OPINION ON THE DISCUSSION PAPER "IMPROVING THE FINANCIAL REPORTING OF INCOME TAX" PUBLISHED BY EFRAG IN DECEMBER 2011

I. General part

The presented discussion paper is an important step towards improving financial reporting in the area of income tax. Bearing in mind the needs of the users of financial statements, the paper's authors considered one by one the disputed issues relating to the reporting of income tax. In the Committee's opinion, the areas were appropriately selected. It seems, however, that the analysis should be expanded to cover the following issues.

First, we believe that the current mechanism for recognition of deferred tax assets is not precise and causes difficulties in practical application. We propose obligatory recognition of all deferred tax assets and introducing a methodology for recording a valuation allowance, which would simplify the application of the standard. Secondly, it seems that the issue of investment tax credit (currently not directly regulated by the IFRS) should be analyzed and regulated in IAS 12. Thirdly, it seems that the presentation of deferred tax assets and liabilities as solely non-current assets and long-term liabilities respectively (IAS 1 par. 70) should be reconsidered.

It seems that the above-mentioned areas should be reflected in the discussion paper.

II. Detailed part - answers to questions

Q 1.1 "Under current IAS 12 a difference between the tax paid and the current tax expense reported in the income statement leads to misunderstandings of these relationships.
Do you agree that additional disclosure that would provide a reconciliation of the taxes paid and current tax expense would help in understanding this relationship?"

In accordance with the Conceptual Framework for Financial Reporting (par. 25) "An essential quality of the information provided in the financial statements is that it is readily understandable by users. For this purpose users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand."

There is no doubt that issues related to reporting of income tax are among difficult accounting matters. However, IAS 12 is not likely to be the source of these difficulties. It is rather the structure of income tax itself, its diversity in different countries and application to many different transactions that cause the complexity of the matter of income tax reporting.

The answer to the question: would additional disclosure help in understanding the relation between the taxes paid and current tax expense – is "yes". It seems that the scope of disclosures in this area is not sufficient in IAS 12.

The answer to this question is: "yes".

It seems that IAS 12, par. 81e should be considerably extended. Expanding IAS 12 in the scope of disclosures should be accompanied by expanding the mechanism for recognition and measurement of deferred tax assets.

Although the question seems technical, the standard should clearly state that:
- deferred tax assets should be recognised with reference to all deductible temporary differences (possibly with marked exceptions), tax losses and unused tax credits.

Q 1.2 "Do you agree that additional more detailed disclosures regarding deferred tax assets, especially unused tax losses and unused tax credits are necessary and useful??"

In the event of impairment of deferred tax assets , the valuation allowance of deferred tax assets should be recognised.
The standard should specify the mechanism of impairment testing of deferred tax assets.
Specifying the impairment test for deferred tax assets would help to expand the information concerning disclosures related to deferred tax assets.

Q 1.3 " Do you agree with the identifed users' information needs in Chapter 1 of Part 1? Do you have any suggestion for additional information requirements regarding reporting of income taxes? (par. 1.8 to 1.24)"

We do not have any other suggestions.

Q 1.4 Do you agree that tax strategies to accommodate user information needs should be disclosed in the management commentary and not in the financial statements? Why or why not? (Paragraphs 1.8 to 1.9)

It seems that the information on the tax strategy can be – if at all – disclosed in the management commentary. The argument in favour of this solution is mainly that the tax strategy is dependent on the plans of an entity that are difficult to verify.

Q 1.5 The reconciliation of the actual tax charge to the charge on profit at the statutory tax rate (tax rate reconciliation) is quite complicated and leads to some misunderstandings. Do you agree that the suggestions made in the paper are helpful by clarifying the explanation why the current tax charge is not equivalent to the standard rate of tax applied to the accounting profit? Why or why not? (Paragraphs 1.19 to 1.20
and 2.21 to 2.34)

The proposed approach to the reconciliation of the tax charge and the accounting gross profit multiplied by the tax rate is notable. The matter of stating more precisely the scope of disclosures is highly desirable due to the complexity of the matter. However, it should be noted here that the following items are proposed for the reconciliation:

1. Income that is exempt from taxation;
2. Non-deductible expenses;
3. Effect of tax losses;
4. Effect of foreign tax rates;
5. Effect of change in income tax rate;
6. Adjustment to current tax of prior years;
7. Other items

It seems that the following items were omitted in the reconciliation:
- taxable income not constituting accounting income;
- tax-deductible costs not recognized for accounting purposes.

The last category will probably occur very rarely. However, for the sake of completeness it should be added to the reconciliation.
In accordance with the Conceptual Framework for Financial Reporting, the objective of accounting is to provide information on the ability of an enterprise to generate cash flows and on the timing and the related risk (cf. Conceptual Framework for Financial Reporting par. 15). Also IAS 1 states that "This information (information arising from the financial statements - author's note), along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty" (IAS 1, par. 9).
In the current accounting model, forecasting future cash flows is a task of financial statements users and not the preparers themselves. Naturally, the objective of accounting is to provide information in such a manner that the task should be as easy as possible to perform. But the process itself of

constructing the economic model of the entity and deciding whether it is able to generate cash flows belongs to the user.
How to help with forecasting cash flows? In the area of deferred tax, we should consider disclosure of the dates for the reversal of temporary differences.
Yes – this should be required. Deferred tax assets and liabilities represent accordingly deferred receivables and liabilities in respect of this tax. The current value of future benefits or obligations arising from deferred income tax is different from their nominal value. Therefore, these assets and liabilities should be discounted. Failure to discount deferred tax assets and liabilities causes the results of tax strategies (which comprise deferring the moment of a tax obligation arising) not to be fully visible in the financial statements.

Q 1.6 "The amounts currently disclosed provide limited information about future tax cash flows. How would you suggest the disclosures in IAS 12 be improved to provide better information about future cash flows? (par. 1.13 to 1.14 and 2.35 to 2.40)."

Q 1.7 "The possibility of discounting deferred tax balances is discussed in paragraphs 2.44 to 2.50. In your view, should discounting deferred tax amounts be required? Please explain."

Q 1.8 "Currently IAS 12 neither provides explicit guidance for accounting for uncertain tax positions nor contains any specific disclosure requirements regarding the tax risk position.

(a) Do you agree that required information regarding uncertain tax positions should be disclosed? If so, which of the following do you prefer:

Alternative 1: Disclosure requirements should be included in the management commentary.
Alternative 2: Disclosure requirements should be split into two parts. Part 1 would include disclosure of all positions for which the tax payer must establish a tax provision under IFRS and will be disclosed in the notes to the financial statements. Part 2 would include all other uncertainties regarding income taxes for which no provision is recognized (par. 1.10 to 1.12).

(b) Do you agree that IAS 12 should address the recognition and measurement of uncertain tax position? Why or why not? If you agree, should the measurement be based on the most likely outcome or a probability weighted method? Should measurement include the likelihood that the tax position will be reviewed by the tax authorities or should that review be assumed?"

The matter of uncertain tax positions is an important element. Disclosure requirements should be included in management commentary.

Q 1.9 "Are there any issues with IAS 12, which are not addressed in Part 1, that would significantly improve the standard? What amendments would address these issues?"
Q 1.10 "What is your view on the exemptions that currently exist in IAS 12?"

It seems that the following areas should be arranged in IAS 12:

1. We propose mandatory recognition of all deferred tax assets and introducing a methodology for recording a valuation allowance, which would simplify the application of the standard. This issue has been described in our answer to question 1.2.
2. Investment tax credit remains an unregulated issue in IFRS. It seems that introducing specific financial reporting principles in this area is desirable.