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Chairman

JH

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Paris, the 11 SEP. 2012

Mr Wayne UPTON
Chairman
IFRS Interpretations Committee
30 Cannon Street
LONDON EC4M 6XH

Re : Draft IFRIC Interpretation DI/2012/1 - Levies Charged by Public Authorities on Entities that Operate in a Specific Market

Dear Mr Upton,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned draft. These views result from the ANC's due process, involving all interested stakeholders. More precisely, the due process includes fundamental work by a diversified experts task force, a full fledge discussion of its assessment by a complete Commission for all International standards and then a global and strategic discussion in the Collège (Board) before this letter was signed.

The ANC acknowledges that there is diversity in practice in how entities account for such levies, and that this issue has to be addressed. We consider that specific guidance in this case is needed and will contribute to consistency in the application of IFRS.

Nevertheless, the ANC believes a potentially significant amount of levies to be scoped-out of the draft interpretation, especially levies that are due only if a minimum revenue threshold is achieved, as well as fixed-fee levies. We consider that excluding these levies from the scope will not enable clarification of the accounting treatment for all the levies on entities operating in a specific market and that this will only partially reduce the diversity in practice.

Furthermore, the concept of "specific market" should be clarified in order to allow a better identification of the levies which are or not included in the scope of the draft interpretation.

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The ANC does acknowledge that the proposed consensus is aligned with the requirements in IAS 37 and the conceptual framework.

Nevertheless, we believe that these requirements do not allow for a faithful representation of the financial position and the financial performance of entities submitted to taxation in most cases, and especially in the interim financial statements. This is due to the specific characteristics of levies enacted by public authorities.

Levies are intended to finance public spending over a fiscal year and the subject of most of them are economic items generated over a year. Moreover, most levies recur from one year to the next.

Under such circumstances, the ANC considers that levies should be recognised through a process of systematic and rational allocation, in order to be matched with the recognition of the items subjected to the levy (in accordance with the Conceptual Framework, § 4.51), regardless of the recognition date of their obligating event. The recognition of a deferred charge on the period between two successive obligating events seems to be the most appropriate, should such levies fall under the scope of IAS 37.

This approach is not new and is in accordance with current standards, as in the recognition of grants related to assets, employer payroll taxes and insurance contributions.

However, the ANC acknowledges that the IFRS Interpretations Committee ("IFRS IC") has not been requested to address these ancillary issues and that they cannot be adressed only by interpreting the requirements of IAS 37.
Under these circumstances, the ANC considers that the proposed interpretation would not clarify totally and in a satisfying way the accounting issue for levies which do not meet the definition of income taxes as per IAS 12.

Moreover, the ANC considers broader thinking on the accounting of all levies to be necessary (and not only levies charged on entities that operate in a specific market), given the characteristics, diversity and complexity of the situations encountered. If deemed necessary, such project should be undertaken by the IASB.

If you have any questions concerning our comments, we would be pleased to discuss them.

Yours sincerely,

Jérôme HAAS

Appendix – Invitation to comment

Question 1 – Scope

The draft Interpretation addresses the accounting for levies that are recognised in accordance with the definition of a liability provided in IAS 37 Provisions, Contingent Liabilities and Contingent Assets. Levies that are within the scope of the draft Interpretation are described in paragraphs 3–5. Do you agree with the scope proposed in the draft Interpretation? If not, what do you propose and why?

Answer

Paragraph 4(b): levies that are due only if a minimum revenue threshold is reached.

Levies that are due only if a minimum revenue threshold is achieved are scoped-out of the draft interpretation. The ANC understands that these levies are outside the scope only because the Interpretation Committee did not reach a consensus as to whether the obligating event is :

- the generation of revenues only after the treshold is reached; or
- the generation of revenues as the entity makes progress towards the revenue threshold.

Nevertheless, the ANC considers that the draft interpretation should have addressed the accounting treatment for such levies, especially as their exclusion leads to scoping out a potentially significant amount of levies. The ANC has identified several levies in France that would in effect be scoped-out, whereas they differ from other similar levies only because of the existence of tax thresholds. This situation would potentially result in different practice for similar types of levies.

Paragraph 5(b): levies that are paid by entities that operate in a specific market as identified by the legislation (such as a specific country, a specific region or a specific market in a specific country).

The ANC considers that this paragraph does not provide sufficient guidance to determine whether a levy is or is not within the scope of the draft interpretation.

While the title suggests that the interpretation applies only to levies supported by entities that operate in a specific market (which is apparently a concise scope), the text illustrates this concept by "such as a specific country". According to the generally accepted principle of the territoriality of levies/taxes, this definition seems to include virtually all taxes within the scope of IAS 37.

The ANC wonders about the practical implications of such definition and considers that:

- Either these criteria have a real utility in determining the scope, in which case they must be better specified;
- Or they must be removed or amended.

Paragraph 5(e): the calculation basis of the levy

This paragraph requires that levies within the scope of the interpretation are to be based on data for the current period or a previous reporting period. The ANC considers that according to these specific criteria, fixed-fee levies will remain outside of the scope of the interpretation.

The ANC considers that these criteria should be reviewed, in order not to exclude fixed-fee levies from the scope of the interpretation.

Question 2 - Consensus

The consensus in the draft Interpretation (paragraphs 7–12) provides guidance on the recognition of a liability to pay a levy.
Do you agree with the consensus proposed in the draft Interpretation? If not, why and what alternative do you propose?

Answer

The ANC does acknowledge that the consensus is aligned with the requirements in IAS 37 and the conceptual framework.
IAS 37 (§ 19) states that "*it is only those obligations arising from past events existing independently of an entity's future actions (ie the future conduct of the business) that are recognised as provisions... [When] the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised*".

According to these requirements, when the obligating event to pay the levy, as identified by the legislation, is to operate in the market on 1/01/N, no provision can be recognised for the levy at the end of the prior period, even if going out of the business to avoid the payment of the levies may be considered as unrealistic in most cases, or if the entity has a legal or contractual requirement to operate in the market in the future periods. In that case, the going concern principle (IAS 1 § 25) does not allow the recognition of the levy, because it does not allow the recognition of items of the balance sheet which do not meet the definition of assets or liabilities (IAS 1 § 15).

In addition, when the measurement of the levy is based on the revenues generated in a prior period (IE1 example 2), the levy cannot be recognised as an expenditure in this prior period, because the matching concept under the Conceptual Framework (§ 4.50) does not allow the recognition of items of the balance sheet which do not meet the definition of assets or liabilities.

Nevertheless, the ANC believes that an interpretation based on the requirements of IAS 37 in the case of levies charged on entities that operate in a specific market, does not reflect the economic reality of these entities.

This is particularly evidenced by the conclusions drawn in the context of interim financial statements: because IAS 34 Interim Financial Reporting (§ 29) states that the same recognition principles should be applied in the annual and the interim financial statements, no liability should be recognised at the end of an interim reporting period if the obligating event to pay the levy has not yet occurred.
On the other end, when a levy is triggered in full, the liability must be recognised in full at the end of the interim reporting period if the obligating event to pay the levy has occurred and the expense cannot be deferred even if the costs associated with the levy tend to recur from year to year.

The ANC thinks that these requirements do not allow for a faithful representation of the financial position and the financial performance of entities submitted to taxation in most cases. This is due to the specific characteristics of levies enacted by public authorities, which is related to the purpose of the levies.

Taxes enacted by Public Authorities are intended to finance public spending in a given period, usually a calendar year. This is why most taxes have a yearly basis. Although generating events for taxes may vary from one tax jurisdiction to another or within a single jurisdiction (immediate or gradual event), as well as due dates and payments, they are only technical features related to the approval process of tax regulations.

However, the dominant common feature is that taxes are intended to fund annual public budgets and they are generally a compulsory levy on the economic items generated by the economic activity throughout the tax year (revenues, sales) or the economic items themselves (assets for example) which support the economic activity over the same period. Moreover, many taxes are enacted for an indefinite period from the date of application and it is therefore expected that they recur from year to year.

It would therefore be consistent with the economic reality of taxation to be able to recognise them in the interim reporting period on the basis of systematic and rational allocation procedures, in accordance with paragraph 4.51 of the Conceptual Framework.

"When economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined, expenses are recognised in the income statement on the basis of systematic and rational allocation procedures. [...] These allocation procedures are intended to recognise expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire".

Several accounting examples (from IFRS and US GAAP) illustrate this principle.

Example 1: Employer payroll taxes and insurance contributions (IAS 34 IE, § B1)
If employer payroll taxes or contributions to government-sponsored insurance funds are assessed on an annual basis, the employer's related expense is recognised in interim periods using an estimated average annual effective payroll tax per contribution rate, even though a large portion of the payments may be made early in the financial year. A common example is an employer payroll tax or insurance contribution that is imposed up to a certain maximum level of earnings per employee. For higher income employees, the maximum income is reached before the end of the financial year, and the employer makes no further payments through the end of the year.

Example 2: Presentation of grants related to assets (IAS 20, § 24 to §27)
Government grants related to assets, including non-monetary grants at fair value, shall be presented in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset.
Two methods of presentation in financial statements of grants (or the appropriate portions of grants) related to assets are regarded as appreciable alternatives.
One method recognises the grant as a deferred income that is recognised in profit or loss on a systematic basis over the useful life of the asset.
The other method deducts the grant in calculating the carrying amount of the asset. The grant is recognised in profit or loss over the life of a depreciable asset as a reduced depreciation expense.

Example 3: Presentation of grants related to income (IAS 20, § 29 and 31)
Grants related to income are sometimes presented as a credit in the statement of comprehensive income, either separately or under a general heading such as "Other income; alternatively, they are deducted in reporting the related expense. Both methods are regarded as acceptable for the presentation of grants related to income.

Example 4: Fees paid to the Federal Government by Pharmaceutical Manufacturers – A consensus of the FASB Emerging Issues Task Force (Subtopic 720-50)
720-50-05-1. *The 720-50 Subtopic provides guidance on the annual fee paid by pharmaceutical manufacturers to the U.S. Treasury in accordance with the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act (the Acts).*
720-50-05-2. *The Acts impose an annual fee on the pharmaceutical manufacturing industry for each calendar year beginning on or after January 1, 2011. An entity's portion of the annual fee is payable no later than September 30 of the applicable calendar year and is not tax deductible. The annual fee ranges from $2.5 billion to $4.1 billion in total, a portion of which will be allocated to individual entities on the basis of the amount of their branded prescription drug sales for the preceding year as a percentage of the industry's branded prescription drug sales for the same period. An entity's portion of the annual fee becomes payable to the U.S. Treasury once a pharmaceutical manufacturing entity has a gross receipt from branded prescription drug sales to any specified government program or in accordance with coverage under any government program for each calendar year beginning on or after January 1, 2011.*

720-50-25-1. The liability related to the annual fee described in paragraph 720-50-05-1 shall be estimated and recorded in full upon the first qualifying sale with a corresponding deferred cost that is amortized to expense during a straight-line method of allocation unless another method better allocates the fee over the calendar year that is payable.

Two views are possible to allow recognition of levies in the interim reporting period matching the recognition of the economic activity generated by the entity.

View 1: Recognition of liabilities according to IAS 37 (depending on the obligating event) and recognition of a deferred charge, allocated on a systematic basis over the generation of the economic items subjected to tax.

According to this view, no liability is recognised until the obligating event is reached. When the obligating event occurs at a point of time, the tax burden is allocated systematically on an annual basis (or on a multi-year basis if the tax is collected for a multi-year period). This recognition method of tax burdens corresponds to the recognition method of income and expense described in IAS 20, § 24 to §27 and U.S. GAAP (Subtopic 720-50).

View 2: Matching the tax burdens with economic items subjected to tax. This corresponds to the recognition method of expenses described in IAS 34 IE, § B1.
The accounting method depends on the respective dates of generation of the economic items subjected to tax and of the obligating event:

- When the obligating event is prior to the generation of the economic items subjected to tax, the levies are recognised by the allocation of a deferred charge on a systematic basis;

- When the obligating event occurs after the generation of the economic items subjected to tax, the levies are anticipated.

We support view 1 as the most appropriate allocation procedure for such taxes, should such taxes fall under the scope of IAS 37.

However, the ANC acknowledges that the IFRS IC has not been requested to address these ancillary issues and that they cannot be addressed only by interpreting the requirements of IAS 37.
Under these circumstances,the ANC considers that the proposed interpretation would not clarify totally and in a satisfying way the accounting issue for levies which do not meet the definition of income taxes as per IAS 12.

Moreover, the ANC considers that broader thinking on the accounting of all levies to be necessary (and not only levies charged on entities that operate in a specific market), given the characteristics, diversity and complexity of the situations encountered. If deemed necessary, such project should be undertaken by the IASB.

Question 3 - Transition

Entities would be required to apply the draft Interpretation retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.
Do you agree with the proposed transition requirements? If not, what do you propose and why?

Answer

The ANC agrees with the proposed transition requirements. In this specific case, the ANC does not see any impediment to full retrospective application.