STAFF PAPER

January 2015

IFRS Interpretations Committee Meeting

Project	Items for continuing consideration		
Paper topic	IAS 12 *Income Taxes* Impact of uncertainty when an entity recognises and measures a current tax liability or asset—Principles of the draft Interpretation		
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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.

2. The Interpretations Committee decided that it should consider separately the question of recognition and the question of measurement of income tax when the tax position is uncertain. At its July 2014 meeting, the Interpretations Committee finalised its agenda decision on recognition in the situation in the original question but it continued discussions on measurement of current income tax when the tax position is uncertain.

3. At the November 2014 Interpretation Committee meeting, the staff were requested to draft an Interpretation on this subject.

4. In addition, the Interpretations Committee asked the staff to contact the staff of the US accounting standard-setter, the Financial Accounting Standards Board (FASB), to discuss its experience with developing guidance on this subject.

Objective of Agenda Papers 2 and 2A

5. The objective of Agenda Paper 2 is to:
   (a) give background information on the issue;
   (b) propose the transition requirements in the draft Interpretation; and
   (c) consider possible unintended consequences of the draft Interpretation and potential consequential amendments to other IFRSs.
6. The objective of Agenda Papers 2A is to present the draft Interpretation for discussion by the Interpretations Committee.

Structure of Agenda Papers 2 and 2A

7. The structure of this Agenda Paper is as follows:
   (a) summary of decisions by the Interpretations Committee;
   (b) summary of the information about the relevant US generally accepted accounting principles (GAAP) guidance;
   (c) staff analysis of:
      (i) the main concerns raised;
      (ii) the transition requirements; and
      (iii) possible unintended consequences and potential consequential amendments;
   (d) staff recommendation; and
   (e) questions for the Interpretations Committee.
8. A proposed draft Interpretation is presented in Agenda Paper 2A. The draft Interpretation reflects the decisions made by the Interpretations Committee and the points analysed in this paper.

Decisions made by the Interpretations Committee

Unit of account

9. At its November 2014 meeting, the Interpretations Committee observed that an entity should make a judgement about the unit of account that provides relevant information for each uncertain tax position ('UTP'). For example, if a decision on a specific UTP is expected to affect, or be affected by, other UTPs, it noted that those UTPs should be accounted for as a single unit of account.

Examination by tax authorities

10. At its September 2014 meeting, the Interpretations Committee tentatively decided that the proposed guidance should clarify that an entity should assume that the tax authorities would examine the amounts reported to them and have full knowledge of all relevant information.

Scope of the draft Interpretation

11. At its November 2014 meeting, the Interpretations Committee tentatively agreed that all income tax positions should be included within the scope of this project. It thought 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. The Interpretations Committee observed that restricting the scope to specific situations is unnecessary. Such a restriction would also become a redundant criterion if the Interpretations Committee were to develop guidance that would require an entity to recognise a current tax asset or liability only if it is probable that it will pay the amount to, or recover the amount from, a tax authority.

12. Consequently, the Interpretations Committee concluded that the Interpretation should provide guidance on recognition and measurement for all income tax positions.

'Probable' recognition threshold

13. At its November 2014 meeting, the Interpretations Committee noted that paragraph 14 and the objective of IAS 12 *Income taxes* refer to the 'probable' recognition threshold, although IAS 12 does not explicitly set the threshold of recognition for a current tax asset or liability. It also noted that the current *Conceptual Framework for Financial Reporting* also refers to a probable recognition threshold.

14. As noted in the final decision on the issue of recognition of current income tax on UTPs in July 2014, IAS 12, not IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, provides the relevant principles on recognition.

15. The Interpretations Committee tentatively agreed that the new guidance should explain that an entity recognises a current tax asset or liability only if it is probable that it will pay the amount to, or recover the amount from, a tax authority.

Possible approach for measurement

16. At its November 2014 meeting, the Interpretations Committee observed that an entity should estimate the amount expected to be paid to (or recovered from) the taxation authorities by using either the most likely amount or the expected value, depending on which method the entity expects to better predict the amount that it will pay to (or recover from) the taxation authorities. This is because this approach would provide useful information to predict future cash flows for each case. It also noted that this approach is similar to the measurement of an amount of variable consideration in IFRS 15 *Revenue from Contracts with Customers*.

17. The Interpretations Committee decided not to propose a 'more-likely-than-not' measurement basis (a basis that would be similar to the US GAAP approach), noting that there is no reference in IFRS to a 'more-likely-than-not amount' and that IFRS 15 and IAS 37 refer only to the expected value and the most likely amount.

Summary of the information about the relevant US GAAP guidance

18. We think that convergence with US GAAP is ideal but not necessary, because IAS 12 is not a converged Standard and no joint projects with the FASB for IAS 12 are expected.

19. In addition, we do not think that full convergence is possible within the existing standards, because there are many differences between IAS 12 and the US GAAP guidance that are beyond the scope of this project. FIN 48 addresses a broader range of issues, including deferred tax, derecognition and disclosure, than our draft Interpretation would. FIN 48 provides more detailed guidance such as guidance on interest and penalties, interim period and change in the unit of account. We also note that the tax regulatory background in the US affected some detailed parts of the US GAAP guidance.

20. FIN 48 is much longer than our draft Interpretation, because of its broader scope and its more detailed guidance. We do not think that we could provide such broad and detailed guidance within the scope of this project.

21. However, we think that the information about the relevant US GAAP guidance is useful for our project to develop our draft Interpretation. Consequently, we summarise the key information in the sections below.

22. The information is based on:

    (a) ASC 740 (formerly known as FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes or FIN 48, codified primarily as paragraphs 740-10-25-6 through 25-17 and 740-10-30-7) [1];

    (b) the US Financial Accounting Foundation (FAF)'s Post-Implementation Review (PIR) report on FIN 48 [2] ;

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[1] The original pronouncements are available from the following web page: 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.

(c) the FASB's response to the PIR report [3]; and

(d) an informal communication with the FASB staff.

Scope of the draft Interpretation

23. When the FASB developed FIN 48, it decided that all tax positions should be subject to the provisions of its interpretation, because it was difficult to define 'uncertainty' and such a scope could be an arbitrary bright line. The FASB thought that such a rule was not necessary, because for many routine business transactions it will be clear that the tax positions meet the recognition criteria.

24. FIN 48 provides illustrative guidance, which is similar to Example 1 in Agenda Paper 2A.

25. FIN 48 addresses a broader range of issues, including deferred tax, derecognition and disclosure, than our draft Interpretation would.

The term 'tax positions'

26. ACS 740-10-20 explains that 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 realisability of deferred tax assets.

27. Under ASC 740, tax position encompasses but is not limited to:

(a) a decision not to file a tax return;

(b) an allocation or a shift of income between jurisdictions;

[2] Refer to the text of the FAF's PIR report: http://www.accountingfoundation.org/cs/ContentServer?site=Foundation&c=Document_C&pagename=Foundation/Document_C/FAFDocumentPage&cid=1176159654068.

[3] In response to this report, the FASB concluded that the criteria for a review or reconsideration of fundamental aspects of FIN 48 are not met, and no discrete standard-setting action was 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.

(c) the characterisation of income or a decision to exclude reporting taxable income in a tax return;

(d) a decision to classify a transaction, entity, or other position in a tax return as tax exempt; and

(e) an entity's status, including its status as a pass-through entity or a tax-exempt not-for-profit entity.

28. We note that a tax position under FIN 48 would result in a benefit (a deduction), based on the benefit-recognition approach under US GAAP. ASC 740-10-25-6 states that (extracted):

> The more-likely-than-not recognition threshold is a positive assertion that an entity believes it is entitled to the economic benefits associated with a tax position.

Unit of account

29. FIN 48 also requires an entity to exercise judgement to determine a unit of account.

30. ASC 740-10-25-13 states that (emphasis added):

> The appropriate unit of account for determining what constitutes an individual tax position, and whether the more-likely-than-not recognition threshold is met for a tax position, is a matter of judgment based on the individual facts and circumstances of that position evaluated in light of all available evidence. The determination of the unit of account to be used shall consider the manner in which the entity prepares and supports its income tax return and the approach the entity anticipates the taxing authority will take during an examination. **Because the individual facts and circumstances of a tax position and of an entity taking that position will determine the appropriate unit of account, a single defined unit of account would not be applicable to all situations.**

Examination by tax authorities

31. FIN 48 has a requirement on 'examination risk', which is similar to our guidance in the draft Interpretation.

Benefit-recognition approach

32. FIN 48 uses the benefit-recognition approach. This 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.

33. The 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.

34. In contrast, we note that paragraph 46 of IAS 12 requires an entity to measure the amount at the 'best estimate'. Paragraph 46 of IAS 12 states that:

> 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.

Recognition threshold

35. FIN 48 sets the more-likely-than-not recognition threshold (ie, equivalent to the 'probable' threshold under IFRS) to recognise a benefit, under the 'benefit-recognition approach'.

Approach for measurement

36. FIN 48 uses an amount under the cumulative-probability approach (ie a more-likely-than-not amount[4]).

37. The PIR report concluded that the benefits of FIN 48's improved consistency and reporting of income tax uncertainty information outweigh its costs.

38. However, the PIR report also explained that FIN 48 increased costs for some entities. The PIR report states:

> Our research indicates that, generally, most preparers did not incur significant incremental FIN 48 implementation and continuing compliance costs. However, some preparers did incur significant implementation costs, particularly smaller entities. Those entities that did incur significant costs cite additional audit fees, external legal and accounting expertise, and documenting existing tax positions as the most significant costs.

39. The PIR report also states that:

> Preparers generally understand FIN 48's provisions. They have difficulty, however, in applying its recognition and measurement provisions because they require judgments about outcome probabilities applied to complex, and often vague, tax codes and practices.

Staff analysis on main comments raised

40. Some Interpretations Committee members informally provided their comments during our drafting process. We analysed the main comments in the following section.

[4] For details of more-likely-than-not approach and other measurements, refer to Agenda Paper 4 discussed by the Interpretations Committee at its September 2014 meeting.

Scope could be too broad

41. Some are concerned that this scope could be too broad for an Interpretation. However, we think that this draft could be appropriate for an Interpretation, because it provides guidance as an interpretation of IAS 12 only for uncertainties relating to current income tax. We think that IAS 12 provides principles for recognition and measurement of current income tax, but it does not provide guidance on its application for uncertainties.

42. We also noted that FIN 48 was developed as an interpretation, although it includes broader and detailed guidance on recognition, derecognition, measurement and disclosures of current and deferred tax assets and liabilities on all tax positions. We think that the scope of our draft Interpretation is narrower than FIN 48's scope and that our scope is not too broad for an Interpretation.

43. We included an illustrative example that would facilitate entities' judgements when the related tax law and its enforcement are clear and highly predictable, because we think that without such an illustrative example, this scope might increase unintended undue costs of making judgements and measurement for some entities. We note that a similar illustrative example accompanies FIN 48.

Accounting for deferred tax

44. Some stated that accounting for deferred tax might be related. However, we have not included accounting for deferred tax within the scope, because we have not so far identified any specific need to clarify it.

The definition of tax positions

45. Some comments implied that defining the term 'tax position' (or 'tax uncertainties') might ease our drafting.

46. However, we did not either use or define the term 'tax position', which US GAAP does, because we did not include accounting for deferred tax within the scope of the draft Interpretation, and our approach is different from the benefit-recognition

approach under US GAAP. Instead of the term 'tax position', we used the general and neutral term '(tax) uncertainties' in the draft Interpretation.

Request for detailed guidance

47. We noted that ASC 740 provides more detailed guidance (for example, when a unit of account should be changed) but we did not include similar detailed guidance in our draft Interpretation. This is because we think that the guidance in the draft Interpretation is clear and set at an appropriately principled level to allow application in broad range of jurisdictions.

48. Instead, we propose limited illustrative examples to support consistent judgements among entities, based on the principles in the draft Interpretation.

Recognition threshold

49. We note that paragraphs 12-14 of IAS 12 provide principles for recognition of a current tax liability and a current tax asset.

50. We note that these paragraphs do not explicitly set a recognition threshold, although paragraph 14 of IAS 12 assumes that an asset meets a 'probable' threshold. Paragraph 13 of IAS 12 states that:

> The benefit relating to a tax loss that can be carried back to recover current tax of a previous period shall be recognised as an asset.

Paragraph 14 of IAS 12 states (emphasis added) that:

> 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**.

51. Some think that paragraph 12 of IAS 12 requires that an entity always recognises a current tax liability or asset (ie without a recognition threshold), because paragraph 12 states (emphasis added) that:

> **Current tax for current and prior periods shall, to the extent unpaid, be recognised as a liability**. 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**.

52. However, we think that paragraph 12 of IAS 12 implicitly assumes that a current tax liability or asset would meet the recognition threshold, when we read paragraph 12 of IAS 12 together with paragraph 14 of IAS 12.

53. Some were also concerned that the IASB's *Conceptual Framework* project will remove the recognition threshold from the future *Conceptual Framework*, but we note recent IASB's decisions mean that the IASB will not do so. [5]

54. Consequently, we suggest retaining the decision made by the Interpretations Committee at the last meeting.

Approach for measurement

55. Some think that convergence with US GAAP is ideal and the cumulative-probability approach under US GAAP (ie a more-likely-than-not amount) would be less costly than the expected value approach.

56. However, we note that this US GAAP approach requires more information (eg more detailed probabilities for possible amounts) than the most likely amount would. We also think that the most likely amount and the expected value are

[5] On 21 May 2014, the IASB tentatively decided that the *Conceptual Framework* should not establish criteria that govern the recognition of an asset or liability in all circumstances. The *Conceptual Framework* should instead describe factors to consider in deciding whether to recognise an asset or liability. Those factors would include whether the resulting information would be relevant and provide a faithful representation, and the costs of providing information relative to the benefits. Information might not be relevant if, for example, it is uncertain whether the asset or liability exists, if it is unlikely that future flows of economic benefits will occur or if there is very significant measurement uncertainty associated with the item.

commonly used and understood in IFRS jurisdictions but the more-likely-than-not amount is not.

57. We think that introducing the US GAAP approach would make our draft Interpretation more complex

58. In addition, we note that paragraph 46 of IAS 12 requires the best estimate approach but FIN 48 does not use it, using the benefit-recognition approach. We think that introducing that US GAAP approach would conflict with the principle described in paragraph 46 of IAS 12.

59. Consequently, we suggest retaining the decision made by the Interpretations Committee at the last meeting.

Staff analysis and proposal on transition provisions

Transition provisions

60. We propose that an entity should apply the draft Interpretation retrospectively to achieve comparability between periods, in accordance with the general requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. In some circumstances, we think that entities already have the necessary information to apply the draft Interpretation retrospectively.

61. For other circumstances, we think that entities might need to collect the past probabilities for possible outcomes to apply the draft Interpretation retrospectively. We are concerned that this might not be possible without the use of hindsight. We think that paragraphs 50-53 of IAS 8 relating to the impracticability of retrospective application should be applied for such circumstances.

62. We think that earlier application should be permitted.

First-time adopters of IFRS

63. Because we did not identify any justification for exemptions, we think that an amendment to IFRS 1 is unnecessary.

Consequential amendments to other Standards and unintended consequences

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

65. We analysed whether the draft Interpretation might result in any unintended consequences. We acknowledge that:

    (a) the scope of the draft Interpretation is narrow and it does not provide guidance on issues other than recognition and measurement of current tax liabilities and current tax assets;

    (b) the draft Interpretation would provide new guidance for accounting for uncertainties when IAS 12 does not provide such guidance; and

    (c) we do not expect that this guidance should conflict with the general principles in IAS 12 for recognition and measurement of current tax.

66. On this basis, we do not think that any significant unintended consequences of the draft Interpretation will arise.

Staff recommendation

67. On the basis of the staff analysis, we recommend:

    (a) retaining the decisions made by the Interpretations Committee;

    (b) retrospective application of the Interpretations as a transition provision;

    (c) no additional provisions for first-time adopters; and

    (d) no consequential amendments.

Questions for the Interpretations Committee

Questions
1. Does the Interpretations Committee agree with the staff's analysis in paragraphs 40–59 on the main comments?
2. Does the Interpretations Committee agree with the staff's analysis and proposal in paragraphs 60–66 on transition provisions and other matters?
3. Does the Interpretations Committee agree with the draft Interpretation in Appendix 2A, based on the staff recommendation in paragraph 67?