International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

23rd July 2009

Dear Sirs

Exposure Draft: Income Tax

We are responding to your invitation to comment on the above Exposure Draft, published in March 2009, on behalf of Swire Pacific Limited.

As a Hong Kong-incorporated company with a significant investment property portfolio in Hong Kong, our principal criticism of the existing standards on income tax, IAS 12 and IAS Int-21, is that they result in the recognition of deferred tax liabilities on revaluation of investment properties despite the Hong Kong tax regime imposing no capital gains tax upon the disposal of investment properties.

Investment properties in Hong Kong are situated on leasehold land. Deferred tax liabilities are recognised on revaluation gains as there is an inherent assumption that the investment properties are held for use (since leasehold land would be classified as a depreciable asset), applying the current profits tax rate of 16.5%. In Hong Kong, leasehold land is often very long-term (of between 50 and 999 years) and in substance analogous to freehold land. This means that the existing standards impose a deferred tax liability which will never crystallise.

The implication of this accounting treatment is very significant for the financial statements. At 31st December 2008, the Swire Pacific Limited Group's deferred tax liability in respect of Hong Kong investment property revaluation surpluses amounted to over HK$15 billion, compared to the Group's net assets of HK$137 billion. We would therefore welcome a pragmatic revision to the existing standards which eliminated the need to provide deferred tax on the revaluation of Hong Kong investment properties.

The Exposure Draft appears to resolve this issue by requiring the tax basis of an asset to be determined by the tax consequences of selling the asset for its carrying value at the reporting date rather than allowing the option of assuming that the carrying value of the assets will be recovered through use. The Exposure Draft states, "The tax basis [of assets] is determined by the consequences of the sale of the assets... for their present carrying amounts." (para. 5 (c)) and, "If the recovery of the asset through sale does not give rise to taxable income, the tax basis shall be deemed to be equal to the carrying amount." (para. 15 (a)). Deferred tax will continue to be provided in respect of the clawback of depreciation allowances, which are deductible for Hong Kong tax purposes but may become repayable on sale of the investment properties. However, as there is no capital gains tax on sale of investment properties in Hong Kong, our understanding is that the proposals will result in no requirement for deferred tax to be provided in respect of revaluation surpluses.

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There appear to be some inconsistencies between the body of the Exposure Draft and the Application Guidance and Illustrative Examples. The Application Guidance states, "if [investment property] would be depreciated if IAS 16 applied, the entity assesses whether it expects to recover the carrying amount through use or sale." (para. B30 (b)). Similarly, Scenario 1 of Example 14 within the Illustrative Examples states, "If the investor expects to recover the asset through use (rental income), deferred tax would be recognised..." The Application Guidance and Illustrative Examples, therefore, appear to suggest that the recovery of the carrying value of investment property can be determined either through use or through sale. We are concerned that if these inconsistencies remain, the accounting treatment for investment properties in Hong Kong will be ambiguous. We would urge the Board to re-draft both para. B30 (b) and Scenario 1 of Example 14 with a view to removing these inconsistencies.

We have identified two further key issues with the Exposure Draft which we would like to raise.

First, we are concerned with the proposals in respect of uncertain tax positions. The Exposure Draft requires current and deferred tax liabilities to be measured using the probability-weighted average amount of all possible outcomes. In our view, this will increase the complexity of calculating uncertain tax positions and, without additional practical guidance, will be difficult for entities to apply as they are effectively asked to second-guess probabilities of possible rulings by the tax authorities or the courts. We believe that the Board should consider adopting the recognition threshold (step 1) currently included in US GAAP (FIN 48) which requires entities to assess whether the uncertain tax positions are likely to be sustained and then only requires measurement for those positions likely to be sustained. Furthermore, we would encourage the Board to reconsider the proposals to increase the disclosure requirements for uncertain tax positions (para. 49). In particular, we are concerned that disclosing the possible financial effects of items under review by the tax authorities may be prejudicial to the outcome of such reviews. In our view, the current disclosure requirements in IAS 37 already provide the readers of the financial statements with an appropriate and adequate understanding of the financial implications of uncertain tax positions.

Second, we are concerned with the proposals to remove the initial exemption recognition, which will require companies to calculate full deferred tax on items to which they previously applied the initial recognition exemption and then to calculate an offsetting premium or allowance. The practical application will be difficult and, as the result is likely to be the same as the current requirement, we question the value of removing the initial exemption recognition.

We have responded to a number of the specific questions raised in the Exposure Draft in an Appendix to this letter. If you have any questions regarding our comments, please do not hesitate to contact the undersigned on +852 2840 8676 or at clarke@swirepac.com.

Yours faithfully,

For and on behalf of Swire Pacific Limited
Andrew M. Clarke
Finance Manager
Encl.

Appendix

Question 1 - Definitions of tax basis and temporary difference
The exposure draft proposes changes to the definition of tax basis so that the tax basis does not depend on management's intentions relating to the recovery or settlement of an asset or liability. It also proposes changes to the definition of a temporary difference to exclude differences that are not expected to affect taxable profit. (See paragraphs BC17–BC23 of the Basis for Conclusions.)
Do you agree with the proposals? Why or why not?

Response
We agree with the proposals to remove management's intentions relating to the recovery or settlement of an asset or liability. However, as noted in our covering letter, there appear to be some inconsistencies between the body of the Exposure Draft and the Application Guidance and Illustrative Examples. The Application Guidance states, "if [investment property] would be depreciated if IAS 16 applied, the entity assesses whether it expects to recover the carrying amount through use or sale." (para. B30 (b)). Similarly, Scenario 1 of Example 14 within the Illustrative Examples states, "If the investor expects to recover the asset through use (rental income), deferred tax would be recognised..." The Application Guidance and Illustrative Examples, therefore, appear to suggest that the recovery of the carrying value of investment property can be determined either through use or through sale. We are concerned that if these inconsistencies remain, the accounting treatment for investment properties in Hong Kong will be ambiguous. We would urge the Board to re-draft both para. B30 (b) and Scenario 1 of Example 14 with a view to removing these inconsistencies.

We agree that the definition of a temporary difference should exclude differences that are not expected to affect taxable profit.

Question 3 – Initial recognition exception
The exposure draft proposes eliminating the initial recognition exception in IAS 12. Instead, it introduces proposals for the initial measurement of assets and liabilities that have tax bases different from their initial carrying amounts. Such assets and liabilities are disaggregated into (a) an asset or liability excluding entity-specific tax effects and (b) any entity-specific tax advantage or disadvantage. The former is recognised in accordance with applicable standards and a deferred tax asset or liability is recognised for any temporary difference between the resulting carrying amount and the tax basis. Outside a business combination or a transaction that affects accounting or taxable profit, any difference between the consideration paid or received and the total amount of the acquired assets and liabilities (including deferred tax) would be classified as an allowance or premium and recognised in comprehensive income in proportion to changes in the related deferred tax asset or liability. In a business combination, any such difference would affect goodwill. (See paragraphs BC25–BC35 of the Basis for Conclusions.)
Do you agree with the proposals? Why or why not?

Response
As stated in our covering letter, we are concerned with the proposals to remove the initial exemption recognition, which will require companies to calculate full deferred tax on items to which they previously applied the initial recognition exemption and then to calculate an offsetting premium or allowance. The practical application will be difficult and, as the result is likely to be the same as the current requirement, we question the value of removing the initial exemption recognition.

Question 7 – Uncertain tax positions
IAS 12 is silent on how to account for uncertainty over whether the tax authority will accept the amounts reported to it. The exposure draft proposes that current and deferred tax assets and liabilities should be measured at the probability-weighted average of all possible outcomes, assuming that the tax authority examines the amounts reported to it by the entity and has full knowledge of all relevant information. (See paragraphs BC57–BC63 of the Basis for Conclusions.)
Do you agree with the proposals? Why or why not?

Response
As noted in our covering letter, the probability-weighted average approach will increase the complexity of calculating uncertain tax positions and, without additional practical guidance, will be difficult for entities to apply as they are effectively asked to second-guess probabilities of possible rulings by the tax authorities or the courts. We believe that the Board should consider adopting the recognition threshold (step 1) currently included in US GAAP (FIN 48) which requires entities to assess whether the uncertain tax positions are likely to be sustained and then only requires measurement for those positions likely to be sustained.

Furthermore, we would encourage the Board to reconsider the proposals to increase the disclosure requirements for uncertain tax positions (para. 49). In particular, we are concerned that disclosing the possible financial effects of items under review by the tax authorities may be prejudicial to the outcome of such reviews. In our view, the current disclosure requirements in IAS 37 already provide the readers of the financial statements with an appropriate and adequate understanding of the financial implications of uncertain tax positions.

Question 17 – Disclosures
The exposure draft proposes additional disclosures to make financial statements more informative. (See paragraphs BC104–BC109 of the Basis for Conclusions.)
Do you agree with the proposals? Why or why not?

Response
We disagree with the proposals to increase the disclosure requirements for uncertain tax positions. In particular, we are concerned that disclosing the possible financial effects of items under review by the tax authorities may be prejudicial to the outcome of such reviews. In our view, the current disclosure requirements in IAS 37 already provide the readers of the financial statements with an appropriate and adequate understanding of the financial implications of uncertain tax positions.