

European Financial Reporting Advisory Group
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Paris, July 12, 2012

RE: Comments on EFRAG Discussion Paper on “Improving the Financial Reporting of Income Tax”

Dear Françoise,

Mazars welcomes the opportunity to comment on the discussion paper on “Improving the Financial Reporting of Income Tax”.

We appreciate the work carried out by EFRAG together with the ASB. We are convinced that there are areas for improving the financial reporting for income tax. In 2009 the IASB tried to address some of the identified issues in IAS 12 but has not completed its project.

The fact that this project was abandoned does not mean that amending IAS 12 was not the right answer. We strongly believe that current deficiencies in IAS 12 could be addressed by limited amendments that would consist in:

- additional exemptions to the recognition or measurement principles, and
- additional disclosures or amendments to the disclosures in order to improve transparency and to better meet the users’ needs.

The additional exemptions that we wish being introduced should deal with the following issues where existing requirements are unsatisfactory:

- deferred tax liabilities relating to intangible assets with indefinite useful life acquired through a business combination,
- the tax rate that should be used for single assets entities,
- the tax rate that should be used for measuring deferred tax arising from the margin elimination on intra-group transfer of assets.

In our opinion this approach is the only one capable of improving the financial reporting of income tax on a timely basis. Part one of the Discussion Paper provides valuable input for identifying the users' needs and areas where disclosures should be completed and/or improved.

Another issue that should be addressed is the scope of the standard. New taxes are currently implemented by several governments, and it is sometimes not clear whether these taxes are within the scope of IAS 12. The IFRS Interpretations Committee has received several submissions and has suffered difficulties in providing a clear answer. We believe that a clarified scope of the standard would be helpful in reducing diversity.

Trying to develop a new standard for accounting for income tax based on new principles is a second step that cannot be completed until years. We believe that the starting point of such project should be the definition of what would be the most relevant outcome of accounting for income tax, in relation to the global objectives of financial statements.

The work done by EFRAG in part II of the Discussion Paper is useful, since it explores the benefits and criticisms of several approaches for accounting for income tax. It is nevertheless difficult to identify among the 5 approaches the basis for a new IAS 12, since the global objective of accounting for income tax has not been defined.

Our answers to the specific questions raised in this DP are presented in the attached appendix.

We would be pleased to discuss our comments with you and are at your disposal should you require further clarification or additional information.

Yours sincerely



Michel Barbet-Massin

Head of Financial Reporting Technical Support

Appendix 1: detailed answers to the questions raised in the DP**Question to constituents**

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?

Accounting for income taxes is a complex issue, and developing a standard that addresses the specific issues raised by the different tax jurisdictions appears to be a challenge. Furthermore, the complexity of income tax and the diversity that exists among tax regulations make it difficult to understand the tax expense and to provide information that meets the users' needs.

IAS 12 tries to address the accounting for income taxes on the basis of the temporary differences approach that relies on two main principles:

- Income tax expense, and deferred tax assets and liabilities, shall be regarded as incremental items to principal items (revenue or expense transactions, and recognised assets and liabilities);
- The recognition of deferred tax assets and liabilities is based on differences between the carrying amount and the tax basis of assets and liabilities, i.e. a balance sheet approach.

The consistent application of these principles may lead to questionable outcomes, such as accounting for a deferred tax liability although the reporting entity has the ability not to pay for it. Some have already been addressed by IAS 12 through specific exemptions to the recognition principle. We believe that limited amendments to IAS 12 could address the remaining issues. The most important issues that should be dealt with are the following:

- single assets entities,
- deferred tax liabilities relating to intangible assets with indefinite useful life,
- elimination of intra-group margin.

This does not mean that we are not in favour of the development of a new standard based on different principles. We believe that undertaking such a work should be preceded by a comprehensive analysis of the users' needs regarding accounting for income tax. Such an analysis would help defining what should be the objectives of accounting for income tax, in relation to the general objective of financial statements. On that basis one would be able to conclude whether IAS 12 principles are suitable or it is necessary to develop a new standard based on different and more relevant principles.

Question to constituents

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)

The question is not whether a reconciliation of the taxes paid and current tax expense will help in understanding the relationship between tax expense and tax cash flows (of course it will), but whether such understanding is useful to users.

We believe that a reconciliation of tax items on the statement of financial position at the beginning and the end of the reporting period, showing tax paid, tax arising from business combinations, tax reported in other comprehensive income, in current tax expense or in discontinued operations would be more useful than an explanation why the tax paid is different from the current tax expense.

Question to constituents

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)

Deferred tax assets arising from unused tax losses are often significant. We believe that additional information, such as the expected timing of recovery, the expiration date of the tax losses or tax credits, the key assumptions on which the recognition of the tax assets relies, could be necessary to clearly present the risks and uncertainties faced by the entity on that matter.

Question to constituents

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)

We believe that some of "users' information needs" identified in Chapter 1 of Part 1 are more users' wishes than users' needs. We do not think that users really need detailed information regarding the tax strategies such as tax planning or transfer pricing, unless the recognition of deferred tax assets relies on a specific tax opportunity.

Information regarding the future tax cash flows, provided it could be considered as a users' need, should not be included in the notes to the financial statements, but rather elsewhere in the comprehensive report.

Uncertain tax positions is a complex issue. We understand both:

- the users' need for information regarding the tax risks taken by the reporting entity, and
- the fact that specific information on that matter could represent additional tax risks for the entity.

We do not favour the issuance of specific provisions regarding uncertain tax positions. We believe that existing disclosure requirements dealing with (i) contingent tax liabilities (IAS 12.88) and (ii) sources of estimation uncertainty (IAS 1.125) are sufficient to provide relevant information.

Question to constituents

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)

We believe that information regarding tax strategies cannot be considered as part of the users' needs, unless the implementation of the tax strategy is a key assumption for recognising deferred tax assets.

Therefore, we believe such disclosure should not be made mandatory neither in the notes to the financial statements nor in the management commentary.

Question to constituents

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 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)

We acknowledge that the way entities present their "tax proof" is often unclear and that there is great diversity in practice. Some present the tax base together with the tax effect, others only the tax effect in currency unit. Some present a reconciliation of the theoretical tax expense to the actual one, others a reconciliation of the theoretical tax rate to the actual one.

Diversity could be reduced and a clearer presentation could be achieved by issuing non-authoritative examples as application guidance. In that purpose, propositions made by EFRAG in the Discussion Paper are interesting, but we do not believe it is useful to segregate current tax from deferred tax on that matter.

What is also important is to provide qualitative information about the different line items of the “tax proof” table. For example, when a tax income is recognised on the basis of previously unrecognised tax losses, we believe it is important to explain the reasons why:

- the use of those tax losses has become possible in the current year when it was considered as non-probable the year before, or
- the assumptions regarding the entity’s ability to use those tax losses in the future have changed.

Question to constituents

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)

We believe it would be useful to provide information about the expected timing of payment or recovery of tax assets and liabilities that are accounted for in the statement of financial position. Nevertheless, we believe that giving no information is better than giving unreliable information. Deferred tax assets and liabilities are not discounted under IAS 12 because it is often impracticable to set up a detailed scheduling of the timing of the reversal of each temporary difference.

We do not believe that information about future tax cash flows should go further than such a timetable, if reliable. Future tax cash flows are closely related to future profits or losses, and financial reporting standards do not require information about the expected performance for the following years on a predictive basis. Providing such information regarding tax would be a non-sense.

Question to constituents

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

One could view the discounting of deferred tax balances as a way to solve some issues raised by IAS 12, such as the recognition under a business combination of significant tax liabilities that will never be paid.

Nevertheless we do not favour introducing discounting of deferred tax balances, for the following reasons:

- the debate on the relevance of discounting deferred tax balances when the underlying asset or liability is already measured on a discounted basis has not been completed. Indeed, it is necessary to conclude whether discounting such deferred tax balances is relevant or not, and, if not, which are the underlying assets and liabilities that should be considered as measured on a discounted basis.
- discounting deferred tax balances would imply establishing a detailed scheduling of the timing of reversal of the temporary differences. We strongly believe that such a scheduling would not be reliable, and would imply continuous reassessment, making tax expense even more difficult to understand.

Question to constituents

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

- (a) Do you agree required information regarding uncertain tax positions should be disclosed? If so, which alternative 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 positions? 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)

As stated in our answer to question Q.1.3 we believe that requiring specific disclosures regarding uncertain tax positions may be problematic.

Uncertain tax positions are sources of uncertainties that should be dealt with like any other source of uncertainties:

- they should be accounted for as a liability if they meet the definition and the recognition criteria of any non-financial liability;
- otherwise they should be disclosed in the notes to the financial statements, according to the provisions of IAS 37.86 regarding contingent liabilities and IAS 1.125.

In 2009 the IASB tried to address the accounting for uncertain tax positions through its Exposure Draft proposing some amendments to IAS 12. At that time we answered that we did not see any rationale for developing different recognition criteria for uncertain tax position than the criteria applying to non-financial liabilities under IAS 37. We did not change our mind. A litigation or potential litigation should not be accounted for nor disclosed differently only because it relates to tax matters.

Question to constituents

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?

We believe that addressing some of the inconsistent outcomes of IAS 12 could significantly improve the standard. The main areas we identified are the following:

- single assets entities,
- deferred tax liabilities relating to intangible assets with indefinite useful life,
- elimination of intra-group margin.

Question to constituents

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

In 2009 the IASB proposed to remove some of the exemptions that exist in IAS 12, in order to make the standard more “principles-based”.

We are convinced that all exemptions that currently exist under IAS 12 are meaningful. They aim to correct in some specific circumstances the inconsistent outcomes resulting from IAS 12 principles.

That is why we do not favour any removal of the existing exemptions. On the contrary we believe that new exemptions should be added in order to address the issues listed in our answer to question Q1.9.

Questions to constituents

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?

Q2.2 Do you think that there are any specific practical difficulties with implementing the approach(es) that you favour in practice?
If so, how can those difficulties be addressed?

Q2.3 Are there any approaches that are not discussed in Part 2 that should be considered?

Q2.4 In your view should a combination of approaches be considered? If so, which approach should be used in what circumstances?

We believe that neither the flow through approach nor the valuation adjustment approach are worth being considered as a basis for further development:

- the flow through approach is simple to implement, but does not provide relevant information by not accounting for deferred tax;
- the valuation adjustment approach seems too complex to implement, and its benefits are not obvious to us.

The partial tax allocation approach relies on the same concept as the temporary difference approach, but proposes to recognise deferred tax assets and liabilities only when a net reversal of temporary differences is foreseeable. We do not favour this method that we find complex and relying on too much judgement.

We believe that the temporary difference approach and the accruals approach, which have already been experienced in several sets of financial reporting standards and have proven to generally provide relevant outcomes, could be a sound basis for developing a new standard on income tax.

The choice between the two approaches as the basis for development of a new standard cannot be made until the objectives of accounting for income tax have been clearly defined. The relevance of each approach can be assessed in the light of these objectives only. That is why we believe that defining the objectives of accounting for income taxes shall be the starting point of any fundamental work on this issue.

Question to constituents

Q2.5 Do you have any further comments on the discussion of the various approaches in Part 2?

As already explained in our answer to question Q1.1 and Q2.1-4, we believe that a clear definition of the objectives of income tax accounting is a mandatory step before trying to develop new approaches.

We believe the Discussion Paper failed to meet this first step.