MALAYSIAN ACCOUNTING STANDARDS BOARD
LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA

31 July 2009

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London ED 4M 6 XH
United Kingdom

Dear Sir David

IASB EXPOSURE DRAFT INCOME TAX

The Malaysian Accounting Standards Board welcomes the opportunity to provide comments on the IASB Exposure - Income Tax (ED).

We appreciate the IASB's commitment to develop an improved standard on Income Tax. The desire to provide users of financial statements with consistent, comparable and understandable information is a constant challenge that our Board shares with the IASB.

We are concerned whether the proposals in the ED represent an improvement to the existing IAS 12 although we understand that the project is a short-term convergence project with the FASB. It may be helpful if the IASB carries out a field-test exercise in a non-US environment to better understand the implications of the proposals and to assess the relevant and usefulness of the information provided under the proposals before finalisation of the ED. Our detailed comments are enclosed in an Appendix to this letter. Generally, our main concerns are on the following:

(a) The rationale of the proposed definition on 'tax basis' is not clearly articulated as to why the tax basis does not generally depend on the expected manner of recovery or settlement of the asset or liability whilst on the other hand, the ED requires management expectation to determine the tax rate in the measurement of the deferred taxes.

(b) The *creation* of the allowance and premium accounts resulting from the removal of the initial recognition exception may not be conceptually justifiable as it is an anomaly created by the methodology of the Standard and hence, we are doubtful whether such allowance or premium recognised meets the definition of an asset or liability under the *Framework for the Preparation and Presentation of Financial Statements.*

(c) The use of 'probability-weighted estimate' approach in the measurement of the current and deferred tax assets and liabilities could result in a measurement that reflects an outcome which may not happen in reality or result in the measurement of an amount that may not be more reliable than the most likely approach and thereby, not providing relevant and useful information.

(d) The proposal to allocate deferred tax into current or non-current may provide users with misleading information with regards to the entity's liquidity position as at the balance sheet date since deferred tax assets and liabilities do not affect cash flows.

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Thank you.

Yours sincerely,

Mohammad Faiz Azmi
Chairman

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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?

We are not agreeable with the conceptual principle underlying the board's proposal to define that 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 at the reporting date because the proposal is not clearly articulated in the ED. It is also not clear why the tax basis does not generally depend on the expected manner of recovery or settlement of the asset or liability. In view of this, we find it difficult to support the proposals.

Similarly, the single approach for the tax basis of a liability may not be feasible because there are some circumstances the tax basis of a liability is dependent on whether the liability is settled or transferred at the reporting date or on another date.

Management expectation of the use of the asset

In addition, it is also difficult to comprehend why the proposal to determine tax basis disregard the important and pertinent consideration of the management's expected use of an asset – ie whether recovery is through sale or use.

The accounting for the tax consequence of the asset should reflect the management's strategy or expectation of the asset acquired. We believe tax basis based on management's expected use of the asset would provide more useful information for users of financial statements than the proposal contained in the ED because how entities recover their operational assets varies from one entity to another entity.

Also, although management expectation is disregarded in the determination of the tax basis, it is considered in some other areas as specified in the ED, namely:

- **when an entity decides whether to recognise a deferred tax asset or a liability (paragraph 10 of the ED);**
- **when measuring deferred tax assets and liabilities including the deferred tax implications that arise on the subsequent re-measurement of assets and liabilities (paragraph 25 of the ED); and**
- **when an entity considers whether a temporary difference arises on the re-measurement of assets to fair value (paragraph B15 of the ED).**

Tax deductions exceed cost of asset

The proposed tax basis concept may also result in unintended consequential effect for cases where the tax deductions exceed the cost of the asset.

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For example, in a case where *additional allowance* is given as an incentive to an entity in addition to its *normal* capital allowance after it has incurred expenditure on certain qualifying project / activity. Say, the *additional allowance* is 60% of the qualifying expenditure and hence, the entity would receive a total of 160% allowance, comprising 60% *additional allowance* and 100% of the normal capital allowance. This 60% *additional allowance* is deducted from taxable income after any other available capital allowances have been used. The amount of the *additional allowance* used in each tax assessment is restricted to 70% of taxable income. If the asset is disposed of within five years of its date of acquisition, there is a 'claw-back' of the *additional allowance* (ie deductions previously received will be added back to taxable income in arriving at the taxable profit in the year of sale). If the asset is disposed after the expiry of the claw back period (ie year-6 onwards), any unused amount of the *additional allowance* can be carried forward to future years to be used when there is sufficient taxable income. In other words, if the asset is sold in the sixth year, deductions of 100% of cost are available whilst the 60% *additional allowance* will remain with the entity.

There are some who believe the *additional allowance* illustrated above meets the definition of 'tax basis' in the ED whilst some believe otherwise.

Under the ED proposals if the additional allowance is treated as part of tax basis, the entity will not be entitled to the additional deduction during the claw back period because of the assumption the entity will sell the asset. On the contrary, if the additional allowances are treated otherwise, ie akin to tax credit, the entity will be able to assume it will be entitled to the additional allowances.

However, on expiry of the claw back period, the entity will be entitled to the additional allowances notwithstanding whether it is treated as part of tax basis or otherwise.

To this, it is difficult to understand the intent of the standard that would result in inconsistent outcome on the additional allowance between the claw back period and the period subsequent to it if it is treated as part of tax basis or otherwise.

Therefore we urge the board to reconsider the definition of tax basis to ensure it is sufficiently robust as IFRS are applied in various jurisdictions with different tax laws.

Question 2 – Definitions of tax credit and investment tax credit

The exposure draft would introduce definitions of tax credit and investment tax credit. (See paragraph BC24 of the Basis for Conclusions.)

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

We agree with the proposal to define tax credit and investment tax credit in the Standard. However, further explanation needs to be provided on the definition of 'tax credit' as defined in the ED.

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Tax Credit

The ED defines tax credit as a tax benefit that takes the form of an amount that reduces income taxes payable.

Based on the proposed definition, there are two schools of thoughts. Some are of the view that tax credit would be confined to only "amounts that *directly* reduces taxes payable". On the other hand, some are of the view that the tax credit definition would include amounts deductible from taxable income in arriving at the taxable profit as the amounts deductible from taxable income would reduce the tax payable, albeit indirectly. In other words, some believe that so long as the tax benefit reduces taxes payable, whether *directly* or *indirectly*, that amount would meet the definition of tax credit. Proponents of this view noted that tax credits or tax deductions would result in similar economic benefits and therefore, should not be accounted differently.

In this regard, we recommend that the board to provide additional clarification whether it is the intent of the board to confine tax credit to only amount that *directly* reduces taxes payable or otherwise. To further remove doubt over the required treatment, it would be helpful to include guidance on the application of the tax credit definition.

Investment tax credit

It also would be helpful to include guidance in accounting for temporary difference arising from investment tax credit should the IASB decide to finalise the tax basis proposal.

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?

We disagree with the proposals as we are doubtful whether the allowance or premium recognised under the board's proposal would meet the definition of an asset or liability in accordance with the *Framework for the Preparation and Presentation of Financial Statements* (*Framework*).

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Also, we find it difficult to comprehend the board's proposal that a premium or allowance must be recognised to make the sum of the recognised amounts equal to the transaction price. The premium or allowance is an anomaly created by the methodology of IAS 12 and this is acknowledged by the board. In this regard we recommend the board to maintain the existing IAS 12 initial exception recognition rule.

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?

We agree with the board's proposal to exempt an entity from recognising a deferred tax asset or liability for a temporary difference between the carrying amount and the tax basis of an investment in a foreign subsidiary or a foreign joint venture.

For temporary difference arising between the carrying amount and the tax basis of an investment in a foreign associate, we understand the exception rule does not apply as the foreign associate is not within the control of the investor. It would be good and the standard would be more comprehensive if the board could explain as to why the exception rule does not apply to a foreign associate.

Question 5 – Valuation allowances

The exposure draft proposes a change to the approach to the recognition of deferred tax assets. IAS 12 requires a one-step recognition approach of recognising a deferred tax asset to the extent that its realisation is probable. The exposure draft proposes instead that deferred tax assets should be recognised in full and an offsetting valuation allowance

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recognised so that the net carrying amount equals the highest amount that is more likely than not to be realisable against taxable profit. (See paragraphs BC52–BC55 of the Basis for Conclusions.)

Question 5A

Do you agree with the recognition of a deferred tax asset in full and an offsetting valuation allowance? Why or why not?

Although the proposed change would have no effect on the net amount recognised in the statement of financial position, we are concern whether the recognition of the deferred tax asset is contrary to the definition of asset in the *Framework*.

The proposal may result in an entity recognising deferred tax asset without giving any due consideration whether it is probable that the future economic benefit of the deferred tax asset will flow to the entity. We believe the determination on whether such deferred tax asset satisfies the definition of asset in the *Framework* is important before it being recognised in the financial statements.

Question 5B

Do you agree that the net amount to be recognised should be the highest amount that is more likely than not to be realisable against future taxable profit? Why or why not?

We support the board's proposal that the net amount to be recognised to be the highest amount that is more likely than not to be realisable against future taxable profit.

Question 6 – Assessing the need for a valuation allowance

Question 6A

The exposure draft incorporates guidance from SFAS 109 on assessing the need for a valuation allowance. (See paragraph BC56 of the Basis for Conclusions.) Do you agree with the proposed guidance? Why or why not?

We support the board's proposal to incorporate the guidance from SFAS 109 on assessing the need for a valuation allowance.

Question 6B

The exposure draft adds a requirement on the cost of implementing a tax strategy to realise a deferred tax asset. (See paragraph BC56 of the Basis for Conclusions.) Do you agree with the proposed requirement? Why or why not?

While we do not disagree with the proposed requirement, we believe it would provide clarity to the new standard if the board includes examples of the cost to implement the tax planning strategies.

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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?

We disagree with the probability-weighted estimate approach in the measurement of the current and deferred taxes. This approach is unduly onerous with an unrealistic expectation to achieve a high degree of precision in accounting for uncertain tax positions that could result in a measurement that reflects an outcome which may not happen and thereby, not providing relevant and useful information to users of financial statements.

In addition, this approach require the entity to determine the probability of each possible outcomes which may result in the measurement of an amount that may not be more reliable than the most likely approach and thereby, not providing useful information to users of financial statements.

In our view we propose the 'most likely' approach to be the measurement for the current and deferred tax assets and liabilities as it is more appropriate and reflective of the possible outcomes. This would be consistent with the spirit of the measurement principle set out in paragraph 25 of this ED, which requires entities to measure deferred tax assets and liabilities based on tax rates that are expected to apply.

Question 8 – Enacted or substantively enacted rate

IAS 12 requires an entity to measure deferred tax assets and liabilities using the tax rates enacted or substantively enacted by the reporting date. The exposure draft proposes to clarify that substantive enactment is achieved when future events required by the enactment process historically have not affected the outcome and are unlikely to do so. (See paragraphs BC64–BC66 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?

We agree with the proposal to measure deferred tax using the tax rates enacted or substantively enacted by the reporting date as it is inappropriate to have to wait until the actual formal announcement of the enacted tax rate is made.

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

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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?

We agree with the proposal.

As stated in our response to Question 1, a more important and pertinent consideration in determining the tax basis of an asset would be the management's expected use of the asset, ie recovery through sale or through use. Therefore we believe the tax rate to be used in measuring the deferred tax asset or liability should be consistent with the expected manner of recovery of the asset or settlement of the liability.

Question 10 – Distributed or undistributed rate

IAS 12 prohibits the recognition of tax effects of distributions before the distribution is recognised. The exposure draft proposes that the measurement of tax assets and liabilities should include the effect of expected future distributions, based on the entity's past practices and expectations of future distributions. (See paragraphs BC74–BC81 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?

We agree with the proposal that the measurement of tax assets and liabilities should include the effect of expected future distributions, based on the entity's past practices and expectations of future distributions as this would result in useful information.

This proposal is consistent with our general view with regard to the way the role of management expectations of the manner of recovery or settlement of the asset or liability.

Question 11 – Deductions that do not form part of a tax basis

An entity may expect to receive tax deductions in the future that do not form part of a tax basis. SFAS 109 gives examples of 'special deductions' available in the US and requires that 'the tax benefit of special deductions ordinarily is recognised no earlier than the year in which those special deductions are deductible on the tax return'. SFAS 109 is silent on the treatment of other deductions that do not form part of a tax basis. IAS 12 is silent on the treatment of tax deductions that do not form part of a tax basis and the exposure draft proposes no change. (See paragraphs BC82–BC88 of the Basis for Conclusions.) Do you agree that the exposure draft should be silent on the treatment of tax deductions that do not form part of a tax basis? If not, what requirements do you propose, and why?

We understand that it would be impractical for the board to list the tax deductions that do not form part of a tax basis ['*special tax deductions*'] from various tax jurisdictions in the development of a global standard as firstly, the principles encapsulated in the Standard should provide adequate guidance and secondly, it would be difficult to develop a comprehensive list of *special tax deductions* covering all jurisdictions that are applying the Standard.

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Therefore, we understand the board's position to stay silent on the treatment of tax deductions that do not form part of a tax basis. Nonetheless, such position should only be taken if the definition of 'tax basis' and other proposals in the ED have been clearly articulated. However, as explained in our response to Question 1, we find the tax basis definition is not clearly articulated.

However, having said that, it would be good if the Standard could provide examples of some *special tax deductions* and how the principles in the ED could be applied therein to these deductions. This would assist to ensure that the principles in the Standard are drafted in a robust manner so as to provide sufficient guidance.

We reiterate that, in our jurisdiction *additional allowance* is given as an incentive to an entity in addition to its *normal* capital allowance after it has incurred expenditure on certain qualifying project / activity. Say, the *additional allowance* is 60% of the qualifying expenditure and hence, the entity would receive a total of 160% allowance, comprising 60% *additional allowance* and 100% of the normal capital allowance. This 60% *additional allowance* is deducted from taxable income after any other available capital allowances have been used. The amount of the *additional allowance* used in each tax assessment is restricted to 70% of taxable income. If the asset is disposed of within five years of its date of acquisition, there is a 'claw-back' of the *additional allowance* (ie deductions previously received will be added back to taxable income in arriving at the taxable profit in the year of sale). If the asset is disposed after the expiry of the claw back period (ie year-6 onwards), any unused amount of the *additional allowance* can be carried forward to future years to be used when there is sufficient taxable income. In other words, if the asset is sold in the sixth year, deductions of 100% of cost are available whilst the 60% *additional allowance* will remain with the entity.

There are some who believe the *additional allowance* illustrated above meets the definition of 'tax basis' in the ED whilst some believe otherwise. We are concerned that if the proposals in the ED are issued, there will continue to be divergent views as it is now based on the existing IAS 12. Hence we would appreciate if the IASB could consider including some examples in the standard to mitigate divergent interpretation of the new standard.

Question 12 – Tax based on two or more systems

In some jurisdictions, an entity may be required to pay tax based on one of two or more tax systems, for example, when an entity is required to pay the greater of the normal corporate income tax and a minimum amount. The exposure draft proposes that an entity should consider any interaction between tax systems when measuring deferred tax assets and liabilities. (See paragraph BC89 of the Basis for Conclusions.) Do you agree with the proposals? Why or why not?

We agree with the board's proposal that an entity should consider any interaction between tax systems when measuring deferred tax assets and liabilities. We believe this will improve the quality of the information of deferred tax assets and liabilities recognised in the financial statements.