

Accounting Standards Board of Japan (ASBJ)

Fukoku Seimei Building 20F, 2-2, Uchisaiwaicho 2-chome, Chiyoda-ku, Tokyo 100-0011, Japan
Phone +81-3-5510-2737 Facsimile +81-3-5510-2717 URL <http://www.asb.or.jp/>



July 31, 2009

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

Comment on “Exposure Draft of IFRS X *Income Taxes*”

Dear Sirs and Madams

We applaud the longstanding efforts of the International Accounting Standards Board (IASB) to address the Income Taxes Project, and we appreciate this opportunity to comment on the “Exposure Draft of IFRS X *Income Taxes*.” The following views have been prepared by the International Issues Standing Committee of the Accounting Standards Board of Japan (ASBJ).

We find it meaningful to eliminate differences between the IFRS and US SFAS 109 and developing a simpler set of principle-based requirements. From this standpoint, we support the direction of considerations included in the exposure draft.

On the other hand, we cannot agree with the detailed requirements on uncertainties on tax positions including the measurement using the probability-weighted average amount of all the possible outcome, which would eliminate the probability criteria for recognition, as we had previously commented on the proposed amendments to IAS 37 *Provisions, Contingent Liabilities, and Contingent Asset*. We recommend that the IASB engage in further discussion taking into consideration of the reliability of information and practicability, in reflecting uncertainties on tax positions in financial statements.

We attach herewith our responses to the itemized questions posed in the exposure draft.

We hope our comments will contribute to the discussions at the IASB.

Sincerely yours,

A handwritten signature in black ink that reads 'Takehiro Arai'.

Takehiro Arai
Chairman
International Issues Standing Committee
Board member
Accounting Standards Board of Japan

Responses to Questions

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?

1. We agree with the proposed definition for the tax basis to avoid ambiguous or opaque interpretation. With respect to the definition of the temporary differences, we also agree with the proposal to exclude differences that are not expected to affect taxable profit in order to clarify the relationship between the deferred tax assets and liabilities.
2. However, for the tax rate applicable at measurement, paragraph 26 and paragraphs B28 to B30 of the exposure draft require an entity to measure the taxable profit at a tax rate applied in a manner expected to recover or settle the carrying value of the assets or liabilities of the entity. Though paragraph BC22 tries to explain this seeming inconsistency between the definition of the tax basis and the notion of measurement, we still think that further explanations are needed in order to avoid misunderstanding.

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?

3. We appreciate this amendment to eliminate exceptions in the temporary differences approach as much as possible. We agree with this proposal, because the accounting treatment would become more consistent with the substance of transactions by adjusting deferred tax assets and liabilities for the allowance or premium incurred at the initial recognition of assets and liabilities.

Question 4 – Investments in subsidiaries, branches, associates and joint ventures

IAS 12 includes an exception to the temporary difference approach for some investments in subsidiaries, branches, associates and joint ventures based on whether an entity controls the timing of the reversal of the temporary difference and the probability of it reversing in the foreseeable future. The exposure draft would replace these requirements with the requirements in SFAS 109 and APB Opinion 23 Accounting for Income Taxes—Special Areas pertaining to the difference between the tax basis and the financial reporting carrying amount for an investment in a foreign subsidiary or joint venture that is essentially permanent in duration. Deferred tax assets and liabilities for temporary differences related to such investments are not recognised. Temporary differences associated with branches would be treated in the same way as temporary differences associated with investments in subsidiaries. The exception in IAS 12 relating to investments in associates would be removed.

The Board proposes this exception from the temporary difference approach because the Board understands that it would often not be possible to measure reliably the deferred tax asset or liability arising from such temporary differences. (See paragraphs BC39–BC44 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not? Do you agree that it is often not possible to measure reliably the deferred tax asset or liability arising from temporary differences relating to an investment in a foreign subsidiary or joint venture that is essentially permanent in duration? Should the Board select a different way to define the type of investments for which this is the case? If so, how should it define them?

4. We basically agree with the proposal in the exposure draft from the viewpoint of eliminating exceptions to the temporary difference approach as much as possible.
5. According to the proposal in this exposure draft, the determination of whether to recognise deferred tax assets and liabilities would not be affected by whether the temporary difference will not reverse in the foreseeable future though dividend from the investee or the sale of the investment in the investee. The complexity of tax effect calculation is cited as the reason that the scope exclusion is applied only to investments in foreign subsidiaries and joint ventures, as mentioned in paragraph BC43.
6. On the other hand, two conditions for non-recognition of deferred tax assets and liabilities

provided in paragraph B5 seems to indicate that the temporary differences is unlikely to reverse in the foreseeable future. For some investments in domestic subsidiaries, the temporary difference may be unlikely to reverse in the foreseeable future, like investments in foreign subsidiaries.

7. Moreover, this exposure draft requires the recognition of deferred tax assets and liabilities for investments in foreign associates even if the tax effect calculation of such assets and liabilities is complex. The reasons for not recognising the deferred tax assets and liabilities for investments in foreign subsidiaries should be explained more clearly.

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?

8. We basically agree that uncertainties should be included in the calculation of the current tax and deferred tax, on the assumption that the uncertainties have been examined by the tax authority based on full knowledge of all relevant information. However, we oppose the proposal to eliminate the probability-based recognition threshold and to measure the uncertainties using the probability-weighted average (expected cash flow approach), as described in paragraph 26, for the following reasons.
9. The reliability of estimates of the probability is highly dependent on the frequency of occurrences of the events or the population of transactions. For tax positions which have been frequently disputed in tax examination or tax litigation with the tax authority and there have been many similar incidents, a reliable estimate would be possible. However, tax cases relating to business combinations and transfer prices, for example, differ in nature and in content from one transaction to another. As such, it may often be difficult to achieve reliable estimates based on estimated probabilities. In those situations, we consider it appropriate to recognise liabilities only in cases where the occurrence is probable, from the perspective of the usefulness of information for users and the costs incurred. In cases where the occurrence is probable, the measurement based on the most likely outcome would provide more useful information than the expected cash flow approach. For example, when there is a 90% probability that a tax loss of CU100 can be taken over in a business combination, it would provide more useful information to determine the recoverability of deferred tax assets after considering the tax effect on the tax loss of CU100 than

considering the tax effect on the tax loss of CU90. It would be appropriate also from the viewpoint of the costs for the entity.

10. The exposure draft states that the issue of tax uncertainties should be addressed consistently with the proposed amendment to IAS 37 because it is an issue of the uncertainties on additional obligations to pay more tax (paragraph BC58). We presume from this statement that only the tax uncertainties in terms of tax liabilities are considered in this context. However, we believe that both tax assets and tax liabilities should be considered, because uncertainties on tax assets exist within the group like a mirror of those on tax liabilities, in the case of the transfer price tax, for example.

Question 9 – Sale rate or use rate

When different rates apply to different ways in which an entity may recover the carrying amount of an asset, IAS 12 requires deferred tax assets and liabilities to be measured using the rate that is consistent with the expected manner of recovery. The exposure draft proposes that the rate should be consistent with the deductions that determine the tax basis, ie the deductions that are available on sale of the asset. If those deductions are available only on sale of the asset, then the entity should use the sale rate. If the same deductions are also available on using the asset, the entity should use the rate consistent with the expected manner of recovery of the asset. (See paragraphs BC67–BC73 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

11. We agree with the proposal in the exposure draft. In measuring deferred tax assets and liabilities based on best estimates, it is natural to apply the tax rate by anticipating the tax rate to be actually applied based on future expectations.
12. However, the proposed definition of tax basis in this exposure draft does not rely on the method of recovery (see Question 1) and, as noted in paragraph BC71, some have argued that it is inconsistent with the proposal that the tax rate for the measurement purpose should be determined in consideration of the actual method of recovery.
13. In spite of the above, paragraph BC72 describes the rationale in support of the application of the tax rate consistent with the method of recovery. We consider further explanations to avoid misunderstanding are needed about the relationship between recognition of temporary differences based on the definition of the tax basis and measurement of deferred tax assets and liabilities.

Question 13 – Allocation of tax to components of comprehensive income and equity

IAS 12 and SFAS 109 require the tax effects of items recognised outside continuing operations during the current year to be allocated outside continuing operations. IAS 12 and SFAS 109 differ, however, with respect to the allocation of tax related to an item that was recognised outside continuing operations in a prior year. Such items may arise from changes in the effect of uncertainty over the amounts reported to the tax authorities, changes in assessments of recovery of deferred tax assets or changes in tax rates, laws, or the taxable status of the entity. IAS 12 requires the allocation of such tax outside continuing operations, whereas SFAS 109 requires allocation to continuing operations, with specified exceptions. The IAS 12 approach is sometimes described as requiring backwards tracing and the SFAS 109 approach as prohibiting backwards tracing.

The exposure draft proposes adopting the requirements in SFAS 109 on the allocation of tax to components of comprehensive income and equity. (See paragraphs BC90–BC96 of the Basis for Conclusions.)

Question 13A

Do you agree with the proposed approach? Why or why not?

The exposure draft deals with allocation of tax to components of comprehensive income and equity in paragraphs 29–34. The Board intends those paragraphs to be consistent with the requirements expressed in SFAS 109.

Question 13B

Would those paragraphs produce results that are materially different from those produced under the SFAS 109 requirements? If so, would the results provide more or less useful information than that produced under SFAS 109? Why?

The exposure draft also sets out an approach based on the IAS 12 requirements with some amendments. (See paragraph BC97 of the Basis for Conclusions.)

Question 13C

Do you think such an approach would give more useful information than the approach proposed in paragraphs 29–34? Can it be applied consistently in the tax jurisdictions with which you are familiar? Why or why not?

Question 13D

Would the proposed additions to the approach based on the IAS 12 requirements help achieve a more consistent application of that approach? Why or why not?

14. We basically support the alternative approach set out in paragraphs 29A-34A.

15. The exposure draft proposes an approach similar to that in SFAS 109 and set out an alternative approach slightly amended from that in IAS 12. The exposure draft, rejecting the alternative approach because of arbitrariness in tracking the source of the temporary differences and complexity of allocation, proposes allocation to continuing operations like SFAS 109. This approach is considered to be the proposal to enable clear and simplified accounting treatment.
16. However, it would be counter-intuitive to include in continuing operations the changes in deferred tax assets and liabilities previously recognised in other comprehensive income (OCI) due to changes in the tax rate, because it would be inconsistent with the basic notion of net profit and loss calculation that none of the changes in the OCI items before the recycling should have impacts on the net income.
17. The difficulty in allocation when loss carryforwards arise from losses recognised in different components (noted in paragraph BC93) is not relevant to the OCI items, because no OCI item has not yet been the source of loss carryforwards nor taxable profit. In our view, the issue noted in paragraph BC93 relates only to the allocation between profit from continuing operations and profit from discontinued operations.
18. Based on the above analyses, we see no need to expand the SFAS 109 approach to the OCI items. We believe that changes in valuation allowances should be accounted for by classifying them as follows:
 - (1) Changes in valuation allowances affecting both profit or loss and the OCI items (such as changes in tax rates) should be recognised in the components where the valuation allowance is initially recognised, in accordance with the alternative approach.
 - (2) Changes in valuation allowances which affect only the components within profit or loss, not affecting the OCI items (such as reassessment of the realisability of the deferred tax assets arising from tax loss carryforwards) should be recognised in the continuing operations, in accordance with the SFAS 109 approach.
19. With regard to Question 13C, we find no obstacles to the adoption of the alternative approach because temporary differences relating to the OCI items can be easily identified in Japan. The additional guidance referred to in Question 13D is expected to make the accounting treatment clearer.

Question 15 – Classification of deferred tax assets and liabilities

The exposure draft proposes the classification of deferred tax assets and liabilities as current or non-current, based on the financial statement classification of the related non-tax asset or liability. (See paragraphs BC101 and BC102 of the Basis for Conclusions.)

Do you agree with the proposals? Why or why not?

20. We agree with the proposal of classification in the exposure draft. As far as assets and liabilities are classified into current and non-current in the statement of financial position, deferred tax assets and liabilities should be classified into current and non-current by taking into account the remaining period up to the recovery or settlement.

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?

The Board also considered possible additional disclosures relating to unremitted foreign earnings. It decided not to propose any additional disclosure requirements. (See paragraph BC110 of the Basis of Conclusions.)

Do you have any specific suggestions for useful incremental disclosures on this matter? If so, please provide them.

21. We do not have objections to the disclosures set out in paragraphs 40 to 49 of the exposure draft, since they are considered to be useful information.
22. However, with respect to the explanation of uncertainties in paragraph 49, we have a concern that an entity might be forced to reveal a disadvantageous problem to the tax authority by disclosing a potential uncertainty. This issue should be considered by weighting the benefits of disclosing the information to users and the costs and difficulties relating to the concern about generating undue tax risks. Therefore, the exceptional treatment as provided in paragraph 92 of IAS 37 *Provisions, Contingent Liabilities, and Contingent Assets*, which exempts an entity from disclosure of the information which can be expected to prejudice seriously the position of the entity, should be considered.