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STAFF PAPER

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IFRS® Interpretations Committee Meeting

Project	**New item for initial consideration**
Paper topic	IAS 12 *Income Taxes*—Interest and Penalties

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Introduction

1. In October 2015, the IFRS Interpretations Committee (the Committee) published a draft Interpretation *Uncertainty over Income Tax Treatments*[1] (the draft Interpretation). The draft Interpretation did not specifically address the accounting for interest and penalties related to uncertain tax treatments. Some respondents to the draft Interpretation expressed concerns about excluding interest and penalties from the scope of the draft Interpretation (Appendix B to this paper includes a summary of the feedback from respondents).

2. The Committee redeliberated the proposals in the draft Interpretation at its meeting in September 2016 (see Agenda Paper 2 of that meeting for the staff analysis). Having considered the feedback, the Committee decided that the Interpretation would apply to income taxes within the scope of IAS 12 *Income Taxes*, and would not specifically address interest and penalties (see IFRIC Update September 2016). Some Committee members, however, observed that the absence of specific requirements for interest and penalties related to income taxes (interest and penalties) has resulted in diversity in practice. Accordingly, the Committee decided to consider whether it should add a

[1] http://www.ifrs.org/Current-Projects/IASB-Projects/IAS-12-Measurement-income-tax-uncertain-tax-position/Draft-Interpretation-October-2015/Documents/ED_IFRIC_UncertaintyOverIncomeTaxTreatments.pdf

separate project to its agenda to address how an entity accounts for interest and penalties.

3. The purpose of this paper is to:

   (a) provide a summary of the results of the staff's research and analysis on interest and penalties;

   (b) explore possible alternatives to address the issue; and

   (c) ask the Committee whether it agrees with our recommendation not to add the issue to its agenda.

Structure of this paper

4. This paper is structured as follows:

   (a) staff analysis, including:

      (i) what are interest and penalties;

      (ii) requirements in IFRS Standards;

      (iii) implications of applying IAS 12 versus IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and

      (iv) possible standard-setting alternatives.

   (b) summary and staff recommendation.

5. There are two appendices to this paper:

   (a) Appendix A—proposed wording for a tentative agenda decision; and

   (b) Appendix B—summary of research, including:

      (i) feedback on the draft Interpretation;

      (ii) previous discussions by the Board and the Committee;

      (iii) research of publicly available data; and

      (iv) review of other accounting literature (US GAAP).

Staff analysis

What are interest and penalties?

6. We understand that interest charges (or receipts) related to income taxes are generally intended to compensate the tax authority (or the entity) for the time value associated with the under (over) payment of income taxes. The applicable interest rate depends on each jurisdiction and the specific tax laws applicable in that jurisdiction. Penalties related to income taxes are generally charges levied on an entity, under income tax legislation, related to the underpayment or late payment of income taxes. The amount of the penalty may be fixed or variable depending on the magnitude, timing, intent and severity of non-compliance with the income tax legislation of the respective jurisdiction.

Requirements in IFRS Standards

7. IFRS Standards do not specifically address the accounting for interest and penalties. We understand that entities apply one of the following approaches:

   (a) *Apply IAS 12*

   Some entities apply the requirements in IAS 12 to interest and penalties. Proponents of this view say the amounts paid or payable for interest and penalties are closely related to the amounts paid or payable for income taxes and, therefore, entities should apply the requirements in IAS 12 to interest and penalties. Proponents of this view also say that in some jurisdictions, the tax authority often issues a single demand for unpaid taxes, which might also include interest and penalties. In such situations, entities are often unable to easily distinguish interest and penalties from income taxes payable.

   (b) *Apply IAS 37*

   Some entities apply the requirements in IAS 37 to interest and penalties. Paragraph 2 of IAS 12 states that 'income taxes include all domestic and foreign taxes which are based on taxable profits.' Proponents of this view say interest and penalties are generally not determined based on taxable profit, but rather on under/over payments of income taxes and other factors. Accordingly, in their view, interest and penalties are not within the scope of IAS 12. They say that the economic substance of reducing or delaying payments of income tax is no different from other financing arrangements or business decisions. Accordingly, they see no basis for applying IAS 12 to interest and penalties. If an entity does not apply IAS 12, it applies IAS 37 to interest and penalties.

(c) *Apply IAS 12 or IAS 37 depending on facts and circumstances*

Some say the application of IAS 12 or IAS 37 depends on the particular facts and circumstances (for example, the basis for calculating interest and penalties, whether interest and penalties result from uncertainties in income taxes or from planned over/under payments by entities, etc.).

8. We have reviewed publicly available financial statements of the 100 largest entities that prepare financial statements using IFRS Standards. This review confirmed that entities apply either IAS 12 or IAS 37 when accounting for interest and penalties. Appendix B to this paper provides further details about our research.

Implications of applying IAS 12 versus IAS 37

Recognition

Recognition of an asset for interest receivable

9. An entity may receive interest from tax authorities, for example, in situations in which an entity has paid an uncertain tax amount to avoid potential future penalties. Subsequently, if the uncertain position is resolved in the entity's favour, the entity may receive a return of funds together with any associated interest. One of the implications of applying IAS 12 or IAS 37 to interest and penalties is the timing of when an entity recognises an asset for such interest receivable.

10. An entity (applying IAS 12) applies paragraphs 12-14 of IAS 12 to recognise a receivable for interest. Although these paragraphs do not have an explicit recognition threshold, we understand that entities apply a 'probable' threshold to recognise

current (and deferred) tax assets. This is aligned with paragraph 14 of IAS 12, which says:

> When a tax loss is used to recover current tax of a previous period, an entity recognises the benefit as an asset in the period in which the tax loss occurs because it is probable that the benefit will flow to the entity and the benefit can be reliably measured.

Further, paragraph 24 of IAS 12 says:

> A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised…

11. An entity (applying IAS 37) recognises an asset only when it is virtually certain of the realisation of the income. Paragraph 35 of IAS 37 states:

> ...If it has become virtually certain that an inflow of economic benefits will arise, the asset and the related income are recognised in the financial statements of the period in which the change occurs. If an inflow of economic benefits has become probable, an entity discloses the contingent asset…

12. Accordingly, an entity applying IAS 12 might recognise an asset for interest receivable earlier than it would if it applied IAS 37.

Recognition of a liability for interest and penalties payable

13. In our view, the recognition criteria in IAS 12 and IAS 37 are broadly similar for liabilities. Paragraph 14 of IAS 37 requires an entity to recognise a provision when:

    (a) the entity has a present obligation as a result of a past event;

    (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

    (c) the entity can make a reliable estimate of the obligation.

14. As explained in paragraph 10 above, the requirements for the recognition of current and deferred taxes do not specifically contain a probable threshold. However, we think it is inherent in these requirements.

15. We observe that IAS 37 explicitly requires an entity to have a present obligation and to be able to make a reliable estimate. IAS 12 does not contain similar requirements for current taxes. However, we think the absence of such requirements in IAS 12 would not result in differences in the recognition of liabilities because those concepts are an embedded part of the recognition of liabilities. Paragraph 4.46 of the *Conceptual Framework* states (emphasis added):

> A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a *present obligation* and the amount at which the settlement will take place can be *measured reliably*…

16. Consequently, we think applying IAS 12 or IAS 37 would not result in significant differences in the recognition of a liability for interest and penalties.

Measurement

Measurement of an asset for interest receivable

17. Paragraph 46 of IAS 12 says:

> Current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

18. IAS 37 does not contain requirements relating to the measurement of assets. However, if it is virtually certain an entity will receive future economic benefits, we expect there to be little (if any) measurement uncertainty in the amount an entity expects to receive. Because of this, at the time that the receipt of economic benefits is virtually certain, we think an entity would measure an asset similarly applying either IAS 12 or IAS 37. However, as noted in paragraph 12 of the paper, an entity applying IAS 12

might recognise an asset for interest earlier (ie because it applies a probable threshold) than it would if it applied IAS 37, which includes a virtually certain threshold.

Measurement of a liability for interest and penalties payable

19. Paragraph 36 of IAS 37 says:

> The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

20. The principle of 'best estimate' is further explained in paragraph 37 of IAS 37:

> The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time…

21. As noted in paragraph 17 above, paragraph 46 of IAS 12 requires an entity to measure current tax liabilities at the amount expected to be paid.

22. We would not expect the different principles (ie 'best estimate' versus 'amount expected to be paid') to result in significant differences in practice in the measurement of liabilities for interest and penalties. However, depending on specific facts and circumstances, it is possible that entities might apply different approaches to measuring a liability if applying IAS 12 or IAS 37. In particular, the draft Interpretation, when finalised, will include requirements on how an entity reflects uncertainty when accounting for uncertain income tax treatments. The requirements in the draft Interpretation could create further differences in outcomes compared to applying the principles in IAS 37.

23. In addition, paragraph 45 of IAS 37 requires an entity to discount a provision if the effect of the time value of money is material. In contrast, IAS 12 is silent on discounting of current tax balances (paragraph 53 prohibits discounting of deferred tax assets and liabilities).

24. Our research of the 100 largest entities that use IFRS Standards did not identify any entities that disclose details of how they measure interest and penalties.

Presentation

25. IAS 12 and IAS 37 do not contain specific requirements regarding presentation. Paragraph 82(d) of IAS 1 *Presentation of Financial Statements* requires an entity to present 'tax expense' as a line item in the statement of profit or loss. In July 2012, the Committee published an agenda decision within which it concluded that the 'tax expense' line item includes only taxes within the scope of IAS 12.

26. Further, paragraphs 55 and 85 of IAS 1 require an entity to present additional line items, headings and subtotals in the statement of financial position and the statement of profit or loss when such presentation is relevant to a user's understanding.

27. Accordingly, an entity (applying IAS 12) includes interest and penalties in the 'tax expense' line item in the statement of profit or loss. An entity (applying IAS 37) applies judgement in determining where to present interest and penalties in the statement or profit or loss—it would not present interest and penalties in the 'tax expense' line item.

Disclosure

28. Paragraph 79 of IAS 12 requires an entity to separately disclose the major components of income tax expense (income). Paragraph 81(c) of IAS 12 also requires an entity to reconcile the tax expense (income) and accounting profit. Accordingly, if material, we think an entity applying IAS 12 is required to disclose interest and penalties.

29. Similarly, paragraphs 84-85 of IAS 37 require an entity to disclose a reconciliation of opening and closing amounts for each class of provision, together with information about its nature and uncertainties in timing or amount. If the inflow of economic benefits is probable, paragraph 89 of IAS 37 requires an entity to disclose information about the nature of contingent assets and, where practicable, an estimate of their effect.

30. Consequently, we think applying IAS 12 or IAS 37 does not result in any significant differences in the disclosure of interest and penalties.

Summary of key implications

31. Our research has identified that some entities apply IAS 12 and others apply IAS 37 to interest and penalties (see Appendix B for details). It is unclear from our research

whether those entities apply different Standards to interest and penalties of a similar nature, or apply different Standards because the nature of the underlying interest and penalties are different.

32. In reviewing the requirements of IAS 12 and IAS 37, we identified three possible sources of diversity in accounting for interest and penalties:

    (a) timing of recognition of assets for interest receivable (paragraphs 13-16);

    (b) measurement of liabilities (paragraphs 19-24); and

    (c) presentation in the statement of profit or loss (paragraphs 25-27).

33. We think accounting for interest receivable is not a significant issue—we would expect the amounts to be relatively insignificant for most entities, and even if significant the effect of any difference in practice between the ‘probable’ and ‘virtually certain’ recognition thresholds in IAS 12 and IAS 37 to be minimal. Our review of publicly available financial statements (see Appendix B for details) did not identify any entities disclosing interest received or receivable.

34. Accordingly, we think that any concerns about the accounting for interest and penalties could potentially relate to the measurement of liabilities and the presentation of the related expense. The differences in the respective measurement requirements in IAS 12 and IAS 37 (discussed in paragraphs 19-27 of the paper) could result in an entity measuring a liability for interest and penalties differently. However we would not expect the effect of any differences in practice to be significant. In saying that, we are unable to quantity or otherwise assess the significance of any potential effect.

35. If material, we would expect an entity to disclosure information about interest and penalties, regardless of whether it applies IAS 12 or IAS 37.

36. On the basis of our assessment, we think the potential implications of applying IAS 12 or IAS 37 to interest and penalties are not of such significance as to warrant standard-setting at this time. Nonetheless, to help the Committee decide whether to undertake any standard-setting activity regarding interest and penalties, we considered some possible standard-setting alternatives in the following paragraphs.

Possible standard-setting alternatives

37. We considered the following three possibilities:

    (a) amend IAS 37 to require entities to apply IAS 37 to interest and penalties;

    (b) provide entities with an accounting policy choice of IAS 12 or IAS 37; or

    (c) amend IAS 12 to require entities to apply IAS 12 to interest and penalties.

Amend IAS 37 to require entities to apply IAS 37 to interest and penalties

38. We first considered a narrow-scope amendment to IAS 37 that would (a) define interest and penalties and (b) explicitly require entities to apply the requirements in IAS 37 to interest and penalties. This is because we think that the nature of interest and penalties (described in paragraph 6 of the paper) would not generally meet the definition of income taxes.

39. Paragraph 2 of IAS 12 defines income taxes as including ‘all domestic and foreign taxes which are based on taxable profits…’. Taxable profit is defined in paragraph 5 of IAS 12 as ‘the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).’

40. We think interest related to income taxes is similar to a financing charge—it is calculated on the amount of under/over payment of income taxes and is not based on taxable profits. Similarly, penalties are generally based on the magnitude, timing, intent and severity of non-compliance with the applicable income tax legislation and are not, in our view, based on taxable profits.

41. Accordingly, we think that interest and penalties are typically not within the scope of IAS 12. Amending IAS 37 to require entities to apply IAS 37 to interest and penalties would be consistent with our view of their nature.

42. However, as noted earlier, if the Committee were to undertake standard-setting, then we would expect it to do so to address any concerns about the measurement and presentation of interest and penalties. The draft Interpretation on IAS 12, when finalised, will explain how to reflect the effect of uncertainty over uncertain tax treatments. We understand that interest and penalties are often related or inextricably

linked to uncertain tax treatments. In addition, neither IAS 1 nor IAS 37 contain specific presentation requirements—applying IAS 37, entities might present interest and penalties within different line items. Accordingly, amending IAS 37 to clarify that interest and penalties are within the scope of IAS 37 may not adequately address any concerns raised.

43. Further, we understand that it is not always possible for entities to easily distinguish amounts relating to interest and penalties from income taxes payable. In such situations, an entity may not be able to reliably estimate interest and penalties. This could lead an entity to conclude that the 'reliable estimation' recognition criterion in paragraph 14 of IAS 37 is not met. We think that any potential amendment to IAS 37 would need to address this issue. One possible solution would be to specify that, in such situations, an entity accounts for the entire amount payable (interest, penalties and income taxes) applying IAS 12. However, this would add complexity to the accounting and would again lead to diversity in accounting for interest and penalties. This would appear to defeat the objective of undertaking any such project.

44. For these reasons, we would not recommend proceeding with this alternative.

Provide entities with an accounting policy choice of IAS 12 or IAS 37

45. We next considered providing entities with an explicit accounting policy choice to apply either IAS 12 or IAS 37 to interest and penalties. In 2009 the Board proposed providing entities with an accounting policy choice for the classification of interest and penalties (see Appendix B—previous discussions by the Board and the Committee). There was general support for this proposal. Providing an accounting policy choice would also align the presentation requirements for interest and penalties in IFRS Standards with those in US GAAP (see Appendix B for US GAAP requirements on interest and penalties).

46. However, the absence of specific requirements in IFRS Standards for interest and penalties appears to have resulted, in practice, in entities having an accounting policy choice to apply IAS 12 or IAS 37. In addition we think that such an accounting policy choice would not address any diversity in accounting for interest and penalties. We therefore think that undertaking a project to explicitly permit entities to choose whether to apply IAS 12 or IAS 37 to interest and penalties would not significantly

improve financial reporting. We therefore think that the benefits of such a project would not outweigh its costs.

47. For this reason, we would not recommend proceeding with this alternative.

Amend IAS 12 to require entities to apply IAS 12 to interest and penalties

48. We then considered a narrow-scope amendment to IAS 12 to require entities to apply IAS 12 to interest and penalties. As outlined in paragraphs 39-41 of this paper, our initial view is that interest and penalties are typically not within the existing scope of IAS 12. However, the Committee could potentially propose to amend IAS 12 to explicitly include interest and penalties within its scope. We would suggest doing this by (a) defining interest and penalties and (b) expanding the scope of IAS 12 to apply to interest and penalties in addition to income taxes. We would not suggest changing the existing scope of IAS 12 more fundamentally by changing, for example, the definition of income taxes—we think such an approach would create a high risk of unintended consequences.

49. Amending IAS 12 as described would, in effect, create a rule. An entity would be required to apply the requirements in IAS 12 to interest and penalties, which in our view do not meet the definition of income taxes. If the Committee wishes to pursue this alternative, we will consider any consequential effects of applying the requirements for income taxes in IAS 12 and other IFRS Standards to interest and penalties.

50. We think this approach could eliminate any potential diversity in the measurement and presentation of interest and penalties:

(a) Including interest and penalties in the scope of IAS 12 would result in entities presenting interest and penalties as part of the 'tax expense' line item in the statement of profit or loss. IAS 12 would then require an entity to disclose the major components of tax expense (income), which if material would include interest and penalties.

(b) The forthcoming Interpretation on uncertain income tax treatments, which adds to the requirements in IAS 12, would then also apply to interest and penalties associated with uncertain tax treatments.

51. If the Committee were to conclude that it should address the accounting for interest and penalties, we would recommend that the Committee pursue this alternative. We think the potential benefits of this approach in the form of greater comparability of information and the elimination of possible diversity could outweigh potential costs.

Summary and staff recommendation

52. Our research has identified that some entities apply IAS 12 and others apply IAS 37 to interest and penalties. We think any concerns regarding the accounting for interest and penalties could relate to possible diversity in the measurement of liabilities and the presentation of the related expense. However, we are unable to quantity or otherwise assess the significance of any potential effect.

53. If the Committee concludes that it is necessary to add to or change IFRS Standards to address interest and penalties, we recommend the Committee consider amending IAS 12 to require entities to apply IAS 12 to interest and penalties, as outlined in paragraphs 48–51 of the paper. We think such an amendment would be narrow in scope and has the potential to resolve any issue in an efficient manner. If the Committee decides to pursue this alternative, we will bring a paper to a future Committee meeting that will provide our analysis and recommendations on how the Committee could develop that narrow-scope amendment to IAS 12.

54. Considering our research and analysis, we think there is insufficient evidence to conclude that the absence of specific requirements on interest and penalties has resulted in materially different information being reported by entities for similar items. Consequently, we are not convinced that the potential benefits of undertaking a standard-setting project on interest and penalties would outweigh the costs of proposing an amendment. Accordingly, we recommend that the Committee does not add this issue to its agenda.

55. If the Committee agrees with our recommendation, we think it should consider whether to publish a tentative agenda decision. We recommend doing so. Although the Committee’s discussion of interest and penalties is not the result of a submission, we see benefit in explaining the Committee’s rationale for not adding the issue to its agenda. We have proposed wording for a tentative agenda decision in Appendix A,

which highlights the existing disclosure requirements in IAS 12 and IAS 37 in this respect.

Questions for the Committee

1. Does the Committee agree with the staff recommendation not to add this issue to its agenda?
2. Does the Committee agree with the staff recommendation to publish a tentative agenda decision?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision outlined in Appendix A to this paper?

Appendix A
Proposed wording of the tentative agenda decision

IAS 12 *Income Taxes*—Interest and penalties related to income taxes

IFRS Standards do not specifically address the accounting for interest and penalties related to income taxes (interest and penalties). Entities apply either IAS 12 *Income Taxes* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to interest and penalties.

The IFRS Interpretations Committee (the Committee) considered whether to add a project to its agenda to address such interest and penalties.

On the basis of its analysis, the Committee concluded that there was insufficient evidence to conclude that the absence of specific requirements on interest and penalties had resulted in materially different information being reported by entities for those items. Consequently, the Committee [decided] not to add a project to its agenda on interest and penalties.

Nonetheless, the Committee observed that (a) paragraph 79 of IAS 12 requires an entity to disclose the major components of tax expense (income); and (b) for each class of provision, paragraph 84-85 of IAS 37 requires a reconciliation of the carrying amount at the start and end of the reporting period as well as various other pieces of information. Accordingly, regardless of whether an entity applies IAS 12 or IAS 37 in accounting for interest and penalties, the Committee concluded that, if material, the entity would disclose information about interest and penalties related to income taxes.

Appendix B
Summary of research

B1. We have performed research on interest and penalties, including considering feedback on the draft Interpretation, previous discussions by the Board and the Committee, publicly available data and other accounting literature (US GAAP).

Feedback received on the draft Interpretation[2]

B2. The draft Interpretation explained that accounting for interest and penalties is not within its scope because outreach conducted when developing the draft Interpretation did not identify any evidence of significant diversity in practice.

B3. Nearly one-third of the respondents—comprising those supporting the draft Interpretation as well as those that do not—expressed concerns about excluding interest and penalties from the scope:

(a) almost all of those that commented on interest and penalties said that they have observed the application of diverse reporting methods in accounting for interest and penalties. One accounting firm[3] commented that this is evidenced by IFRS guidance produced by the large accounting networks on this matter. For example, three of the four large accounting networks allow an accounting policy choice between applying IAS 12 and IAS 37, whilst the fourth large accounting network states a preference for IAS 37.

(b) a few respondents suggested that the scope of the draft Interpretation be extended to cover interest and penalties, at least insofar as they arise directly from uncertain tax treatments already within its scope.

B4. A few respondents commented that they agree that the scope does not include interest and penalties. In their view, interest and penalties arise from the misapplication of tax law, and are not subject to uncertainty. Nonetheless, they suggest revising the Basis

[2] Reproduced from paragraphs 20-22 of Agenda Paper 7 of the Committee's July 2016 meeting.

[3] KPMG IFRG Limited (CL37)

for Conclusions to explain why interest and penalties are excluded from the scope, rather than to state that there is no diversity in practice.

Previous discussions by the Board and the Committee

B5. In June 2004, the Committee discussed a request to clarify how an entity classifies interest and penalties. The Committee did not add this to its agenda and noted that ‘the disclosure requirements of IAS 12 and IAS 1 *Presentation of Financial Statements* provide adequate transparency of these items’.

B6. In March 2009, the Board published an Exposure Draft of amendments to IAS 12. The Exposure Draft proposed to specifically address how an entity classifies interest and penalties, as follows:

> 39 An entity shall make an accounting policy decision whether to classify interest and penalties payable to tax authorities as tax expense.

B7. The Board’s rationale for proposing this requirement was included in paragraph BC103 of the Exposure Draft:

> FIN 48 [A US GAAP document titled *Accounting for Uncertainty in Income Taxes*, the requirements are now included in ASC 740-10] states that the classification of interest and penalties payable to the tax authority is a matter of accounting policy choice that should be disclosed. The Board decided that this was a helpful requirement and should be included in the new IFRS. FIN 48 also requires disclosure of the amount of penalties and interest. The Board proposes not to require this disclosure. If interest and penalties are material, paragraph 97 of IAS 1 requires their disclosure. The Board noted that materiality depends on the nature of the item as well as its size.

B8. The Board discussed the feedback on the Exposure Draft at its October 2009 meeting. There was general support for the proposed treatment of interest and penalties. Some respondents disagreed with the proposal because they thought that, applying IAS 1, an entity should present interest and penalties as an operating expense. Some said that interest and penalties were not significant enough to warrant a separate disclosure. In contrast, supporters of the proposed amendments said that, in many jurisdictions, uncertain tax positions were settled on a 'net' basis. The net settlement included the additional tax assessed together with the associated interest and penalties.

B9. Because of wider feedback on the Exposure Draft, the Board did not finalise the proposed amendments to IAS 12. Instead, the Board initiated a research project on income taxes. However, having considered feedback on its 2015 Agenda Consultation, the Board decided not to proceed with this project at this time.

Research of publicly available financial statements

B10. We analysed the financial statements of the 100 largest companies, by market capitalisation (as at 30 August 2016), that prepare financial statements using IFRS Standards. Our objective was (a) to identify how entities present and disclose interest and penalties related to income taxes, and (b) if possible gather evidence as to whether interest and penalties are material for entities. We used the financial search engine, AlphaSense, to search for interest and penalties in each company's most recent annual financial statements (going back no more than 12 months).

B11. Our analysis identified eight entities that specifically disclose interest and penalties in their financial statements. Four of these companies present interest and penalties as a tax expense. In contrast, the other four companies present interest and penalties as finance charges and other expenses and/or include a provision for these charges applying IAS 37. None of the companies included in the research disclose any interest receivable related to income taxes.

Other accounting literature (US GAAP)

B12. We reviewed the requirements of US GAAP ASC 740-10 (previously FIN 48 *Accounting for Uncertainty in Income Taxes*), which includes requirements for the recognition and presentation of interest and penalties related to uncertain tax positions.

B13. Paragraph ASC 740-10-25-26 discusses the recognition of interest payments on income taxes. It states:

> When the tax law requires interest to be paid on an underpayment of income taxes, an entity shall begin recognizing interest expense in the first period the interest would begin accruing according to the provisions of the relevant tax law.

B14. Penalties are addressed in ASC 740-10-25-57 which states:

> If a tax position does not meet the minimum statutory threshold to avoid payment of penalties (considering the factors in paragraph 740-10-25-7), an entity shall recognize an expense for the amount of the statutory penalty in the period in which the entity claims or expects to claim the position in the tax return. If penalties were not recognized when the position was initially taken, the expense shall be recognized in the period in which the entity's judgment about meeting the minimum statutory threshold changes.

B15. Paragraph ASC 740-10-45-25 allows entities a choice in presenting interest and penalties. It states:

> Interest recognized in accordance with paragraph 740-10-25-56 may be classified in the financial statements as either income taxes or interest expense, based on the accounting policy election of the entity. Penalties recognized in accordance with paragraph 740-10-25-57 may be classified in the financial statements as either income taxes or another expense classification, based on the accounting policy election of the entity. Those elections shall be consistently applied.