STAFF PAPER

April 2015

IASB Meeting

Project	**Draft Interpretation for IAS 12 *Income Taxes*—Accounting for uncertainties in income taxes**
Paper topic	Summary of due process followed and technical matters agreed by the IFRS Interpretations Committee

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Purpose of this paper

1. The IFRS Interpretations Committee ('the Interpretations Committee') received a request for clarification of the recognition of a current 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 but an entity intends to appeal against the additional charge.

2. The Interpretations Committee noted that IAS 12 *Income Taxes* provides guidance on recognition in such a situation, but observed broader diversity in practice for recognition and measurement of a tax liability or asset when there is uncertainty in the application of the tax law. In response to the diversity in practice, the Interpretations Committee decided to develop an Interpretation, considering the Interpretations Committee's agenda criteria described in paragraphs 5.14—5.22 of the *Due Process Handbook*.

3. At its January 2015 meeting, the Interpretations Committee reached general agreement on the technical matters to publish a draft Interpretation on accounting for uncertainties in income tax.

4. In accordance with paragraph 7.7 of the *Due Process Handbook*, we present this agenda paper to the IASB to:

(a) provide the IASB with a brief summary of the Interpretations Committee's general agreement;

(b) ask the IASB to confirm that it is satisfied that all due process requirements to date have been complied with; and

(c) recommend a comment period for the draft Interpretation.

Summary of the Interpretations Committee's general agreement [1]

Scope

5. The Interpretations Committee decided that the draft Interpretation should provide guidance whenever there are uncertainties in the amount of income tax payable (recoverable). (In other words, the Interpretations Committee decided that the draft Interpretation should not limit the scope to any specific situation.) This is because it thought that nearly all income tax involves some uncertainty and noted that attempting to limit the scope to specific situations, for example when an entity has unresolved disputes with a tax authority, would lead to an arbitrary rule.

6. The Interpretations Committee understood that accounting for deferred tax might also be questioned, for example if an uncertainty may affect the tax base of the asset or liability. It thought that guidance for deferred tax for uncertainties should be consistent with the accounting for current tax for uncertainties.

Unit of measurement for uncertainties

7. The Interpretations Committee noted that the amount of a tax liability or asset to be presented in the statement of financial position could be affected by whether each uncertainty is considered individually or on a combined basis (ie whether the uncertainties form a single unit). It concluded that an entity should identify the unit that will, in the entity's judgement, provide the most relevant information. In

[1] For further details of the past discussions and meetings, see our project page: http://www.ifrs.org/Current-Projects/IASB-Projects/IAS-12-Measurement-income-tax-uncertain-tax-position/Pages/Home.aspx

reaching this conclusion, it thought that such judgement is needed in order to reflect the range of situations that will arise in different jurisdictions.

8. The Interpretations Committee thought that, in making that judgement, the entity should consider the interrelationship of those uncertainties and whether more relevant information will be provided by considering two or more uncertainties together.

Determination of whether an uncertainty should be reflected in the amount of a tax liability or asset in the statement of financial position

9. Paragraph 88 of IAS 12 refers to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. However, it is only for disclosures of tax-related contingent liability and contingent assets. The Interpretations Committee noted that income taxes are specifically excluded from the scope of IAS 37. The Interpretations Committee noted that paragraph 88 of IAS 12 provides guidance only on disclosures, and that IAS 12, not IAS 37, provides the relevant guidance on recognition.

10. The Interpretations Committee noted that paragraphs 12-14 of IAS 12 provide principles for recognition of a current tax liability and a current tax asset.

11. The Interpretations Committee noted that these paragraphs do not explicitly set a recognition threshold, although it thought that paragraph 14 of IAS 12 assumes that an asset meets a 'probable' threshold. The Interpretations Committee thought that IAS 12 had not provided specific guidance for the situation in which the tax uncertainties are considered.

12. The Interpretations Committee observed that the objective of IAS 12 and the requirements for deferred tax asset also refer to this 'probable' threshold.

13. Taking account of the observations above, the Interpretations Committee decided that, when an entity recognises a tax liability or asset, the entity should reflect an uncertainty in measurement of a tax liability or asset if it is 'probable' that an entity will pay or recover an amount for the uncertainty. It thought that this approach would result in providing relevant information within the scope of this

draft Interpretation. It thought that setting this explicit hurdle would increase comparability among entities and remove undue costs of measurement when it is not probable that an entity will pay or recover the amount for the uncertainty.

How an uncertainty should be reflected in measurement

14. The Interpretations Committee observed that an entity should measure a tax liability or asset using the expected value or the most likely amount, depending on which method it expects to better predict the amount that it will pay or recover.

15. The Interpretations Committee observed that this approach would be understandable, because the IASB and the US Financial Accounting Standards Board (FASB) took a similar approach when developing the new revenue standard.

16. The Interpretations Committee considered a 'more-likely-than-not amount' (ie an amount using a cumulative-probability approach, as used in US GAAP), but decided that it should neither permit nor require an entity to use it, because no Standard or Interpretation in IFRS describes such an amount. It noted that the expected value and the most likely amount are commonly used in IFRS.

17. The Interpretations Committee thought that introducing the US GAAP approach to measurement would make the draft Interpretation more complex and might conflict with the principle described in paragraph 46 of IAS 12. That principle is that current tax liabilities (assets) should be measured at the amount expected to be paid to (recovered from) the tax authorities, whereas the US GAAP guidance uses the cumulative-probability approach and the benefit-recognition approach. [2] Because the draft Interpretation is interpreting the existing Standards, including

[2] The benefit-recognition approach requires that:

(a) a liability for the uncertain position is recognised 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.

The US Financial Accounting Foundation (FAF)'s Post-Implementation Review (PIR) report explains that the benefit-recognition approach tends to recognise, at least initially, income tax uncertainty liabilities that are larger than amounts actually settled.

IAS 12, the Interpretations Committee did not propose using the measurement of the US GAAP approach.

Examination by tax authorities—general considerations

18. The Interpretations Committee noted that there were diverse views in practice on whether the likelihood that the tax authority may or may not examine the amounts reported should be reflected in the measurement of a tax asset or liability.

19. The Interpretations Committee thought that income tax should be based on the enforceable rights and obligations, irrespective of the entity's expectation with respect to examination by tax authorities. This is because paragraphs 46-47 of IAS 12 require an entity to measure tax liabilities (assets) based on enacted or substantively enacted tax laws. It also thought that assuming full examination and knowledge by the tax authority would be consistent with the definition of a liability as a present obligation, as described in paragraph 4.15 of the *Conceptual Framework for Financial Reporting.*

20. Consequently, the Interpretations Committee concluded that an entity should assume that the tax authority will examine the amounts reported to it and have full knowledge of all relevant information, if the tax authority has the right to examine these amounts.

Examination by tax authorities—specific considerations of derecognition of tax liabilities and assets, including effect of a statute of limitations

21. The Interpretations Committee raised concerns about the implication of the assumptions about examination by tax authorities on the derecognition of tax liabilities and assets, when, for example there is no statute of limitations.

22. The Interpretations Committee observed that, if facts and circumstances change, an entity should reassess the judgements and estimates required by this draft Interpretation. The expiry of the period in which the tax authority may examine the amounts reported to it would be such a change. For example, if it is no longer

probable that an entity will pay the amount to the tax authority for the uncertainty, the entity shall derecognise that amount of the tax liability.

23. The Interpretations Committee made the observations described in the following paragraph. These observations are not proposed to be included in the guidance, because they are too detailed; they are the result of the application of the principles in the draft Interpretations. These observations would, however, be included in the Basis for Conclusions.

24. The Interpretation Committee observed the following points:

(a) For jurisdictions in which there is a statute of limitations for periods of examinations by the tax authority, an entity should make the assumption described in paragraph 20 of this paper until the statute of limitations expires, subject to the following points. After the statute of limitations expires, the entity should reflect the changed rights of the tax authority in its accounting. If there is no statute of limitations, then this assumption should continue indefinitely, subject to the following points.

(b) If the tax authority continues to have the right to (re-)examine the amounts after the implicit or explicit acceptance of a tax payable (recoverable) by the tax authority following an examination, an entity should continue to assume that the tax authorities will re-examine all amounts reported to it and have full knowledge of all relevant information when making those examinations. This assumption should be reflected in the accounting for tax assets and liabilities, but the results of the past examination(s) should also be reflected in the accounting (see the point (c)).

(c) If a tax authority has implicitly or explicitly accepted an entity's tax position, the entity should not assume that the tax authority will change its view on the acceptability of that tax position, unless facts and circumstances indicate that it is probable that this will happen. (For example, if the entity becomes aware that the tax authority has challenged a similar position with another entity that the tax authority had previously accepted for the reporting entity; this fact could imply that it is probable that the tax authority will change this position in future examinations.)

(d) The tax authority may explicitly accept an entity's specific positions during an investigation for a specific year (eg Year 1). This explicit acceptance would be a new fact for the positions within the scope of the investigation (ie those for Year 1) and may affect similar positions (eg similar positions for Year 2), yet to be examined by the tax authority.

(e) The tax authority may implicitly accept an entity's specific positions, eg the tax authority has reviewed the tax return including specific positions for a specific year (eg for Year 1), and there is no indication that the tax authority will re-open the review for that year. This implicit acceptance would be a new fact for the positions within the scope of the investigation (those for Year 1). However, the Interpretations Committee thought that the implicit acceptance would not be a new fact for similar positions that are not within the scope of the investigation (eg similar positions for Year 2).

Disclosure

25. The Interpretations Committee noted that paragraphs 117-133 of IAS 1 *Presentation of Financial Statement* provide guidance for disclosure of accounting policies and sources of estimation uncertainty. It also noted that paragraph 88 of IAS 12, which refers to IAS 37, provides guidance for disclosures of contingent liabilities and contingent assets. It decided that it does not need to propose additional disclosure requirements in respect of tax uncertainties; instead, it decided to explain in the draft Interpretation the identified relevant guidance for disclosure because this would be helpful in practice.

26. For example, the guidance would explain that the entity should determine whether an uncertainty should be disclosed in accordance with paragraph 88 of IAS 12 and with paragraphs 86-92 of IAS 37, when an entity does not reflect the uncertainty

in the amounts recognised in the financial statements because the amount is not expected to be paid (recovered).

Transition

27. The Interpretations Committee proposes that an entity should apply the draft Interpretation prospectively, recognising the cumulative effect of initially applying the draft Interpretation in opening retained earnings at the start of the reporting period in which an entity first applies the draft Interpretation. This is because it thought that full retrospective application would often be impossible without the use of hindsight. However, it also thought that retrospective application should be permitted if an entity has the information necessary to do so without using hindsight.

28. It thought the entity should disclose which method of transition it has applied.

29. Earlier application would be permitted.

Comment period

30. We suggest that the comment period for this draft Interpretation should be no less than 90 days, which is the normal comment period in accordance with paragraph 7.11 of the *Due Process Handbook*.

Due process steps

31. In Appendix A, we have summarised the due process steps we have taken and that we will take in developing and publishing the draft Interpretation.

32. We note that the required due process steps have been or will be completed, as presented in Appendix A.

Proposed timetable for balloting and publication of the draft Interpretation

33. The balloting process will start in May 2015 and its publication is scheduled for June 2015.

Supplementary information

34. This project was discussed at the March 2015 GPF meeting as one of the recent topics that had been considered by the Interpretations Committee. Some GPF members provided following comments:

(a) One GPF member thought that full retrospective application could be difficult, because this could involve hindsight in making the assessment of changes brought about by introducing this Interpretation.

(b) Another GPF member stated that the expected value is more difficult to estimate than the most likely amount, because the expected value would require an entity to estimate the probability for each outcome.

(c) A few GPF members were concerned that the scope currently proposed is broader than the question in the original submission (ie a question on recognition of current income tax in a specific situation).

(d) Another GPF member generally agreed with the Interpretations Committee's tentative decisions. However, this member did not want the disclosure requirements to increase because of this draft Interpretation. In addition, this member thought that the disclosure requirement in US GAAP on this topic caused burdens for entities.

(e) Another GPF member preferred a ‘principle-based’ approach for this issue, rather than detailed requirements, such as those found in US GAAP.

35. Similar points were considered when the Interpretations Committee discussed this issue. We note that:

(a) the Interpretations Committee concluded that the full retrospective application should not be mandatory. It thought that retrospective application should be permitted if an entity has the information necessary to do so without using hindsight.

(b) the Interpretations Committee concluded that an entity should use the expected value or the most likely amount, on the basis of which method it expects to better predict the amount that it will pay or recover. We think that judgements and estimates should be made on the basis of information that is available to entities.

(c) The original questions received by the Interpretations Committee focused only on recognition, and not measurement, of a tax prepayment asset. Initially, the Interpretations Committee decided to reject the issue and published a tentative agenda decision. When the Interpretations Committee discussed the comment letters on its tentative decision, it noted that addressing only the original question would not eliminate diversity in practice for this issue effectively. It noted that the scope of the US guidance for this issue was broader than our proposals, when the US guidance was first developed as FASB Interpretation No. 48. We think that the scope of the draft Interpretation is appropriately confined to interpretation of relevant Standards.

(d) the Interpretations Committee decided against adding additional disclosure requirements. It decided instead to highlight the current disclosure requirements, which it thinks are adequate.

(e) We think that the draft Interpretation would provide appropriately principle-based guidance for this issue, which we think would improve comparability among entities.

Next steps

36. Subject to the IASB's responses to the questions below:

(a) The Interpretations Committee members will be asked to ballot the draft Interpretation; and

(b) The IASB members will be asked if they object to the the release of the draft Interpretation.

(c) Provided at least 10 Interpretations Committee members vote in favour of the draft Interpretation and no more than 3 IASB members object, the draft Interpretation will be published for public comment.

Questions to the IASB
1. Do any IASB members intend to object to the release of the draft Interpretation during the future balloting process? 2. Is the IASB satisfied with the due process steps required to date that relate to development and publication of the draft Interpretation? 3. Does the IASB agree with a comment period of no less than 90 days (ie a normal period for a draft Interpretation) for the proposed amendments? 4. Do the staff have permission to ballot the draft Interpretation?

Appendix A: Confirmation of Due Process Steps in the development and publication of a draft Interpretation

A1. The following table sets out the due process steps followed by the IASB and the Interpretations Committee:

Step	*Required/ Optional*	*Metrics or evidence*	*Actions*
The Interpretations Committee meetings are held in public, with papers being available for observers. All decisions are made in public session.	Required	Meetings held. Project website contains a full description with up-to-date information. Meeting papers have been posted in a timely fashion.	The issues were discussed on the basis of publicly available agenda papers at the IFRS Interpretations Committee meetings. We created and updated a project page for this project. The Interpretations Committee discussed the relevant issues at its January, May, July, September and November 2014 and January 2015 meetings. All results of the discussions of the Interpretations Committee were summarised in the *IFRIC Update* for the meetings.
Due process steps are reviewed by the IASB	Required	Summary of all due process steps have been discussed by the IASB before a draft Interpretation is issued.	Summary of all due process steps will be discussed at this April 2015 IASB meeting. A copy of this paper is being circulated to the Due Process Oversight Committee.
Draft Interpretation has an appropriate comment period.	Required	The IASB sets a comment period. If outside the normal comment period, an explanation has been provided by the Interpretations Committee to the DPOC, and approval is provided, if necessary.	We suggest 90 days, which is the normal period.
IASB members polled to identify any objections to releasing the draft Interpretation	Required	Poll undertaken.	IASB members will be asked whether they object to the release of the draft Interpretation during the balloting process, in accordance with paragraph 7.10 of the *Due Process Handbook*.
Drafting quality assurance steps are adequate.	Required	The Translations team have been included in the review process.	The Translation team will be asked to review the draft.

Step	*Required/ Optional*	*Metrics or evidence*	*Actions*
Drafting quality assurance steps are adequate.	Required	The XBRL team have been included in the review process.	The XBRL team will be asked to review the draft.
Drafting quality assurance steps are adequate.	Optional	The Editorial team has been included in the review process. In addition, external reviewers have been used to review drafts and the comments have been collected and considered by the Interpretations Committee.	The Editorial team will be asked to review the draft.
Drafting quality assurance steps are adequate.	Optional	Draft for editorial review is made available to members of the International Forum of Accounting Standard-Setters (IFASS) and the comments collected are considered by the Interpretations Committee.	Not done. Comments from IFASS members will be sought as part of public consultation.
Drafting quality assurance steps are adequate.	Optional	Draft for editorial review has been posted on the project website.	Not done. Comments will be sought as part of public consultation.
Draft Interpretation published.	Required	Draft Interpretation has been posted on the Interpretations Committee website.	Draft Interpretation will be posted on the website.
Press release to announce the publication of the draft Interpretation.	Required	Press release has been published. Media coverage of the release.	Press release will be published to announce publication.