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Mr. Steve Ong
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Hong Kong Institute of Certified Public Accountants
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Dear Steve,

IASB Exposure Draft on Deferred Tax: Recovery of Underlying Assets ("Exposure Draft")

I refer to your letter dated 16 September 2010 on the above to our Mr. Mark Dickens which has been passed to me for my attention.

We have completed our review of the Exposure Draft and our views are set out below.

General

The IASB proposes to amend IAS 12 "Income Taxes" to introduce a rebuttable presumption that investment property, other property, plant and equipment or intangible assets carried at fair value under IAS 40, IAS 16 or IAS 38 is recovered entirely by "sale" (paragraph 51B of the Exposure Draft).

We support the objective of the IASB to address concerns on IAS 12 that result in recognition of deferred tax liabilities on revaluation gains that have no significant future tax consequences. The proposals would be a pragmatic solution for entities holding investment properties or other relevant assets stated at fair value. However, the proposed amendment may not achieve its intended purpose because of the way in which the proposed amendment is worded.

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Under the proposals, the presumption will be rebutted if there is clear evidence that the asset's economic benefits would be consumed throughout its economic life. We believe that the carrying value for investment properties will normally be recovered through both "use" and subsequent "sale" and therefore there will be clear evidence that the presumption is invalid.

We also agree with the observation made in paragraph BC8 that *"In many cases, it is difficult or subjective to determine the expected manner of recovery when a temporary difference arises from investment property that is measured using the fair value model in IAS 40. Without specific plans for disposal of the investment property, it is difficult and subjective to estimate how much of the carrying amount of the investment property will be recovered by cash flows from rental income and how much of it will be recovered by cash flows from selling the asset"*.

To resolve the above issues, a possible solution may be to replace the term "entirely" with the word "primarily" in the phrase describing the rebuttable presumption in paragraph 51B of the Exposure Draft. We also believe the IASB should consider replacing the word "sale" with a more generic term such as "disposal" as the word "sale" generally implies that there will be a buyer whereas a "disposal" would also cover other circumstances such as demolition and redevelopment of the property by the reporting entity.

Principle-based accounting standards

We believe financial reporting standards should be principle-based and the current proposal, although pragmatic, is rule-based. We believe that the proposed exception to the measurement principle provides evidence that the current standard on deferred tax is deficient and also raises the more fundamental question of whether deferred tax accounting provides useful information and is conceptually sound.

In our view, the current deferred tax standard results in "bookkeeping" entries which are not indicative of the "actual" cash flows and the tax liabilities (namely, "present obligations") payable to tax authorities. We believe that deferred tax liabilities recognised under the current standard are in fact not "liabilities" under the Conceptual Framework.

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We understand that the IASB is considering a fundamental review of tax accounting. Given the concerns raised on whether IAS 12 provides useful information to readers of financial statements, we believe that the IASB should refrain from making any further substantial changes to IAS 12 until completion of the fundamental review on how taxes should be accounted for in financial statements and how the proposals are consistent with the Conceptual Framework.

We hope that the above comments are useful.

Yours sincerely,
For and on behalf of
The Stock Exchange of Hong Kong Limited



Colin Chau
Senior Vice President
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CC/ESA/el

c.c. Mr. Mark Dickens – Head of Listing