Hong Kong Institute of
Certified Public Accountants
香港會計師公會

27 April 2009

**To: Members of the Hong Kong Institute of CPAs**
**All other interested parties**

**INVITATION TO COMMENT ON IASB EXPOSURE DRAFT OF *INCOME TAX***

***Comments to be received by 10 July 2009***

The Hong Kong Institute of Certified Public Accountants' (Institute) Financial Reporting Standards Committee (FRSC) is seeking comments on the IASB Exposure Draft which has been posted on the Institute's website at:
www.hkicpa.org.hk/professionaltechnical/accounting/exposuredraft/content.php.

The Exposure Draft proposes to replace IAS 12 with a new standard on income tax, but retain the temporary difference approach for deferred taxes. The objective of that approach is to recognise now the future tax consequences of past events and transactions, rather than waiting until the tax is payable.

Although the proposed standard retains the same principle, the IASB proposes to remove most of the exceptions in IAS 12, to simplify the accounting and strengthen the principle in the standard. In addition, the IASB proposes a changed structure for the standard that will make it easier to use.

--- The significant changes to IAS 12 are set out in the Appendix.

In accordance with the Institute's Convergence Due Process, comments are invited from any interested party. The FRSC would like to hear from both those who do agree and those who do not agree with the proposals contained in the IASB Exposure Draft.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the IASB Exposure Draft to be considered, they are requested to be received by the Institute on or before **10 July 2009**.

Comments may be sent by mail, fax or e-mail to:


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Comments may be made available for public review unless otherwise requested by the contributor.

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**Appendix**

**<u>Proposed significant changes to IAS 12</u>**

**Definitions of "tax basis" and "temporary difference"**

(a) changes to the definition of tax basis. Tax basis would be defined as "the measurement under applicable substantively enacted tax law of an asset, liability or other item".

(b) an additional specification that the tax basis of an asset is determined by the tax deductions that would be available if the entity recovered the carrying amount of the asset by sale. This replaces the requirement in IAS 12 that the tax basis depends on how the entity expects to recover the carrying amount of an asset.

(c) the introduction of an initial step in determining deferred tax assets and liabilities so that no deferred tax arises in respect of an asset or liability if there will be no effect on taxable profit when the entity recovers or settles its carrying amount.

(d) all other temporary differences would be measured at the rate expected to be incurred as the entity recovers (or settles) the carrying amount of the asset (or liability).

**Definition of tax credit and investment tax credit**

(e) introduction of definitions of tax credit and investment tax credit as follows: *Tax credit* is a tax benefit that takes the form of an amount that reduces income tax payable. *Investment tax credit* is a tax credit that relates directly to the acquisition of depreciable assets.

**Elimination of the initial recognition exception**

(f) removal of the initial recognition exception in IAS 12. That exception prohibits an entity from recognising deferred tax assets and liabilities that arise when an asset or liability has a tax basis different from its initial carrying amount, except in a business combination or in a transaction affecting accounting or taxable profit. Instead, the exposure draft introduces a proposal 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 (i) an asset or liability excluding entity-specific tax effects and (ii) any entity-specific tax advantage or disadvantage. An entity would recognise and measure the former after initial recognition in accordance with applicable standards and recognise a deferred tax asset or liability for any resulting temporary difference between the carrying amount and the tax basis. If the consideration paid or received differs from the total recognised amounts of the acquired assets and liabilities (including deferred tax), an entity recognizes the difference as an allowance against, or premium on, the deferred tax asset or liability.

**Investments in subsidiaries, branches, associates and joint ventures**

(g) changes to the exception in IAS 12 from the temporary difference approach relating to a deferred tax asset or liability arising from investments in subsidiaries, branches, associates and joint ventures. The proposed exception is restricted to investments in foreign subsidiaries, joint ventures or branches that are essentially permanent in duration. No exception is proposed for associates.

**Recognition of deferred tax assets**

(h) a proposal to recognise deferred tax assets in full, less, if applicable, a valuation allowance to reduce the net carrying amount to the highest amount that is more likely than not to be realisable against taxable profit. This approach replaces the existing single-step recognition of the portion of a deferred tax asset for which realisation is probable.

(i) additional guidance on assessing the realisability of deferred tax assets, including the treatment of significant expenses for any relevant tax planning strategies.

**Uncertain tax positions**

(j) a proposal that current and deferred tax assets and liabilities should be measured using the probability-weighted average amounts of possible outcomes assuming that the tax authorities will examine the amounts reported to them by the entity and have full knowledge of all relevant information. IAS 12 is silent on the treatment of uncertainty over tax amounts.

**Substantive enactment**

(k) clarification that "substantively enacted" means that future events required by the enactment process historically have not affected the outcome and are unlikely to do so.

**Tax effects of distributions**

(l) a change to the requirements relating to the tax effects of distributions to shareholders. An entity would measure current and deferred tax assets and liabilities using the rate expected to apply when the tax asset or liability is realized or settled, including the effect of the entity's expectations of future distributions. This would replace the requirement in IAS 12 to use the undistributed rate.

**Allocation of tax to components of comprehensive income or equity**

(m) adoption of the SFAS 109 requirements for the allocation of income tax expense to the components of comprehensive income and equity. In particular, some changes in tax effects that were initially recognised outside continuing operations would be allocated to continuing operations.

**Classification of deferred taxes**

(n) classification of deferred tax assets and liabilities as either current or non-current on the basis of the financial reporting classification of the related non-tax asset or liability. IAS 1 *Presentation of Financial Statements* requires all deferred tax to be classified as non-current.

**Classification of interest and penalties**

(o) clarification that the classification of interest and penalties is an accounting policy choice and hence must be applied consistently, and introduction of a requirement to disclose the chosen policy.