncertainty should be factored into the measurement of both current and deferred tax amounts and applying distributed and undistributed rates.