SAS Quadra 05. Bloco J. CFC
Brasília, Distrito Federal – Brazil
www.cpc.org.br

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

RE: IAS 19 - Discount rate for defined benefit liability: pre-tax rate or post-tax rate

Dear Board Members,

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)[1] welcomes the opportunity to respond the IFRS Interpretations Committee – IAS 19 – Discount rate for defined benefit liability: pre-tax rate or post-tax rate.

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

IAS 19 - Discount rate for defined benefit liability: pre-tax rate or post-tax rate?

In a jurisdiction the predominant past practice has been to use a post-tax discount rate to calculate defined benefit liabilities.

Typically, IFRSs require the use of a pre-tax discount rate (see for example IAS 36 paragraph 55 and IAS 37 paragraph 47). The question raised to us is therefore: are defined benefit obligations different to other liabilities in this regard?

The feature of defined benefit schemes in this jurisdiction that is different to other liabilities is the tax position of the schemes. In summary, investment income and contributions received are taxable, but benefits paid are not deductible.

The example provided to us is:

- The fund must pay a single benefit that amounts to CU70 a year in perpetuity.
- No contributions are received.

[1] The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).

- The pre-tax, risk free interest rate is 10%.
- Tax on investment income is 30%.

If the fund was designed to be fully funded and invest solely in risk free assets, the income statement would be:

Investment income	100
Tax	(30)
Investment income after tax	70
Benefits	(70)
Net income	Nil

This income statement would imply that CU1.000 of risk free assets are required to generate the CU70 of cash per year necessary to pay the CU70 of benefits.

If a pre-tax, interest free discount rate (10%) were used to value the benefit liability of CU70 a year in perpetuity, the resulting liability would be CU700. This would result in a fund surplus of CU300 (being the assets of CU1,000, less the liability of CU700).

Some think that this is incorrect because the resulting CU700 of risk free investments would only generate CU49 of cash after tax, which is insufficient to pay the CU70 of cash benefits. However, if a post-tax, risk free discount rate (7%) is used to value the benefit liability, the resulting liability would be CU1,000. This would exactly match the CU1,000 of investments and therefore the scheme would be fully funded – neither in surplus, nor in deficit.

The submitter thinks that the result of the above implies that in this situation (ie investment income and contributions received are taxable, but benefits paid are not deductible) the post-tax discount rate should be used.

Regarding this issue I would appreciate your feedback on the following aspects:

Question 1: In your jurisdiction, how common is this situation (ie investment income and contributions received are taxable, but benefits paid are not deductible)? If it is common, could you provide us with information that the Committee could use to assess how widespread the issue is?

In Brazil, most pension funds are subject to a special tax regimen, and thus, investment income, contributions received and benefits paid are non-taxable. However, contributions paid by the employer are tax deductible.

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Question 2: In your view, does IAS 19 (2011) require a pre-tax discount rate to calculate defined benefit liabilities? What is the predominant approach used in practice?

In Brazil, it is used pre-tax discount rates, considering the above scenario, on which there is no taxation on investment income.

If you have any questions about our comments, please contact us at operacoes@cpc.org.br.

Yours sincerely,

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Chair of International Affairs
Comitê de Pronunciamentos Contábeis (CPC)