Group Finance

30 July 2009

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Canon Street
London EC4M 6 XH

Dear David

Exposure Draft 2009/2: Income Tax

Thank you for the opportunity to comment on this Exposure Draft. Australia and New Zealand Banking Group Limited (ANZ) is listed on the Australian Stock Exchange and remains one of a select group of banks who continue to be AA rated. Our operations are predominantly based in Australia, New Zealand and Asia and our most recent annual results reported profits of USD2.6 billion and total assets of USD376 billion.

As a general principle we support the convergence project and as such understand the necessity for the issuance of a revised standard to achieve this end. There are several proposals within the new standard which we believe provide a more appropriate basis for accounting for income taxes, and are therefore an improvement to the current requirements of IAS 12.

However, we note that there are also inconsistencies in the basis for the various approaches outlined in this proposed standard. In some instances, the proposals appear to have been determined in the interest of achieving comparability and reducing complexity (such as the removal of the manner of recovery assessment when determining the tax basis of an asset or liability). In other instances proposals seem to be formed in the interest of time and convergence, even though the result may be counter-intuitive and more complex than the current requirements under IAS 12 (such as allocation).

Our overall assessment is that the more significant proposals such as the change to a "through sale" manner of recovery and changes to allocation make the requirements more complicated to apply, rather than improve the standard. ANZ supports the fundamental principle of IAS 12, which is to recognise deferred tax balances based on the future tax consequences that are most likely to arise. This principle ensures that economic reality is reflected in an entity's financial statements and thus the most meaningful information is provided to users. We are not in favour of proposals which go against this principle and which ultimately provide less accurate information, simply in the interest of convergence. We are therefore not supportive of the Exposure Draft in its current form.

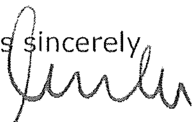
Furthermore, when reviewing the proposals for amended disclosures, once again we observe the worrying trend of additional detailed reconciliations being required in the notes to financial statements. As previously indicated in our comment letters in relation to other recent exposure drafts, we believe that such reconciliations do not provide users of the financial statement with more useful information, nor do they make the statements easier to understand.

Australia and New Zealand Banking Group Limited ABN 11 005 357 522

Detailed comments on all matters raised in the Exposure Draft are attached to this letter.

Should you have any queries on our comments, please contact Rob Goss, Head of Accounting Policy, Governance and Compliance at Rob.Goss@anz.com.

Yours sincerely,



SHANE BUGGLE
Group General Manager Finance

cc: Mr Kevin Stevenson – Chairman, Australian Accounting Standards Board

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 do not agree with the proposal. We support accounting requirements which faithfully represent economic reality in an entity's financial statement. This proposal goes against such an outcome in the interest of comparability and convergence. The Board acknowledges in its basis for conclusions (BC 72) that this proposal was driven by a desire to reduce application complexity and achieve consistency with existing requirements under US GAAP. The Board has chosen to override the reality that the manner of recovery determination is necessary to achieve accuracy in relation to accounting for deferred taxes. We do not understand the purpose of recognising amounts in financial statements which are not likely to eventuate in the foreseeable future, even if this is in an effort to achieve consistency of practice. Furthermore, as identified in the basis for conclusions, the manner of recovery is a question of fact, and the resulting tax consequences are a direct result. We are unclear as to why the application of this requirement is considered overly complex and difficult to interpret.

It is also important to take into consideration that management intent is a fundamental principle in relation to classification and measurement of other assets and liabilities throughout many existing standards. For example, when determining the classification and thus measurement of traded financial instruments in IAS 39, IFRS 5 in its entirety and determining value-in-use for the purposes of impairment testing in IAS 36, to name a few. It appears counter-intuitive to move away from this principle in the proposals for the new income tax standard.

The Board perhaps is taking the position that, ultimately, all assets will be "sold" in some form or another, and there are not many assets that will be "used up" in their entirety by an entity. While we acknowledge that there is some merit to this point, we fundamentally believe that the measurement of tax consequences should be based on the most likely outcome at a point in time. When calculating a sale value on, for example, an investment at a point in time when it is not likely to be sold, the value is unlikely to take into account dividend repatriation and other activities which are likely to occur to extract value from the investment prior to sale. Thus a very different outcome and value would be achieved if a planned sale was actually to occur, resulting in the measurement of deferred tax with no basis in reality.

In relation to the point of reducing complexity, we question whether this change in approach actually achieves this end. Certain "sale" tax basis calculations for particular assets can be overly difficult to apply.

For the reasons identified above, in summary, we do not support this proposal.

With respect to the change in the definition of a temporary difference we support this amendment, as we interpret this to mean that if there are no future tax consequences then no temporary difference exists.

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 definitions of tax credit and investment tax credit as they provide clarity in relation to the usage of these terms.

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?

Again, stressing our fundamental belief that the accounting for income taxes should reflect economic reality, we support the proposal to remove the initial recognition exception, as in these instances, a deferred tax consequence will, in fact, arise. The recognition of the discount or premium also provides a solution to the anomaly created by the temporary difference approach. However, the requirement to split the temporary difference into entity and non-entity specific tax effects seems to add undue complexity to the calculation for little added benefit.

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 fundamentally agree with a requirement to exempt recognition of temporary differences when it is apparent that the temporary difference will not reverse in the foreseeable future. This aligns with our position that only tax consequences which will in fact eventuate are recognised. We are unclear as to why this exemption would only relate to foreign investments (as a reliable estimate could potentially not be achieved on

domestic investments) and recommend that the exemption be available to any investment that meets the appropriate criteria. Furthermore, this exemption appears inconsistent with the approach taken on all other assets in relation to determination of future tax consequences through sale.

Overall this exception requires, at a minimum, additional guidance. It is unclear as to what future tax consequences the proposal is intending to capture conceptually. We again go back to the principle that the recognition of future tax consequences should be based on the most likely economic outcome, either through sale or earnings remittance. This will ultimately provide the most reliable estimate for measurement.

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?

Yes, we support the recognition of a deferred tax asset in full and an offsetting valuation allowance as it better reflects the economic reality of the future tax consequences and provides additional ability to reconcile and track tax balances.

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?

Yes, we agree with this approach as the measurement reflects the most likely outcome.

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?

Yes, we agree with and support the guidance as it provides clarity around what should be included in the assessment.

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 understand the rationale for including the cost of implementing a tax strategy when measuring the valuation allowance, we question whether this cost would ever materially impact the determination. We note however that the word "significant" has been used in the requirement thus we do not disagree with it.

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 support additional guidance on accounting for uncertain tax positions and clarification in relation to determining the amount to be recognised. However, the proposals do not appear to be clear in relation to what constitutes an "uncertain" position and we recommend that guidance be added to address the ambiguity. The basis for conclusions par BC 62 acknowledges this issue and indicates that "the Board does not intend entities to seek out additional information...rather it proposes that entities do not ignore known information". We suggest that if this is the Boards intention, that additional guidance be included in the proposed standard to make this point clear. This will reduce the probability of interpretational positions requiring entities to perform detailed analysis and probability calculations for relatively minor 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?

Yes, we concur with this proposal and support the additional clarity it provides.

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?

It is a logical conclusion that the rate that is used should be consistent with the manner of recovery of the asset. However, if the rate chosen is restricted to alignment with the intended manner of recovery only in instances whereby the deductions are consistent with a through sale assessment, we do not support the proposal. Clearly the determination of the tax base as well as the rate should be based on the intended and likely manner of recovery (how the economic benefits are expected to be taxed), thus providing the most accurate calculation of the future tax consequences for a particular asset or liability. Refer also to our comments under question 1.

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 proposals in the exposure draft as they are consistent with our principles that the measurement of tax effects should be based on realistic estimates of the future tax consequences.

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?

In the interest of clarity and consistency, the proposed standard should take a position in relation to the treatment of special deductions. Furthermore, we see little difference between the concept of a 'special deduction' and items which have no carrying value but have a tax base (refer par 9 of IAS 12). In both instances, there is no accounting balance sheet item recognised but there is a future tax consequence. It is our position that all future tax consequences that are likely to occur should be recognised, as this most appropriately reflects the economic reality for the entity.

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 these proposals as they require measurement on a basis that most appropriately reflects economic reality.

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.

We can not support an approach which produces counter-intuative results and can be more difficult to apply, which is the case with this proposal in the exposure draft. We also do not support the approach simply because it speeds up the convergence project and "is a more fully specified method" as outlined in the basis for conclusions BC 96. IFRS is based "principles based" fundamentals and we would hope strives to develop principles which, when applied, provide meaningful information. We therefore support the alternative approach provided in the proposed standards which maintains the principles of IAS 12, which are logical, but also attempts to cover particular circumstances whereby using the backward tracing methodology poses difficulties.

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.)

We do not currently apply SFAS 109 and therefore can not reliably determine the materiality of the impact of the change. In relation to the approach based on the IAS 12 requirements, as mentioned above, we support this approach.

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?

Yes, we do believe that the alternative approach which is based on the IAS 12 requirements will provide more useful information. If a requirement of the proposed standard is to allocate current and deferred tax to the same components of comprehensive income and equity as the underlying transaction or events, why would a revision to this amount say for instance due to a change in tax rate be taken to a different component of comprehensive income or equity. While we acknowledge that there are some instances whereby this approach may cause difficulties (as described in BC 92 and 93), it is clearly the approach which provides the most accurate accounting for the tax effects of the underlying transactions and provides the most consistent approach in application of the principles of the proposed standard. We do not see any reason why this approach would cause significant application inconsistency.

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?

It is difficult to determine which approach would achieve more consistent application. Arguably the SFAS 109 approach may achieve a higher level of consistency in application

on the basis that there are fewer options available. The additional complexity of the SFAS 109 approach may counter any consistency achieved. Overall, it is our position that meaningful information and consistency in principle are far more important when determining an approach than a potential for slight inconsistency in application.

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?

We agree with the proposal as it reflects economic reality and is consistent with the approach used currently in Australia. It may be appropriate to add in a requirement that the allocation methodology should be consistent with the way the entity manages it's business and the arrangements it has with it's consolidated entities.

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?

Yes we agree with this proposal as the previous requirements in IAS 12 have also been a point of contention in practice.

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 are supportive of the decision to allow the classification of interest and penalties to be classified as tax expense to be a policy choice, and to be disclosed accordingly.

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 have a fundamental concern regarding the reconciliation of the opening and closing balances of deferred tax assets and liabilities for each type of temporary difference and unused tax losses and credits. The relevance of providing these reconciliations appears to be questionable and unnecessarily burdensome to the financial statement preparer. The reconciliations seem to be more appropriate to internal control processes than improved decision-making. If a reconciliation of total tax expense for a period to current tax payable is the information that users are after, then this reconciliation (in aggregate) should be required.

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.

No, we do not have any suggestions for incremental disclosure.

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 that the effects of transition for entities that use IFRS should not be retrospective and any adjustment arising on the initial application should be recognised in retained earnings. This position is formed for the same reasons identified in the basis for conclusions and on the basis that the undue burden of retrospective application would provide little advantage to financial statement users.