

31st July 2009

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

Dear Boards' members,

Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF) the accounting standards setter body in Mexico, welcomes the opportunity to submit its comments on the **Exposure draft: Income Tax**. Set forth below are our comments to the topics included in the Exposure Draft (ED).

Comments related to topics not considered in the questions

In general terms, we consider that the structure of the ED is complex. The way the ED is presently structured (with the two appendixes) makes unnecessary difficult the reading of the document. We believe that appendixes A and B should be included in the mandatory part of the standard in order to facilitate the reading and understanding of the standard.

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?

Tax basis. We do not agree with the proposed change to the tax basis definition, specifically in the case of assets. This is because the proposed definition in the ED establishes that the tax basis of an asset is the amount to be determined by tax deductions that are available as if the asset is sold at the reporting date.

This new approach presents at least the following problems:

- a) Not all the assets owned by the entity are available for sale, as in the case of property, plant and equipment. Thus, the definition of tax basis could be misinterpreted because the entity could believe that if it does not have the intention to sell the asset it should not determine a deferred tax. For example: if property, plant and equipment originates temporary differences due to financial depreciation rates different from tax rates or, due to impairment, the entities might not recognise the effects that these differences cause.
- b) This definition of tax basis is difficult to apply to receivables. In some tax jurisdictions, such as Mexico, income resulting from a credit sale is sometimes accumulated as taxable income when cash is received; this situation without any doubt originates a

temporary difference and, consequently, a deferred tax liability. We believe that applying the new definition to this type of assets is inappropriate.

Consequently, taking into consideration different situations in some jurisdictions and also considering practical matters we propose to maintain the definition established in paragraph 7 of IAS 12, which says:

The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

Temporary difference. We do not agree with the new classification of temporary differences: a) those that originate within the tax jurisdiction of the subsidiary and /or joint venture; and b) those that originate within the tax jurisdiction of the parent or investor.

The reason for our disagreement is the following:

This proposed classification is related to paragraphs B1 and B9 which establish that it is necessary to determine: the individual deferred taxes from assets and liabilities of the subsidiaries and/or joint ventures. Additionally, in the financial statements of the parent company, deferred taxes should be determined on the investment in such entities, this investment is presented by the parent in its separate financial statements because it is valued at cost, therefore the carrying amount of the investment may differ in the two sets of financial statements (separate and consolidated).

The CINIF has always expressed its disagreement with the presentation of different values of investments in subsidiaries in the separate and consolidated financial statements. The CINIF considers that the investments in subsidiaries that are presented in separate financial statements must be measured with the equity method which cause that equity presented in the separate financial statements is the same than the equity presented in the consolidated financial statements.

Consequently, the CINIF also disagrees with the temporary differences that arise from the investment in the separate financial statements, in addition to the temporary differences from the assets and liabilities of the subsidiary in the consolidated financial statements.

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 proposals? Why or why not?

Tax credit. We agree with the proposed definition, because it is clear and understandable.

Investment tax credit. We do not agree with the incorporation of this definition because:

- a) we believe that the incorporation of the tax credit term is sufficient for the understanding of the document;
- b) moreover, the term investment tax credit is not utilised in the ED.

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 agree with removing the exception, since the temporary differences determined at the initial recognition of an asset or liability, produce payments or recoveries of income tax with the passing of time; therefore, the deferred tax must be recognised.

Nevertheless, **we do not agree** with the recognition of the asset or liability separately: a) a part of the asset or liability excluding any entity-specific tax effects; and b) another part with the entity-specific tax effects. The ED requires each component to be recognised separately based on the IFRS. We consider this is complex, impractical and useless. Moreover, this represents a rule that should not exist within a principle based on a standards' system.

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.)

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

We do not agree with the Boards' proposal; we consider that this exception for subsidiaries and joint ventures is a practical rule but it lacks a conceptual basis.

In case the rule remains in the final standard, we believe that in order to be consistent, the associates should also be included in the exception.

4.2 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?

Certainly, determining a deferred tax asset or liability related to a permanent investment in a foreign operation is usually complex, but this fact does not justify avoiding the recognition.

4.3 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 reiterate our position regarding the exception, which we believe should not exist.

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 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?

We agree with the recognition of a complete deferred tax asset and an offsetting valuation allowance and the disclosure of this information. We consider that this information provides better elements for the analysis of financial information.

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 agree with the proposal. Nonetheless, we consider that the addition of the term “it is more likely than not” should also be included in the Conceptual Framework of the IFRS.

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 agree with the proposed guidance.

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?

We agree with the proposed requirement.

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 do not agree with the proposals, because this kind of recognition involves a high degree of subjectivity. We believe that it is sufficient that a deferred tax liability qualifies as “more likely than not to be realisable” in order to require its entire recognition.

In the case of deferred tax assets, the ED requires the recognition of a valuation allowance which we believe should be sufficient to attain that the value of such assets reflects the expected levels of uncertainty.

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 do not agree with the proposal. We consider that when determining the income tax: current and deferred, the entity must always use enacted rates. Otherwise, there is a risk of presenting an incorrect amount of tax liabilities and assets in the financial statements issued, if at the end the tax rate used is not enacted.

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?

Essentially **we agree** with the proposal. However, it should be enhanced by establishing in the ED that it is necessary to use the rate that will be applicable at the moment of recovering

the asset or paying the liability. As we mention in our response to question 1, there are different ways to recover an asset and pay a liability.

Additionally, we believe that the approach in paragraph B29 of the ED highlights another reason to reject the definition of tax basis of an asset, which establishes that such basis of an asset is the amount expected to be deducted if the asset is sold. Paragraph 29 from the exposure draft confirms the need for identifying the way the asset will be recovered, which is not always the sale of the asset.

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; considering that the deferred tax assets or liabilities must be determined applying the tax rate that will be effective at the moment of reversion of temporary differences and, if the rate is determined by the income distribution policy, this fact must be considered.

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 recognized 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?

The CINIF does not clearly understand which transactions could be deductions for tax purposes and at the same time do not integrate the tax basis. We suppose that it could be the case of contingent transactions or, transactions that depend on the occurrence of other events in order to become deductions.

We propose to the Board that if it has visualised any of these transactions, it should be clearly discussed in the ED.

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?

Essentially **we agree** with the proposal. However, we consider that the Board should provide more specific guidance for the recognition of deferred tax assets and liabilities when an entity is required to pay tax based on one of two or more tax systems. Our comment is based on the fact that in practice, as it is the case of Mexico, there are different ways to measure these assets and liabilities in an alternate way between two or more tax systems, and such procedures could lead to substantially different determinations 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?

We do not agree with the proposal of the ED, because we consider that income tax must be presented, in all cases, directly affecting the profit or loss generating the tax, whether it is presented in continuing operations or in each component of comprehensive income, otherwise the effective income tax rate will be distorted. For this reason, we consider that the adjustments to the deferred assets or liabilities must also affect the comprehensive income item that they affected originally; otherwise, the recognition would be inconsistent.

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?

We consider that the sum of the income tax recognised with the application of paragraphs 29 to 33 should not produce different results from the total income tax of the period. Moreover, we consider that paragraph 34 should be deleted, because it produces inappropriate interpretations.

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?

We believe that the alternative approach based on IAS 12 “with some changes” is better (paragraphs 29A-32A), since as we said before in our response 13A, recognising the changes in measurement of deferred tax assets and deferred tax liabilities in the same components of comprehensive income that were affected initially, provides information that is more reliable.

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?

Yes, we consider that the proposed additions would help based on what we explained in our response to question 13C.

Question 14 – Allocation of current and deferred taxes within a group that files a consolidated tax return

IAS 12 is silent on the allocation of income tax to entities within a group that files a consolidated tax return. The exposure draft proposes that a systematic and rational methodology should be used to allocate the portion of the current and deferred income tax expense for the consolidated entity to the separate or individual financial statements of the group members. (See paragraph BC100 of the Basis for Conclusions.)

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

Yes, we agree with the proposal; however, we consider extremely important that the standard establishes in an emphasised manner, that the consolidated entity's tax must be recognised, in the separate financial statements, of the entity that has the obligation to pay the tax.

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?

The CINIF considers that in some cases, the realisation date for deferred tax liabilities or the deferred tax assets could be different from the realisation date for the item they are related with.

However, we agree with the Board's proposal because it is a practical procedure that allows to provide information better related to the economic reality of the entity.

Question 16 – Classification of interest and penalties

IAS 12 is silent on the classification of interest and penalties. The exposure draft proposes that the classification of interest and penalties should be a matter of accounting policy choice to be applied consistently and that the policy chosen should be disclosed. (See paragraph BC103 of the Basis for Conclusions.)

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

We agree with the proposal.

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?

We agree with the proposed disclosures.

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

We do not have additional suggestions.

Question 18 – Effective date and transition

Paragraphs 50–52 of the exposure draft set out the proposed transition for entities that use IFRSs, and paragraph C2 sets out the proposed transition for first-time adopters. (See paragraphs BC111–BC120 of the Basis for Conclusions.)

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

We agree with the proposal.

Should you require additional information on our comments listed above, please contact me at 00-52-55-5596 5633/26/34 or by e-mail at fperezcervantes@cinif.org.mx

Sincerely,

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