The Quoted
Companies Alliance

The Quoted Companies Alliance
6 Kinghorn Street
London EC1A 7HW
Tel: +44 20 7600 3745
Fax: +44 20 7600 8288

Web: www.quotedcompaniesalliance.co.uk
Email: mail@quotedcompaniesalliance.co.uk

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
Email: commentletters@iasb.org

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Dear Sirs,

Exposure Draft ED/2009/2 – Income Tax

INTRODUCTION

The Quoted Companies Alliance (QCA) is a not-for-profit membership organisation dedicated to promoting the cause of smaller quoted companies (SQCs), which we define as those 2,000+ quoted companies outside the FTSE 350 (including those on AIM and PLUS) representing 85% of the UK quoted companies by number. Their individual market capitalisations tend to be below £500m.

The QCA is a founder member of European**Issuers**, which represents over 9,000 quoted companies in thirteen European countries.

This has been produced by our Financial Reporting Committee. A list of Committee members is detailed at Appendix A.

RESPONSE

The introduction of the Income Tax ED, as it is currently drafted, would have a number of practical implications for smaller quoted companies (SQCs), and in summary we do not believe that a new standard should be issued based on it.

Our main comments on the areas that are likely to affect SQCs are set out below:

Uncertain Tax Positions ("UTPs")

The ED proposes new guidance on the treatment of UTPs, in particular the move from a probability threshold approach to a probability-weighted average approach, and outlines disclosure requirements for major areas of uncertainty.

The likely practical effects of this are:

1. Increased analysis and consideration of uncertain positions:

Companies will need to consider the full range of outcomes in relation to any uncertain tax position and apply a probability to each outcome. Depending on the number of uncertain positions, this could significantly increase the level of work required in order to provide support for the amounts recognised in the financial statements.

Even where a company has a high level of confidence regarding a position, it will be necessary to consider alternative outcomes in order to calculate a probability-weighted average.

Depending on the level of uncertain positions a company may have, this could result in increased management time and also additional audit costs. We do not believe this approach will provide more relevant information for users, as the calculation on which it is based is a subjective estimation.

2. Disclosure of uncertain positions:

The proposed disclosure requirements in relation to UTPs include a description of the nature of the uncertainty and the possible financial impact. Such disclosures would not only apply to issues which may already be under discussion with HM Revenue & Customs (for example, where there is an open tax enquiry), but also to items which a company, or perhaps more likely, its auditors, consider to be at risk of future HMRC challenge. Such disclosures may therefore increase the likelihood of HMRC challenge.

The above factors are likely to be most relevant where companies have ongoing HMRC enquiries or have adopted contentious or aggressive positions on certain areas. The impact of the proposals is therefore likely to depend on the underlying tax risk profile on a company by company basis.

Removal of the Initial Recognition Exemption ("IRE")

The proposed removal of the IRE and replacement with recognition of the temporary difference and an associated discount or premium against that difference is likely in many cases to result in the same net deferred tax being recognised. The proposed approach will increase complexity and will require additional calculations to be prepared.

Removal of 'backward tracing' for amounts taken to Other Comprehensive Income ("OCI") or Equity

Currently, IAS 12 requires tax charges and credits to be taken to OCI or equity where the items that the tax relates to are taken directly to OCI or equity. Any subsequent changes to the tax amounts are also taken to the OCI or equity – this is 'backward tracing'.

With the exception of tax relating to share-based payments, the ED proposes to remove backward tracing. We would anticipate that for SQCs the key affected areas are likely to be

- Fair value adjustments on Available for Sale investments
- Actuarial gains and losses
- Fair value movements on cash flow hedges

The main practical impact of the proposed change is that companies' effective tax rates are likely to become more volatile, in particular where for example a company has substantial available for sale investments and pension schemes. This may necessitate additional disclosure in company financial statements in order to explain the effective tax rate to the market.

Deferred tax on investments in subsidiaries, associates and Joint Ventures ("JVs")

IAS12 currently requires companies to recognise a deferred tax liability on temporary differences associated with its investments in subsidiaries, associates, JVs and branches, although an exception applies where the investing company can control the reversal of a temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Similar provisions apply to the recognition of deferred tax assets relating to investments.
A common example of such a difference is the unremitted earnings of overseas investee companies which are likely to be paid to shareholders by way of dividend.

The main change proposed by the ED is to restrict the exemption to only temporary differences in overseas subsidiaries and JVs which are permanent in nature, meaning that all temporary differences arising in relation to associates would have to be recognised.

The likely practical effect of this on many investor companies is that additional work, for example, collation of data on investee companies, may be required in order to comply with the ED. The extent of any additional work will obviously depend on a company's investment portfolio.

Balance sheet classification – current or non-current

The ED proposes to amend IAS 1 and require the classification of deferred tax assets and liabilities to be consistent with the underlying asset or liability. In addition to the effort required to determine the split this could also have a detrimental impact on a company's operating working capital ratios.

Other comments

Several of the changes proposed in the ED will require additional information to be collected and disclosed. It will also require the preparation of additional calculations, some of which will be complex (for example, measurement of UTPs, measurement of deferred tax assets against which a full valuation allowance will be created, recognition of deferred tax in relation to investments).

This could result in an increased amount of the finance team's time being taken up or, where a company's internal tax resources may be limited, increased cost of using external advisers. In our opinion, these changes will not enhance the practical usefulness sufficiently to justify the additional cost for SQCs who have limited resources.

If you wish to discuss these issues with us, we will be pleased to attend a meeting.

Yours sincerely,

John Pierce
Chief Executive

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Nick Winters/James Lole	-	Vantis plc
John Pierce	-	The Quoted Companies Alliance
Kate Jalbert	-	The Quoted Companies Alliance

*Main Author