

Taxation Services

Background

Existing Section 290 states that taxation services are generally not seen to create a threat to independence. The IESBA had considered whether this position continued to be appropriate and concluded that additional guidance in this area is necessary. The proposed revised Section 290 recognizes that performing certain tax services may create self-review and advocacy threats and contains guidance on four broad categories of taxation services:

- *Tax return preparation* – these services involve assisting clients with their tax reporting obligations. The IESBA was of the view that such services do not generally threaten independence as long as management takes responsibility for the returns including any judgments made.
- *Preparation of tax calculations* – The IESBA was of the view that preparing calculations of tax liabilities (or assets) for an audit client for the purposes of the preparation of accounting entries that will be subsequently audited by the firm may create a self-review threat. In addition, for audit clients that are entities of significant public interest, the public interest is such that the firm should not perform calculations for the primary purpose of preparing accounting entries that are material to the financial statements.
- *Tax planning and other tax advisory services* – The IESBA was of the view that a self-review threat may be created where the advice will affect matters to be reflected in the financial statements. In addition, where the effectiveness of the advice depends upon a particular accounting treatment or presentation and there is reasonable doubt as to the appropriateness of the treatment or presentation, and the outcome of the advice will have a material effect on the financial statements the advice should not be provided because the self-review threat would be so significant no safeguards could address the threat.
- *Assistance in the resolution of tax disputes* – The IESBA was of the view that an advocacy threat may be created when the firm represents an audit client in the resolution of a tax dispute once the tax authorities have made it known that they have rejected the audit client's arguments on a particular issue and are referring the matter for determination in a formal proceeding, for example before a tribunal or court. In addition, where the services involve acting as an advocate for an audit client before a public tribunal or court in the resolution of a tax matter and the amounts are involved are material to the financial statements, the service should not be provided because the advocacy threat would be so significant no safeguards could address the threat. What constitutes a public tribunal or court should be determined according to how tax proceedings are heard in the particular jurisdiction.

Discussion

Comments Received

Many respondents had overall comments on the proposals, in addition to providing specific comments on the broad categories of tax services described in the ED. These general comments included the following sentiments:

- We generally support the proposal. (2 respondents)
- We generally agree that the threats and safeguards approach should be applied to tax services. (13 respondents)
- Tax services historically have not created a threat to independence. (2 respondents)
- The proposal appears to be moving to a rules-based approach where the restrictions are not based on threats. The length of the section on taxation seems out of proportion and is too detailed. (12 respondents)
- The provision of tax services enhances audit quality and consequently, it is in the public interest for accountants to provide tax services to their audit clients. (8 respondents)
- Companies rely on their auditors for tax services and additional costs will be incurred if they need to seek other advisors, which is not in the public interest. (11 respondents)
- Smaller firms will be put in a disadvantageous position as compared to larger firms and/or small firms will not be able to implement the safeguards mentioned. (2 respondents)
- The proposed restrictions could adversely affect the quality of tax return preparation and tax calculations. (2 respondents)
- No recognition is given to the nature of tax regimes in different countries. (2 respondents)
- The proposal could be strengthened further since the approach taken contradicts the general principles on management function.
- The proposals applicable to ESPI are supportable, but for others, the proposals should be deferred to assess whether the restrictions would enhance audit quality. (1 respondent)

From the above, it appears that although many of the respondents believe that taxation services should be analyzed using a threats-and-safeguards approach, the same as in the

case of any other non-audit service, they are concerned about what appears to be a disproportionate amount of space devoted to covering services that are traditionally provided by accountants to their audit clients without restrictions. Moreover, arguments are posited that these services are in the public interest as they enhance audit quality, reduce the audit client's costs, and help ensure accurate tax filings. However, the Task Force noted that a majority 38 out of 73 had no comments on the tax proposals.

Many of the respondents providing the general comments noted above nevertheless offered comments on the specific types of tax services covered in the ED. Many suggestions for clarifying the language were received, but as for the more substantive overall comments related to specific services, the most comments were received regarding "preparation of tax calculations used as the basis for the accounting entries in the financial statements."

Recommendation

The Task Force concluded that it was necessary to seek Board input at this time on the general comments provided by respondents, as well as the proposal on preparation of tax calculations since that area generated the most comments. This paper does not address the many clarification issues raised by respondents. Those issues will be addressed by the Task Force before the next Board meeting.

The Task Force first addressed whether the approach taken in the ED regarding tax services was appropriate in view of the comments. Although the Task Force appreciated that the discussion on tax services had been greatly expanded from what is currently in the Code, the Task Force is of the view that the guidance covering the four categories of tax services is helpful and should be retained. Moreover, the Task Force noted that given the differing conclusions on the independence consequences of certain services, it was necessary to discuss the categories of tax services separately. As a result, other than possibly streamlining the language where possible, the Task Force concluded that the paragraphs in the ED on tax services covering the scope of tax services commonly provided by accountants was appropriate.

The Task Force considered the comments on preparation of tax calculations, noting that this was the area that generated the most disagreement with the ED among the respondents who commented on tax services. Eight respondents suggested that the preparation of tax calculations should only be restricted for entities of significant public interest if the amounts are material and there is a high degree of subjectivity. Some argued that safeguards should be able to be applied to minimize any threat resulting from preparing tax calculations. (DTT, IRBA, ICAEW, Australia, WpK, ACCA, FEE, AICPA, CSOEC, SMP/DNC) Several respondents noted that either determining the "primary" purpose of the calculations would be difficult or the purpose of the calculations is not what gives rise to the threat. (ICAEW, BDO, GT, DTT) Two respondents argued that the threat to independence depends on the timing of the calculations. (APB, DTT).

In considering the comments, the Task Force first concluded to defer consideration of the comments regarding subjectivity. The Task Force noted that similar comments were made regarding the proposed changes in the ED to the restriction on valuation services where the degree of subjectivity was eliminated as a factor to consider. The Task Force was of the view that it would likely make sense for the restrictions on valuation services and preparation of tax calculations to be consistent. The Task Force will therefore consider this issue before the next Board meeting at the same time it considers the comments received on valuation services.

Taking into account the comments made on preparing tax calculations, the Task Force reconsidered whether the proposed restriction on providing this service to entities of significant public interest was appropriate. The Task Force noted that for such entities, bookkeeping services were prohibited, without regard to materiality. Thus, a restriction against the auditor calculating the tax liability for use by the client in preparing its accounting entries was not unreasonable.

The Task Force discussed whether the restriction should depend on the timing of the preparation of the tax calculations, recognizing that in some instances, the calculations are performed before the audit is complete whereas in other cases, the calculations are performed after the audit. The Task Force was of the view that the critical issue, regardless of timing, is whether the client makes a good faith effort at calculating its current and deferred tax liabilities and preparing its accounting entries. The Task Force believes that timing is not the basis on which a restriction should be based for several reasons:

1. even if the calculations are made after the audit report is issued, the amounts are taken into account during the “true-up” in the subsequent year and will as a result, potentially affect the financial statements in such year; and
2. calculations prepared before the audit is complete, such as for example, the amount of estimated tax required to be paid, may not be used by the client for purposes of preparing its entries. For these reasons, the Task Force concluded that the restriction should not be based on timing.

The Task Force agreed with the respondents who questioned the inclusion of “primary” in the restriction, noting that not only is it difficult to assess whether the purpose of the client’s use of the calculations, but the self-review threat is not diminished if a secondary purpose of the calculations is to provide the audit client with the amounts to enable the client to prepare its accounting entries. As a result, the Task Force recommends that the reference to “primary” should be deleted.

As noted, the issue of whether subjectivity should be included as a consideration will be taken up at a later date.

Action requested

Members are asked to consider the recommendation of the Task Force and provide feedback to the Task Force.