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Dear Steve,

IASB Exposure Draft ED/2009/2 Income Tax ("the Exposure Draft")

I refer to your letter dated 5 May 2009 on the above to our Mr. Joseph Mau which has been passed to me for my attention.

We have reviewed the Exposure Draft and our comments for your consideration are set out below.

<u>General</u>

The objective of the Exposure Draft is to clarify and improve certain aspects of IAS 12 "Income Taxes" and to reduce the differences between IAS 12 and US generally accepted accounting principles (US GAAP).

We fully support the objectives of improving the requirements relating to accounting for income tax. However, the proposed guidance in the Exposure Draft is inconsistent in a number of areas, such as clarity in differentiating and identifying the tax basis of an asset or a liability, and the proposal that the tax basis does not depend on the intended or expected manner of recovery or settlement. Without clarity in measuring the tax basis, the resulting standard will be difficult to interpret and apply on a consistent basis. As a consequence, the financial statements of entities will become less comparable and understandable. We do not believe that the Exposure Draft in its current form is an improvement to the existing IAS 12 and we understand the Australian accounting institutes have also come to this conclusion.

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Creating a meaningful accounting standard on taxation that will also cater for multinational companies that have exposure to a vast diversity of income tax regimes around the world is not an easy task and perhaps is impossible. We are concerned that the expected time required to be spent in coping with the complexities of the proposed requirements may not provide meaningful and useful information.

Given that national accounting standard setters in the UK and Germany are undertaking a fundamental review of income tax accounting, which indicates that the current deferred tax accounting standard is possibly deficient, we believe the IASB should consider whether it is appropriate to propose revisions at this time. We note that there are diverse views on income tax accounting and suggest that the IASB should seriously consider the fundamental conceptual basis for accounting for deferred tax and whether deferred tax assets and deferred tax liabilities are in fact "assets" and "liabilities" under the conceptual Framework that should be recognised.

We have concerns that the proposed income tax standard appears to be inconsistent with the current Framework. We note that the IASB is proposing changing the requirements in individual standards ahead of changes to the Framework. We would prefer that the IASB reviews the Framework before changing individual standards.

The concept of deferred tax is in substance an exercise in smoothing tax charges made to the income statement. It recognises that in determining taxable profit and the tax charge a separate basis is used by the tax authorities to that used in determining accounting profit. There are different measurement bases and there will always be differences, both of a permanent or a temporary nature, and it would appear that more meaningful and relevant information would be disclosure of a summarised tax computation, particularly in cases where tax is based on the reporting legal entity alone rather than on a group basis.

In the event that the Board proceeds with its proposals it should consider the comments from constitents before the implementation of the proposed standard, including adequate field testing to ensure the full implications are understood and are workable in practice. We set out some additional comments in the paragraphs below.

Tax basis and temporary differences

The Exposure Draft's major changes include the revised calculation methodology and the definition of the tax basis and temporary differences.

We note from paragraph 10 of the Exposure Draft that if there will be no effect on taxable profit when an entity recovers or settles the carrying amount of an asset or a liability, then no deferred tax will arise in respect of that asset or liability. We appreciate that the objective of the proposal is to avoid the recognition of a tax liability for amounts that are not taxable. However, we have concerns that the proposed approach may not address all relevant issues.

(a) Recovery through "sale"

The Exposure Draft states that the tax basis of an asset or a liability is *"the measurement, under applicable substantively enacted tax law, of an asset, liability or other item"*. In addition, paragraph 15 of the Exposure Draft provides additional guidance that the tax basis of an asset is determined by the tax consequence that would arise if its carrying amount was recovered through "sale". This approach is different to that currently required under IAS 12, which requires consideration of management's intention for recovery or settlement of the relevant asset or liability.

Paragraph BC21 states that the IASB is aware of different approaches in determining the tax basis of an asset. We understand an intended purpose of the guidance by referring to a "sale" is to simplify the determination of the tax basis and to eliminate consideration of management's intention. We however believe that determining the tax basis of an asset based on the assumption of a sale and not taking into account management's intention is not realistic.

We believe that the acquisition and retention of an asset is determined by management's intention and as a consequence this determines its balance sheet classification. Tax authorities also consider management's intention when arriving at taxable income, that is, whether the asset is of a capital or of a trading nature. Entities often acquire assets for use or consumption in their daily operations, and may not necessarily recover these assets through sale.

We therefore believe that the single "sale" approach may not result in a faithful representation of the tax consequences. We believe that the tax basis of an asset or a liability should depend on how an entity intends to recover an asset or settle a liability.

(b) Expected manner of recovery or settlement

The IASB has attempted to eliminate management's intention when determining the tax basis. However, it does not remove management's intention entirely. IAS 12 currently defines a temporary difference as the difference between the carrying amount of an item and its tax base, and that difference is recognised as a deferred tax balance. The Exposure Draft refines the meaning of a temporary difference to mean the difference between the carrying amount of an item and its tax basis that the entity "expects" will affect taxable profit when the carrying amount of the related asset or liability is recovered or settled.

Therefore, management's intention must still be applied in determining temporary differences. We have concerns that the Exposure Draft considers the relevance of management's intention in determining temporary differences but rejects it in determining the tax basis.

In summary, we believe that the IASB needs to reconsider its proposals and establish a clearly articulated principle in the application of management's intention. The tax basis determined on "sale" may not reflect future tax consequences. We suggest that the IASB should reconsider the interaction between management's intention and the calculation methodology in recognising and measuring deferred tax balances.

Uncertain tax positions

The Exposure Draft proposes guidance on uncertain tax positions that is different to both the current practice under IFRS and US GAAP. The proposed standard requires entities to measure current and deferred tax assets and liabilities using the probability-weighted average amount of all the possible outcomes. All possible outcomes must be considered. We believe that the proposed measurement requirement would be unduly onerous. Moreover, the cost of implementing the proposal is likely to be significant and we wonder whether the cost is justified. When an uncertainty exists, regardless of the estimation technique used, they are arbitrary, are based on assumptions and reflect management's best judgement. Instead, we recommend the standard should articulate a clear measurement objective, without specifying a particular estimate technique, together with disclosures of major assumptions used to provide users with relevant and reliable information about uncertain tax positions.

Investments in subsidiaries and joint ventures

We agree with the argument in paragraph BC43 that calculating deferred taxes for foreign subsidiaries and joint ventures are so complex that the costs outweigh the benefits. However, calculating temporary differences for domestic subsidiaries and joint ventures may also be complex. Moreover, in those jurisdictions where entities are taxed on a group basis, the allocation of tax amounts within the group companies will be arbitrary and the assets and liabilities of a particular entity on its own may bear no relationship to the tax charge.

Fundamental rethink required

One of the main purposes of financial statements is to inform and to enable readers to assess future cash flows. We believe the proposed approach in the Exposure Draft lacks simplicity in conveying relevant and reliable information. Instead it appears to add to complexity and costs.

The IASB should seriously reconsider whether deferred tax accounting provides useful information in making economic decisions and whether it assists in achieving the objectives of financial reporting. Deferred tax items are in substance only "bookkeeping" entries and are not indicative of the actual cash flows and tax liabilities or "present obligations" payable to or receivable from tax authorities. We understand that users of financial statements normally ignore or adjust the deferred tax balances when performing financial statements analyses.

We hope that you find our comments useful.

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

Colin Chau
Senior Vice President
Listing Division

CC/el

c.c. Mr. Joseph Mau – Company Secretary
Mr. Mark Dickens – Head of Listing