



Power & Utilities Webcast Series presents:

IAS 12 - Income Taxes

Presenters: Mike Reno and Chris Barton

Moderator: Bill Graf

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Audit • Tax • Consulting • Financial Advisory

About your presenters



Mike Reno, Deloitte Tax LLP

Mike is a tax partner in Deloitte's Energy & Resources Group and is part of the organization's National Energy Tax Service team. Mike has significant experience serving regulated electric and gas utilities including multinationals and foreign-owned companies.

Mike regularly assists clients in the areas of planning, supporting and explaining tax reporting positions and performs tax return reviews and tax provision reviews. His work with utilities also includes consultation and representation with respect to IRS controversies, performance of deferred tax studies and participation in accounting method reviews. Mike is also involved in due diligence with respect to merger and acquisitions involving power and utilities companies.



Chris Barton, Deloitte Tax LLP

Chris Barton is a member of Deloitte's Washington National Tax FAS 109 Group. He consults on FAS 109 and FIN 48 matters. He also has significant experience in consulting on the deferred tax impacts of business combinations (e.g., FAS 141(R)).

Over the past ten years, Chris has served multinational corporations and private equity investors in structuring acquisitions and dispositions, developing and implementing comprehensive tax strategies, performing due diligence reviews and providing transaction closing assistance. Chris has significant experience with tax-free reorganizations and spinoffs, taxable acquisitions and dispositions, cross-border transactions, and leveraged transactions.

Agenda

IFRS overview

IFRS accounting for income taxes

Differences in accounting for income taxes

Accounting differences with an income tax impact

Closing

Questions and answers

Drivers of IFRS interest

- SEC may allow U.S. companies to report using IFRS
 - SEC transition roadmap issued November 14, 2008
- Concern that peers may adopt IFRS
 - Creation of expectation that IFRS information is necessary and/or required for comparison
- Globalization of capital markets
 - Lower cost of capital since standards can facilitate access to foreign capital markets
- Convergence of FAS 109 and IAS 12

IFRS tax literature

- IAS 12, Income Taxes
 - Originally effective January 1, 1998
 - Revised in 1999 and 2000
 - Amended by several IFRS pronouncements
- IAS 20, Accounting for Governmental Grants and Disclosure of Governmental Assistance
- IAS 34, Interim Financial Reporting
- IAS 37, Provisions, Contingent Liabilities and Contingent Assets
- SIC-21, Income Taxes – Recovery of Revalued Non-depreciable Assets
- SIC-25, Income Taxes – Changes in the Tax Status of an Entity or Its Shareholders

Convergence update

- Plan to issue modified IAS 12 as exposure draft
 - Timing uncertain
- Plan to amend IAS 12 for uncertain tax positions
 - To revise measurement approach
 - To provide approach for disclosure of income tax uncertainties similar to FIN 48
- Plan to amend FAS 109
 - Exposure draft had been expected in late 2008
 - Deliberations suspended indefinitely – August 2008
 - May revisit after IASB develops its replacement for IAS 12

Similarities* between IFRS and U.S. GAAP

- Comprehensive asset/liability (balance sheet) approach
- Deferred tax provided on all temporary differences
- Measured at enacted tax rates
- Tax assets reduced to “more likely than not” recoverable amount

*Conceptual similarities – differences in the details

Accounting for income tax differences

- Uncertain tax positions
- Balance sheet classification of deferred tax assets and liabilities
- Tax rates
- Investment tax credit
- Flow-through accounting
- Balance sheet classification of valuation allowances
- Business combinations
- Interim reporting
- Tax base
- Share-based compensation
- Other differences

Uncertain tax positions

- U.S. GAAP
 - Asset approach
 - A more-likely-than-not recognition standard
 - Cumulative probability measurement model
 - Classification of interest and penalties may be included in tax expense
- IFRS
 - Liability approach
 - A more-likely-than-not (probable) recognition standard
 - “Best estimate” measurement model
 - Does not specifically address classification of interest and penalties
- IASB decision
 - Tentative decision to amend IAS 12 to probability weighted average measurement model

Uncertain tax positions - Example #1

Individual Probability	Cumulative Probability	Amount Sustained	Weighted Probability
10%	10%	\$1000	\$100
15%	25%	\$800	\$120
26%	51%	\$600	\$156
39%	90%	\$400	\$156
10%	100%	\$200	\$20
			\$552

Best estimate = \$400

Largest tax benefit MLTN to be realized = \$600

Weighted average of probable outcomes = \$552

Uncertain tax positions - Example #2

Individual Probability	Cumulative Probability	Amount Sustained	Weighted Probability
60%	60%	\$100	\$60
40%	100%	\$0	\$0
Total			\$60

Best estimate = \$100

Largest tax benefit MLTN to be realized = \$100

Weighted average of probable outcomes = \$60

Balance sheet classification - Long-term v. short-term

- U.S. GAAP
 - DTAs/DTLs must be allocated between current and noncurrent
 - FERC: All are classified as noncurrent
- IFRS
 - All DTAs/DTLs are classified as noncurrent under IAS 12
- Expected resolution
 - IASB expected to change to FAS 109 approach

Tax rates

- U.S. GAAP
 - Enacted tax rate
 - Exception for regulated utilities
- IFRS
 - Enacted or “substantively” enacted
 - Stage of passing law where further stages are administrative (e.g., in the UK, this would be passing of a bill in Parliament rather than signing by the Queen)
- Expected resolution
 - Enacted rate for operations within the U.S.
 - IASB will clarify that “substantive enactment” means that future steps in the enactment process will not change the outcome

Investment tax credit

- U.S. GAAP
 - Recognition
 - Deferral method
 - Normalization requirements
 - Flow-through method
 - Presentation
 - Temporary difference
- IFRS
 - No specific ITC guidance
 - Specifically excluded from scope of IAS 12 and IAS 20
 - IAS 20 implies flow-through method is permissible
 - IAS 12 indicates DTAs will not be provided for tax basis reductions
- Issue is out of scope for current income tax convergence project

Ratemaking

- U.S. GAAP
 - FAS 109 recognizes the effects of FAS 71
 - Tax-related regulatory assets (e.g., prior flow-through) and liabilities (e.g., excess deferred taxes)
- IFRS
 - Minimal industry guidance
 - No equivalent of regulatory assets and liabilities
 - Test individually under general definitions of asset and liability
- Normalization requirements
 - Regulatory books of account

Example - Flow-through accounting

- Facts
 - Flow-through difference = \$1,000 (capitalized for book, deducted for tax)
 - Tax rate 40 percent
- Journal entries

In all cases	\$ Debit	\$ Credit
Debit current taxes payable	400	
Credit current tax benefit		400
APB No. 11		
No deferred tax entry		
SFAS No. 109		
Debit regulatory asset	670	
Credit deferred tax liability		670
IFRS		
Debit deferred tax expense	400	
Credit deferred tax liability		400

Example – Excess deferred taxes

- Facts
 - Normalized difference = \$1,000 (tax depreciation in excess of book depreciation)
 - Tax rate decreased from 46 percent to 35 percent
- Balances

APB No. 11	\$ Alternative 1	\$ Alternative 2
Deferred tax liability	<460>	<460>
SFAS No. 109		
Deferred tax asset	59	0
Deferred tax liability	<350>	<291>
Regulatory liability	<169>	<169>
IFRS		
Deferred tax liability	<350>	<350>

U.S. GAAP v. regulatory books of account

- APB 11 – full comprehensive interperiod tax allocation*
- FAS 109
 - Balance sheet approach*
 - Use of enacted tax rates*
 - Classification of DTA/DTL as current or noncurrent**
 - Intercompany tax allocation**
- FIN 48
 - Redefinition of temporary differences (classification of FIN 48 liabilities related to temporary differences)**
 - Classification of tax-related interest and penalties**
- Pro forma adjustments reflected in ratemaking
 - Tax benefits charged directly to equity
 - Tax deficiencies and related interest

*Regulatory accounting exception generally reflected in GAAP/financial reporting

**Regulatory accounting exception generally reflected only in regulatory reporting

Balance sheet classification - Valuation allowances

- U.S. GAAP
 - Recognize all DTAs and record valuation allowance if more likely than not that (some or all of) DTA will not be recognized
- IFRS
 - Recognize the “probable portion” of DTAs
 - Record the DTA at the realizable amount
- Expected resolution
 - IASB will adopt U.S. GAAP methodology of recording an asset and a valuation allowance
 - IASB has agreed that “probable” means more likely than not and will add explanation to IAS 12

Business combinations

- Adjustments to an acquired entity's tax balances related to information existing on the acquisition date
 - Information obtained during the measurement period
 - U.S. GAAP – reduce goodwill to zero and then record to income tax expense
 - IFRS – reduce goodwill to zero and then record to income tax expense
 - Information obtained after the measurement period
 - U.S. GAAP
 - Pre-FAS 141R – reduce goodwill to zero and then record to income tax expense
 - FAS 141R – record to income tax expense
 - IFRS – record to income tax expense
- Adjustments to an acquired entity's tax balances related to post-acquisition events occurring during or after the measurement period
 - U.S. GAAP – record to income tax expense
 - IFRS – record to income tax expense

Interim reporting

- U.S. GAAP
 - APB 28 and FIN 18 require use of a forecasted annual effective tax rate
 - Exception for “discrete” and prior period items
- IFRS
 - IAS 34 requires use of the best estimate of the weighted average annual income tax rate expected for the full financial year
 - Exception for tax benefits that relate to a one-time event
 - Exception for tax benefits or credits more similar to a governmental grant

Tax basis

- U.S. GAAP
 - No definition of tax basis
- IFRS
 - Determination of tax base dependent on the expected manner of recovery under IFRS
- Expected resolution
 - Adoption of a new joint definition of tax base
 - Tax basis of an asset determined as amount deductible if asset were to be sold for carrying value at balance sheet date
 - “Management intention” principle to be removed
 - Not intended to change current U.S. accounting practice

Share-based compensation

- U.S. GAAP
 - Deferred tax asset based on cumulative compensation cost recorded for financial reporting purposes
 - Benefit of excess tax deduction recorded as an increase to APIC upon realization
 - Write-off of unrealized DTA to equity or income statement depends on availability of APIC pool
- IFRS
 - Deferred tax asset is based on expected future tax benefit as measured at the end of each reporting period
 - Excess tax benefit is immediately recognized in equity (i.e., there is no FAS 123R realization requirement and APIC can arise from recognition of a DTA)
 - Any DTA not realized is written-off to the income statement (write-off to equity is not permitted)

Example - Share-based compensation

- Assume that an award with a fair value of \$200 is being amortized over a four-year vesting period for book purposes
- Assume a tax rate of 40 percent
- Assume it is exercised in year 6 when the intrinsic value was \$300
- Also assume the following intrinsic values at the end of each reporting period:

	Year 1	Year 2	Year 3	Year 4	Year 5
Assumed intrinsic value at reporting date	\$20	\$0	\$300	\$100	\$300

U.S. GAAP example - Share-based compensation

	Year 1	Year 2	Year 3	Year 4	Year 5
Cumulative compensation cost reported in P&L	\$50	\$100	\$150	\$200	\$0
Tax rate	40%	40%	40%	40%	40%
Target DTA	\$20	\$40	\$60	\$80	\$0
Tax benefit (expense) recognized in P&L under U.S. GAAP	\$20	\$20	\$20	\$20	\$0

Year 6 exercise:	\$ Debit	\$ Credit
Current tax payable	\$120	
Current tax provision		\$120
Deferred tax provision	\$80	
Deferred tax asset		\$80
Tax provision as increase in equity	\$40	
Equity		\$40

IFRS example - Share-based compensation

	Year 1	Year 2	Year 3	Year 4	Year 5
Assumed intrinsic value at reporting date	\$20	\$0	\$300	\$100	\$300
Amount vested	1/4	1/2	3/4	4/4	4/4
Tax rate	40%	40%	40%	40%	40%
Target DTA	\$2	\$0	\$90	\$40	\$120
Tax benefit (expense) recognized in P&L under IFRS	\$2	\$(2)	\$60	\$(20)	\$40
Tax impact booked to APIC			\$30	\$(30)	\$40

Year 6 exercise:	\$ Debit	\$ Credit
Current payable	\$120	
Current provision		\$120
Deferred tax provision	\$120	
Deferred tax asset		\$120

Summary - Share-based compensation

	Year 1	Year 2	Year 3	Year 4	Year 5
CY book compensation expense recognized under U.S. GAAP and IFRS (base on given facts)	\$50	\$50	\$50	\$50	\$0
Tax benefit (expense) recognized in P&L under U.S. GAAP	\$20	\$20	\$20	\$20	\$0
Tax benefit (expense) recognized in P&L under IFRS	\$2	\$(2)	\$60	\$(20)	\$40

Other issues

- Special deductions
- Alternative minimum taxation requirements
- Effect of change in an entity's tax status
- Leveraged leases
- Distributed v. undistributed
- Initial recognition exemption
- Backwards tracing
- Foreign nonmonetary assets
- Disclosure requirements

Differences affecting tax method of accounting - Key considerations

- Is the new financial reporting standard a permissible tax accounting method?
- Is the new book method prohibited for tax purposes?
- Is the new book method preferable for tax purposes?
- Is it necessary to file changes in methods of accounting?
 - Is any required Form 3115 “automatic” or “manual”?
- Will there be modifications in the computation of permanent and temporary differences?
- Will the information be available to compute the item under the historical approach?
- How will reporting in accordance with IFRS impact the computation of taxable earnings and profits, foreign source income, and investments in subsidiaries?

Differences affecting tax method of accounting

- Under Reg. Sec. 1.446-1(a)(1), taxable income is computed under the method of accounting on the basis of which the taxpayer regularly computes income for bookkeeping purposes
- Many acceptable tax accounting methods are based on financial accounting methods
- As the accounting treatments of various items change under IFRS, companies must assess any corresponding changes in treatment for tax purposes and the ability to obtain information maintained under U.S. GAAP that may not be necessary under IFRS

Examples of accounting differences - U.S. GAAP v. IFRS

- Inventory valuation – LIFO
- Plant items
 - Research and development costs
 - Asset componentization and depreciation
 - Plant impairments
 - Reimbursements for construction costs
 - Asset retirement obligations
 - Sale and leaseback transactions
- Regulatory accounting
- Pension liabilities and assets
- Revenue recognition principles
- Share-based compensation

U.S. GAAP v. IFRS accounting differences

LIFO inventory

- IFRS prohibits the use of LIFO for the reporting of inventories
- LIFO conformity requirements – IRC Sections 472(c) and (e)(2)
 - Taxpayers reporting inventories on LIFO for tax purposes are required to use LIFO for financial reporting purposes
- Current tax law remains an impediment to companies with significant LIFO reserves

U.S. GAAP v. IFRS accounting differences

LIFO inventory (continued)

- Recognition of cumulative catch-up (Section 481(a) adjustment)
 - Conformity violation
 - Voluntary method change
 - Rev. Proc. 2008-52 addresses changes due to IFRS conversions
- Alternative inventory valuation methods – tax
 - FIFO, specific identification
 - Rolling average – Rev. Proc. 2008-43

U.S. GAAP v. IFRS accounting differences

LIFO inventory – Potential impacts

- Regulatory accounting creates specific impact on PGA clauses upon LIFO liquidation
- Without a PGA clause
 - Sales price is unaffected
 - Acceleration of tax payment
 - No impact on current or deferred tax liability
- With a PGA clause
 - Impact on sales price
 - Larger net cash flow decrease
 - No impact on current or deferred tax liability
 - Transition plans/incentive ratemaking

U.S. GAAP v. IFRS accounting differences asset componentization and depreciation

- U.S. GAAP
 - Revaluations – prohibited
 - Inspection or overhaul – expense, capitalize, or defer
 - Residual value – only adjusted down
 - Componentization – generally single element
- IFRS (IAS 16)
 - Revaluations – permitted
 - Inspection or overhaul – capitalize
 - Residual value – adjusted up or down
 - Componentization – if part of an item is significant in relation to the cost of the entire item, that part is capitalized and depreciated separately
- Tax implications
 - IRS will be promulgating rules defining unit of property

U.S. GAAP v. IFRS accounting differences reimbursements for construction costs

- U.S. GAAP – practices vary by industry and by regulatory jurisdiction
- IFRS
 - Current treatment
 - IFRIC draft interpretation – D24, customer contributions
 - Utility industry examples
 - Revenue recognition – record asset at fair value
 - Liability recognition in certain circumstances
- Tax implications
 - Analyze all reimbursements to assess taxability/exclusion and basis inclusion/exclusion

U.S. GAAP v. IFRS accounting differences asset retirement obligations

- U.S. GAAP

- Only external costs included in estimates of provision
- Use credit-adjusted, risk-free rate for discount
- Incremental obligation remeasured for changes in discount rate each balance sheet date

- IFRS

- Can incorporate internally generated costs in estimates of provision
- Use rate specific to liability reflecting current market conditions and risks
- Entire obligation remeasured for changes in discount rate each balance sheet date

U.S. GAAP v. IFRS accounting differences regulated enterprises

- Under IFRS, no FAS 71 concept of regulated enterprise accounting
 - Enterprise must determine existence of regulatory assets and liabilities under general IFRS definitions
- Status
 - November 2008 IFRIC meeting
 - Tentatively decided not to add the issue to its agenda
 - Divergence in practice does not appear significant
 - Acknowledged potential divergence upon adoption
 - Will revisit in January 2009 for potential agenda inclusion
 - IASB may address

Next steps

- Tax involvement with project implementation team
- Discussions with regulators
- Systems changes
- Filing Form 3115s
- Forecast IFRS effective tax rate and draft IFRS disclosures

Deloitte resources

- www.iasplus.com
 - A news page (updated almost daily)
 - Detailed summaries of all standards and interpretations
 - E-learning modules for each IAS and IFRS
 - Model IFRS financial statements and disclosure and compliance checklists
 - Downloadable Deloitte publications relating to IFRS (over 100 publications available)
 - Background on all IASB and IFRIC agenda projects, plus decision summaries of all IASB and IFRIC meetings
 - Comparisons of IFRS and various local GAAP

Deloitte resources (continued)

- www.deloitte.com/us/ifrs
 - Recent publications on IFRS issues
 - IFRS trainings
 - Resource library
 - Podcasts and Dbriefs
 - IFRS and U.S. GAAP pocket comparison
- DART (subscription only)
 - Q&A on key differences between U.S. GAAP and IFRS on accounting

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IAS 16 – Property, Plant and Equipment

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Regulatory Assets/Liabilities

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IFRS Tax Update

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