

## STAFF PAPER

July 2014

## IFRS Interpretations Committee Meeting

IFRS IC January 2014  
and May 2014

Project	Items for continuing consideration
Paper topic	IAS 12 <i>Income Taxes</i> Recognition of current income tax on uncertain tax position— Principles of the draft Interpretation
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*. The approval of a final Interpretation by the Board is reported in *IASB Update*.

## Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify the recognition of a tax asset in the situation in which tax laws require an entity to make an immediate payment when a tax examination results in an additional charge, even if the entity intends to appeal against the additional charge. In the situation described by the submitter, the entity expects, but is not certain, to recover some or all of the amount paid. The Interpretations Committee was asked to clarify whether IAS 12 *Income Taxes* (and a ‘probable’ threshold) is applied to determine whether to recognise an asset for the additional payment, or whether the guidance in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (and a ‘virtually certain’ threshold) should be applied.
2. The Interpretations Committee discussed the issue at two meetings in January and May 2014 and noted significant diversity in practice. In response to that diversity in practice it tentatively decided to develop an interpretation on the issue at its meeting in May 2014.

### Objective of Agenda Papers 3 and 3A

3. The objective of Agenda Papers 3 and 3A is to:
  - (a) give background information on the issue;
  - (b) propose the scope and the transition requirements of the draft Interpretation;
  - (c) consider possible unintended consequences of the draft Interpretation and potential consequential amendments to other IFRSs; and
  - (d) present the draft Interpretation for discussion by the Interpretations Committee.

### Structure of the Agenda Papers 3 and 3A

4. The structure of this Agenda Paper is as follows:
  - (a) summary of previous discussions, including decisions taken by the Interpretations Committee, the feedback from consultations with individual IASB members and analysis of the concern raised;
  - (b) staff proposal in respect of the scope and the transition requirements of the draft Interpretation;
  - (c) staff analysis of possible unintended consequences and potential consequential amendments;
  - (d) overview of the relevant US GAAP guidance;
  - (e) summary of staff recommendation; and
  - (f) questions for the Interpretations Committee.
5. A proposed draft Interpretation is presented in Agenda Paper 3A.

## Previous discussions

### ***Decisions taken by the Interpretations Committee***

6. The Interpretations Committee discussed the issue in January and May 2014<sup>1</sup> and noted that:
- (a) Paragraph 12 of IAS 12 provides guidance on the recognition of current tax assets and current tax liabilities. In particular, it states that:
    - (i) current tax for current and prior periods shall, to the extent unpaid, be recognised as a liability; and
    - (ii) if the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess shall be recognised as an asset.
  - (b) In the specific fact pattern, described in the submission, an asset is recognised if the amount of cash paid (which is a certain amount) exceeds the amount of tax expected to be due (which is an uncertain amount).
  - (c) The timing of payment should not affect the amount of current tax expense recognised.
7. The Interpretations Committee acknowledged significant diversity in practice on whether IAS 12 or IAS 37 should be applied to determine whether an asset should be recognised.

### ***Feedback from consultations with IASB members***

8. We consulted IASB members at various meetings in June 2014 to inform them of the tentative decision to develop an interpretation taken by the Interpretations Committee at the May meeting and to obtain their individual views on this issue.

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<sup>1</sup> Refer to Agenda Paper 13 discussed in January 2014 (<http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/January/AP13-IAS%2012%20-%20Uncertain%20tax%20position.pdf>) and Agenda Paper 5A discussed in May 2014 ([http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/May/AP05A%20-%20IAS12%20-%20Uncertain%20Tax%20Position\\_CLs%20attached.pdf](http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/May/AP05A%20-%20IAS12%20-%20Uncertain%20Tax%20Position_CLs%20attached.pdf)).

We did not ask the IASB members to make any decisions when we consulted them.

9. The feedback that we received from those consultations can be summarised as follows:
- (a) the IASB members consulted supported the Interpretations Committee's technical conclusions described in paragraph 6 above;
  - (b) the majority of the IASB members also expressed support for developing an interpretation on this issue; however
  - (c) three IASB members were concerned about addressing the issue through an interpretation because they thought that the existing guidance in IAS 12 is sufficiently clear and developing additional guidance on the issue is not necessary.
10. We analyse the concern raised by IASB members in the paragraphs below.

### ***Analysis of the concern raised***

11. We think that the identified diversity in practice indicates that the existing guidance is not sufficiently clear. The diversity was identified at all stages of the project:
- (a) *responses to the outreach requests*: diversity in practice was identified in seven jurisdictions out of eleven jurisdictions where the issue is common;
  - (b) *comment letters on the tentative agenda decision*: six respondents<sup>2</sup> out of ten expressed the view that additional guidance in respect of the uncertain tax position is needed. However, we acknowledge that four of them<sup>3</sup> pointed out that addressing the recognition issue without developing guidance on measurement will not resolve the existing

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<sup>2</sup> Those were ESMA, Financial Supervisory Service of Korea, KASB, Kookmin Bank (Korea), KPMG and OIC.

<sup>3</sup> Those were ESMA, Financial Supervisory Service of Korea, KASB, Kookmin Bank (Korea).

diversity in accounting because measurement is the main source of the diversity in practice that has arisen; and

(c) *analysis of the existing accounting literature*<sup>4</sup>.

12. We think that authoritative guidance on the narrow issue of recognition of the current tax would reduce the existing diversity in practice and would therefore improve financial reporting.
13. We also think that issues relating to measurement could not be addressed by the Interpretations Committee because this would be too broad an issue for it to deal with on a timely basis.

## Staff proposals

### ***Scope of the draft Interpretation***

14. The submission to the Interpretations Committee described a particular situation when an entity makes a payment to tax authorities in respect of an uncertain tax position.
15. We think that the scope of the draft Interpretation could be broadened to include recognition of current tax liabilities and current tax assets, irrespective whether an entity made a payment to tax authorities. This is because the recognition requirements should not depend on the timing and manner of settlement of the liability and thus recognition of current tax liabilities and current tax assets in a broader range of situations would be consistent with the principles applied to the specific question submitted.
16. Consequently, we think that the draft Interpretation should address the issue of which standard shall be applied to current tax liabilities and current tax assets, the amount of which is uncertain (paragraph 5 of the draft Interpretation).

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<sup>4</sup> Eg the diversity of views in accounting literature is illustrated in the comment letter of Kookmin Bank (Korea) attached to the Agenda Paper 5A which was discussed by the Interpretations Committee in May 2014.

**Transition requirements of the draft Interpretation***Entities that already apply IFRS*

17. We think that the Interpretation could be applied retrospectively in most of the cases, because we expect entities to have the information needed for retrospective application. This is because:

- (a) If an entity applied IAS 37 requirements to recognition of a current tax asset, amount of which is uncertain, it would have assessed the probability of the flow of economic benefits to comply with the disclosure requirements in paragraph 89 of IAS 37 (below):

Where an inflow of economic benefits is probable, an entity shall disclose a brief description of the nature of the contingent assets at the end of the reporting period, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 36–52.

- (b) We expect that an entity would have assessed the uncertainty in respect of its tax position on a regular basis and in sufficient detail, in particular if the amount involved is material. We also think that those assessments would have been made, even though a ‘virtually certain’ threshold was subsequently applied.

18. However, we acknowledge that retrospective application may be difficult in some cases, especially if an entity would need to use hindsight. We think that in such cases the draft Interpretation would be applied in accordance with paragraph 25 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* below:

When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable.

19. Consequently we think that the draft Interpretation should be applied retrospectively. If retrospective application is impracticable, guidance in IAS 8 would apply.

*First-time adopters of IFRS*

20. We propose retrospective application of the draft Interpretation, which is the general treatment required by IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Consequently, we think that no specific provisions should be made for first-time adopters of IFRS in respect of the draft Interpretation.

**Consequential amendments to other Standards**

21. We have reviewed other Standards for potential consequential amendments triggered by draft Interpretation. As a result of this review, we do not propose any consequential amendments.

**Unintended consequences**

22. We analysed whether the draft Interpretation might result in any unintended consequences. We acknowledge that:
- (a) the scope of the draft Interpretation is very narrow and it does not provide guidance on issues other than recognition of current tax liabilities and current tax assets; and
  - (b) the draft Interpretation does not change the recognition principles of IAS 12. Instead, it states that current tax liabilities and current tax assets, the amount of which is uncertain, are within the scope of IAS 12 and should be recognised in accordance with the principles of the Standard.
23. On this basis, we do not think any significant unintended consequences of the draft Interpretation may arise.

## Relevant US GAAP guidance

### **Overview of the guidance**

24. FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* (FIN 48, codified primarily as paragraphs 740-10-25-6 through 25-17 and 740-10-30-7)<sup>5</sup> clarifies accounting for uncertainty in income taxes (an ‘uncertain tax position’).
25. The term *tax position* is defined in ASC 740-10-20 (an extract below) as follows:
- Tax position is a position in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods.
- A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets.
26. FIN 48 uses ‘a benefit-recognition approach’ which requires that:
- (a) a liability for the uncertain position is recorded as the difference between the amount taken in the tax return and the benefit recognised; and
  - (b) a benefit (a deduction) is recognised when it is more likely than not to be sustained based on the technical merits of the position.
27. In January 2012, the Financial Accounting Foundation (FAF) issued a post-implementation review (PIR) report on the pronouncement<sup>6</sup>. The report

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<sup>5</sup> Refer to the text of the pronouncement:

[http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175822209924&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=199472&blobheadervalue1=filename%3Daop\\_fin48.pdf&blobcol=urldata&blobtable=MungoBlobs](http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175822209924&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=199472&blobheadervalue1=filename%3Daop_fin48.pdf&blobcol=urldata&blobtable=MungoBlobs).

<sup>6</sup> Refer to the text of the FAF report:

[http://www.accountingfoundation.org/cs/ContentServer?site=Foundation&c=Document\\_C&pagename=Foundation/Document\\_C/FAFDocumentPage&cid=1176159654068](http://www.accountingfoundation.org/cs/ContentServer?site=Foundation&c=Document_C&pagename=Foundation/Document_C/FAFDocumentPage&cid=1176159654068).



concluded that “on balance, the benefits of FIN 48’s improved consistency and reporting of income tax uncertainty information outweigh its costs.” The PIR team also acknowledged that:

- (a) the comparability of information about income tax uncertainties across companies could not be achieved because of the managements’ judgements involved and complexity of the tax law; and
- (b) the information may not be predictive or confirmatory of future cash flows because FIN 48 employs a benefit-recognition approach, not a best-estimate approach for liabilities to be settled.

28. The report also addressed a number of operational questions; in particular it stated that generally most preparers did not incur significant implementation and continuing compliance costs.

***Possibility of convergence***

29. We do not think that convergence with US GAAP in respect of the recognition requirements could be fully achieved within the existing standards (IAS 12 and ASC 740 (SFAS 109)) because:

- (a) *Unit of account*: we observed that US GAAP provides specific guidance in this respect. However IAS 12 does not define the unit of account and we understand that current practice is mixed.
- (b) *A benefit-recognition approach*: as described in paragraph 26 above. US GAAP uses a benefit-recognition approach, not a best-estimate approach, for liabilities to be settled.

30. FIN 48 also addresses a broader range of issues than the proposed draft Interpretation, including in particular measurement and disclosures.

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In Response to this report FASB concluded that the criteria for a review or reconsideration of fundamental aspects of FIN 48 are not met, and no discrete standards-setting action were undertaken. Refer to the text of the FASB response:

[http://www.fasb.org/cs/ContentServer?site=FASB&c=Document\\_C&pagename=FASB%2FDocument\\_C%2FDocumentPage&cid=1176159919974](http://www.fasb.org/cs/ContentServer?site=FASB&c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176159919974).

31. We do not think that the issues in paragraphs 29 and 30 above could be addressed in the draft Interpretation because they are not specific to accounting for current tax liabilities and current tax assets, amount of which is uncertain, and should therefore be considered in a broader project.

### Summary of staff recommendation

32. We think that the scope of the draft Interpretation should be broadened to address recognition of current tax liabilities and current tax assets, irrespective whether an entity has made a payment to tax authorities. Consequently, we recommend that the draft Interpretation should address the issue of which standard shall be applied to current tax liabilities and current tax assets, the amount of which is uncertain (paragraph 5 of the draft Interpretation).
33. We also think that the draft Interpretation should be applied retrospectively, because we expect entities to have the information needed for retrospective application (paragraphs 7 and 8 of the draft Interpretation).
34. The proposed draft Interpretation is included in Agenda Paper 3A.

### Questions for the Interpretations Committee

#### Questions for the Interpretations Committee

1. Does the Interpretations Committee have any questions on the feedback from consultations with IASB members?
2. Does the Interpretations Committee agree with the staff recommendations with respect to the scope and the transition requirements of the draft Interpretation?
3. Do the Interpretations Committee members foresee any unintended consequences of the draft Interpretation?
4. What comments do the Interpretations Committee members have on the proposed draft Interpretation in Agenda Paper 3A?