FRC

Accounting Standards Board

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Françoise Flores
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Email: commentletter@efrag.org

4 November 2010

Dear Françoise

EFRAG's Draft Comment Letter on the IASB's Exposure Draft (ED) 'Recovery of Underlying Assets'

This letter sets out the ASB's comments on the above DCL. The ASB agrees with EFRAG that IAS 12 *Income taxes* lacks guidance in accounting for income tax in relation to assets for which the tax consequences depend on the way the carrying amount of the underlying asset is recovered and is supportive of the IASB addressing this issue.

The ASB has responded directly to the IASB, and a copy of our response is attached. As you will see, we share EFRAG's disagreement with the proposal to use an exception to the measurement principles in IAS 12 to resolve the issue. We concur with EFRAG that the issue should be addressed by extending application guidance on the measurement principle and basing the guidance on the 'expected manner of recovery or settlement' of the underlying asset. That is, explaining how to determine the expected manner of recovery in paragraph 52 of IAS 12.

The ASB agrees that the scope of the ED should be restricted to investment properties at fair value under IAS 40 *Investment Property*, as this is the issue to be resolved as a matter of urgency, and that proposals should not expand the exception to temporary differences to other types of assets.

Should you wish us to expand on any aspect of this response, please contact me or Jennifer Guest j.guest@frc-asb.org.uk

Yours sincerely

David Loweth

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Mitsuhiro Takemura
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4 November 2010

Dear Mitsuhiro

IASB's Exposure Draft 'Recovery of Underlying Assets'

This letter sets out the Accounting Standards Board's (ASB's) comments on the Exposure Draft (ED) '*Recovery of Underlying Assets*'.

The ASB is aware that some constituents consider IAS 12 *Income taxes* lacks guidance in accounting for income tax in relation to assets for which the tax consequences depend on the way the carrying amount of the underlying asset is recovered and is supportive of the IASB addressing this issue.

However, we disagree with the proposal to use an exception to the measurement principles in IAS 12 to resolve the issue for the reasons outlined in our response to question one of the invitation to comment. The ASB is unconvinced by the IASB's arguments put forward in paragraph BC 10 and we do not agree that that this proposal is an improvement on current practice under IAS 12. In our view, that the IASB should address the issue by extending application guidance on the measurement principle and basing the guidance on the 'expected manner of recovery or settlement' of the underlying asset. That is, explaining how to determine the expected manner of recovery in paragraph 52 of IAS 12.

Our other main concern is with the scope of the ED. We consider that the scope should be restricted to investment properties at fair value under IAS 40 *Investment Property* as this is the issue to be resolved as a matter of urgency. The ASB does not agree with the IASB's decision, in the proposals, to expand the exception to temporary differences to other types of assets.

It is the ASB's view that property, plant and equipment or intangible assets measured using the revaluation model in IAS 16 *Property, plant and equipment* and IAS 38 *Intangible Assets*, respectively, should continue to be accounted for in accordance with the principles underlying IAS 12 *Income Taxes*.

Please find attached, as an appendix to this letter, our detailed responses to the invitation to comment questions.

Should you wish us to expand on any aspect of this response, please contact me or Jennifer Guest j.guest@frc-asb.org.uk

Yours sincerely

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Appendix

RESPONSE TO SPECIFIC QUESTIONS IN THE EXPOSURE DRAFT
'Deferred Tax: Recovery of Underlying Assets'

1.1 *This Appendix sets out the ASB's responses to the questions set out in the exposure draft's Invitation to Comment.*

Question 1 – Exception to the measurement principle

The Board proposes an exception to the principle in IAS 12 that the measurement of deferred tax liabilities and deferred tax assets should reflect the tax consequences that would follow from the manner in which the entity expects to recover or settle the carrying amount of its assets and liabilities. The proposed exception would apply when specified underlying assets are remeasured or revalued at fair value.

Do you agree that this exception should apply when the specified underlying assets are remeasured or revalued at fair value?

Why or why not?

No, the ASB does not agree. The ASB considers that the IASB should not introduce an exception in the general principle of IAS 12 because it:

(a) may result in financial reporting that does not necessarily reflect an entity's expectations or best estimates and is therefore to be less relevant or decision-useful to users of financial statements;

(b) may give rise to significant internal inconsistencies with the underlying principles of IAS 12;

(c) adds complexity to the standard; and

(d) assumes that the carrying amount of assets will be entirely recovered through sale (which may not be the case).

The ASB is unconvinced by the IASB's arguments put forward in paragraph BC 10 that this proposal is an improvement on current practice under IAS 12.

As an alternative, the ASB considers it appropriate for the IASB to provide additional guidance for entities who apply the fair value model in IAS 40 *Investment Property*. Our preference is for the IASB to extend application guidance on the measurement principle and base the guidance on the 'expected manner of recovery or settlement' of the underlying asset. That is, explaining how to determine the expected manner of recovery in paragraph 52 of IAS 12.

Question 2 — Scope of the exception

The Board identified that the expected manner of recovery of some underlying assets that are remeasured or revalued at fair value may be difficult and subjective to determine when deferred tax liabilities or deferred tax assets arise from:

a) investment property that is measured using the fair value model in IAS 40;

b) property, plant and equipment or intangible assets measured using the revaluation model in IAS 16 or IAS 38;

c) investment property, property plant and equipment or intangible assets initially measured at fair value in a business combination if the entity uses the fair value or revaluation model when subsequently measuring the underlying asset; and

d) other underlying assets or liabilities that are measured at fair value or on a revaluation basis.

The Board proposes that the scope of the exception should include the underlying assets described in (a), (b) and (c), but not those assets or liabilities described in (d).

Do you agree with the underlying assets included within the scope of the proposed exception?

Why or why not? If not, what changes to the scope do you propose and why?

No, the ASB does not agree with the proposed scope. The ASB considers that the scope of this present ED should be restricted to investment properties at fair value under IAS 40 *Investment Property* as this is the issue to be resolved as a matter of urgency. The ASB does not agree with the proposal to expand the exception to temporary differences to other types of assets.

It is the ASB's view that property, plant and equipment or intangible assets measured using the revaluation model in IAS 16 *Property, plant and equipment* and IAS 38 *Intangible Assets*, respectively, should continue to be accounted for in accordance with the principles underlying IAS 12 *Income Taxes*.

Question 3 — The Board proposes that, when the exception applies, deferred tax liabilities and deferred tax assets should be measured by applying a rebuttable presumption that the carrying amount of the underlying asset will be recovered entirely through sale. This presumption would be rebutted only when an entity has clear evidence that it will consume the asset's economic benefits throughout its economic life.

Do you agree with the rebuttable presumption that the carrying amount of the underlying asset will be recovered entirely by sale when the exception applies?

Why or why not? If not, what measurement basis do you propose and why?

No, the ASB does not agree with the rebuttable presumption that the carrying amount of the underlying asset will be recovered entirely by sale. In addition, we do not believe that the rebuttable presumption is operational. We consider that the IASB should not proceed with the proposal for a rebuttable presumption for the reasons given in our response to question one above.

However, if the IASB wishes to proceed with these proposed amendments, we would recommend that the rebuttable presumption be redrafted to reflect the tax consequences that would follow from the manner in which the entity expects to recover the carrying amount of an asset, rather than require entities to rebut the presumption that the asset will be sold. In addition, the IASB should define what it means by 'clear evidence' because without this clarification reporting under IAS 12 may become less comparable than at present, which seems contrary to the Board's intentions.

Finally we are not convinced that an approach based on a presumption that an asset is recovered entirely through sale (unless the entity can demonstrate that recovery will occur in another manner) results in useful information.

Question 4 — Question 4 – Transition

The Board proposes that the amendments should apply retrospectively. This requirement includes retrospective restatement of all deferred tax liabilities or deferred tax assets within the scope of the proposed amendments, including those that were initially recognised in a business combination.

Do you agree with the retrospective application of the proposed amendments to IAS 12 to all deferred tax liabilities or deferred tax assets, including those that were recognized in a business combination?

Why or why not? If not, what transition method do you propose and why?

The ASB agrees that the amendments should be applied retrospectively.

Question 5 – Other comments

Do you have any other comments on the proposals?

The ASB is not convinced by the arguments set out in paragraphs BC 27 and 28 of the ED that the benefits of the exception outweigh the concern acknowledged by the IASB that the amendments will increase the administrative burden for some entities.