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—Proposed draft IFRIC Interpretation		
CONTACT(S)	Akemi Miura	amiura@ifrs.org	+44 (0)20 7246 6930

Proposed draft IFRIC Interpretation X *Impact of uncertainty when an entity recognises and measures a current tax liability or asset*

References

- *Conceptual Framework for Financial Reporting*
- IFRS 15 *Revenue from Contracts with Customers*
- IAS 12 *Income Taxes*
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Background

1 An entity's income tax payable (receivable) typically includes uncertain amounts. For example, it may be unclear as to how a specific requirement of the tax law should apply to a particular transaction or circumstance. The payable (receivable) may be affected by the results of a tax examination or dispute, the results of which are uncertain at the end of the period.

2 Questions have been raised about how to apply IAS 12 to the recognition and measurement of a current tax liability or asset when such uncertainties exist.

Scope

3 This [draft] Interpretation applies to recognition and measurement of current tax as defined by IAS 12 when there are uncertainties in the amount of income tax payable (receivable).

Issues

4 To provide guidance on the recognition and measurement of current income, this [draft] Interpretation addresses the following issues:

(a) how an entity should determine the unit of account when considering uncertainties in the recognition and measurement of a current tax liability or asset;

(b) what assumptions an entity should make about the knowledge and actions of tax authorities when considering uncertainties in the recognition and measurement of a current tax liability or asset;

(c) how an entity should consider uncertainties in the recognition of a current tax liability or asset; and

(d) how an entity should consider uncertainties in the measurement of a current tax liability or asset.

Consensus

Unit of account when considering uncertainties

5 The amount of a current tax liability or asset may depend on the resolution of more than one uncertainty in the application of the tax law. An entity shall make a judgement about whether each uncertainty should be considered independently or whether some uncertainties can be considered together, when recognising and measuring a current tax liability or asset.

6 If a decision on a specific tax uncertainty is expected to affect, or be affected by, another tax uncertainty, it is likely that more relevant information will be provided

by accounting for those uncertainties as if they were one uncertainty, ie accounting for them as a single unit of account.

7 After this determination of the units of account, these units of account shall be applied consistently in assessing the recognition and the measurement of a current tax liability or asset.

Examination by tax authorities

8 An entity shall assume that the tax authorities will examine all amounts reported to it and have full knowledge of all relevant information when making those examinations. An entity shall reflect these assumptions in its recognition and measurement of a current tax liability or asset.

Consideration of uncertainties in recognition

9 When an entity applies paragraphs 12-14 of IAS 12 and considers uncertainties, the entity shall recognise a current tax liability or asset if it is probable that it will pay the amount to, or recover the amount from, the tax authority.

Consideration of uncertainties in measurement

10 When an entity applies paragraph 46 of IAS 12 and considers uncertainties, the entity shall estimate the amount expected to be paid to (or recovered from) the taxation authority by using one of the following methods, depending on which method the entity expects to predict better the amount that it will pay or recover:

(a) The most likely amount—the most likely amount is the single most likely amount in a range of possible outcomes. The most likely amount may be a better prediction if the possible outcomes are binary or are concentrated to one value (for example, a dispute to determine a specific expense will be either deductible or non-deductible for tax purposes, forming an individual unit of account as a case-specific dispute).

(b) The expected value—the expected value is the sum of probability-weighted amounts in a range of possible amounts. The expected value may be a better prediction if possible outcomes are widely dispersed with low probabilities (for example, there are a number of transfer pricing issues that might be challenged by a taxation authority, and which form a single unit of account).

Effective date and transition

11 An entity shall apply this [draft] Interpretation retrospectively for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies this [draft] Interpretation for an earlier period, it shall disclose that fact.

Illustrative examples

These examples accompany, but are not part of, [draft] IFRIC X.

A1. The objective of these examples is to illustrate how an entity should account for uncertainty when an entity determines a unit of account and recognises and measures a current tax liability or asset.

Example 1—when no adjustment for uncertainty is necessary, because of the recognition threshold
Entity A files income tax in one jurisdiction. The income tax law and its enforcement in this jurisdiction are clear and predictable. Entity A anticipates no disputes on its tax filings at the end of the period and it has been rare for Entity A to have disputes with the tax authority in this jurisdiction. Entity A decides to use the amounts in its tax filings as amounts expected to be paid and decides that no adjustment for uncertainty is necessary, because it is probable that the tax authority will accept the full amount in Entity A's tax filing and Entity A does not expect any changes to that amount.

Example 2A —when a filing with an unresolved dispute forms a unit of account, a liability is recognised and an entity uses the most likely amount
Entity B has an unresolved dispute with a tax authority. If Entity B is unsuccessful in its challenge to the tax authority, it will pay CU100[1] as current tax to the tax authority. If Entity B is successful, it will pay CU 0. This is a case-specific dispute and Entity B therefore decides that the filing with this uncertainty should form an individual unit of account. Entity B thinks that it is probable that it will be unsuccessful, based on an evaluation of all available evidence. Entity B therefore recognises a current tax liability of CU100, using the most likely amount as the amount expected to be paid.

[1] In this draft Interpretation, currency amounts are denominated in 'currency units' (CU).

Example 2B —when a filing with an unresolved dispute forms a unit of account, an asset is recognised as the excess amount paid

Entity B has already paid CU 100 as current tax. Entity B has an unresolved dispute with a tax authority for this amount. If Entity B is successful in its challenge to the tax authority, it will recover CU100 from the tax authority. If Entity B is unsuccessful, it will not recover this amount. This is a case-specific dispute and Entity B therefore decides that the filing with this uncertainty should form an individual unit of account. Entity B thinks that it is probable that it will be successful, based on an evaluation of all available evidences. Entity B therefore recognises a current tax asset at CU100 as the excess amount paid in accordance with paragraph 12 of IAS 12.

Example 3—when more than one uncertainty form a single unit of account, a liability meets the recognition criteria and an entity uses the expected value

Entity C's tax filing included transfer pricing on a number of transactions that might be challenged by the tax authority in its jurisdiction. Because deductions based on transfer pricing are subject to the tax authority's specific judgement, and because the tax authority's decisions on these transactions would affect each other, Entity C decides that they form a single unit of account. Entity C notes that the tax authority would not always examine the amounts reported, but Entity C assumes that the tax authority will examine the amounts reported to them and have full knowledge of all relevant information, as required paragraph 8 of this [draft] Interpretation. Under this assumption, Entity C estimates the probabilities of what it would pay after the tax authority's judgements to be as follows:

	Estimated outcome, CU	Individual probability, %	Estimate of expected value, CU
Outcome 1	0	25%	0

Outcome 2	200	20%	40
Outcome 3	400	15%	60
Outcome 4	600	5%	30
Outcome 5	800	5%	40
Outcome 6	1,000	30%	300
		100%	**470**

Entity C observes that it is probable that it will pay an amount greater than zero (ie the liability meets the recognition threshold).

Although the decisions relate to a specific requirement of the tax law, the different circumstances mean that the tax authority may reach different conclusions on such a decision (ie possible outcomes are varied). Entity C thinks that the most likely amount of 1,000 CU is not useful, because the possible outcomes are widely dispersed with low probabilities. Entity C therefore concludes that the expected value would be better to provide the most relevant information.

Consequently, Entity C recognises the current tax liability at the amount of CU470, using the expected value as the most relevant prediction of the amount to be paid.

Basis for Conclusions on [draft] IFRIC Interpretation X *Impact of uncertainty when an entity recognises and measures a current tax liability or asset*

This Basis for Conclusions accompanies, but is not part of, [draft] IFRIC X.

Introduction

BC1 This Basis for Conclusions summarises the IFRS Interpretations Committee's (the 'Interpretations Committee') considerations in reaching its consensus.

Background

BC2 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.

BC3 The Interpretations Committee noted that IAS 12 provides guidance on recognition in such a situation, but observed broader diversity in practice for recognition and measurement of a current tax liability or asset when there is uncertainty in the application of the tax law.

BC4 In response to the diversity in practice, the Interpretations Committee decided to develop an Interpretation.

Scope

BC5 The Interpretations Committee decided that the [draft] Interpretation should not limit the scope to any specific situation. This is because it thought nearly all current 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.

BC6 Consequently, the Interpretations Committee decided that the [draft] Interpretation should provide guidance on recognition and measurement of a current tax liability or asset in all situations.

BC7 The Interpretations Committee understood that when tax uncertainties are considered, accounting for deferred tax might also be questioned. However, accounting for deferred tax is not included in the scope of this [draft] Interpretation, because IAS 12 already provides sufficient guidance on accounting for deferred tax and there is no specific reason to extend the [draft] Interpretation.

Consensus

Unit of account when considering uncertainties

BC8 The Interpretations Committee noted that the recognition and measurement of a current tax liability or asset could be affected by whether each uncertainty is considered individually or on a combined basis (ie whether the uncertainties form a single unit of account). It concluded that an entity should identify the unit of account that will, in the entity's judgement, provide the most relevant information. In reaching this conclusion, it thought that such judgement is needed in order to reflect the range of situations that will arise in different jurisdictions.

BC9 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.

BC10 To provide useful and consistent information, the Interpretations Committee thought that the same units of account should be applied for both the recognition and measurement of a current tax asset or liability.

Examination by tax authorities

BC11 The Interpretations Committee understood that there were diverse views on whether the likelihood that the tax authority may or may not examine the amounts reported should be reflected in the measurement of a current tax asset or liability.

BC12 The Interpretations Committee thought that income tax should be based on the enforceable rights and obligations, irrespective of the entity's expectation in respect of examination by tax authorities. This is because paragraph 46 of IAS 12 requires an entity to measure current 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*.

BC13 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.

Consideration of uncertainties in recognition

BC14 The Interpretations Committee noted that income taxes are specifically excluded from the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The Interpretations Committee noted that paragraph 88 of IAS 12 provides guidance only on disclosures required for such items, and that IAS 12, not IAS 37, provides the relevant guidance on recognition.

BC15 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.

BC16 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 noted that the objective of IAS 12 and the requirement for deferred tax also refer to this threshold, as well as paragraphs 4.44 and 4.46 of the *Conceptual Framework for Financial Reporting*. The Interpretations Committee thought that paragraphs 12-14 of IAS 12 implicitly assume that a current tax liability and a current tax asset would meet the recognition threshold and IAS 12 had not provided specific guidance for the situation in which the tax uncertainties are considered.

BC17 Consequently, the Interpretations Committee decided to set the threshold for recognition of a current tax liability or asset at 'probable', because this would enhance consistency within IAS 12 and consistency between IAS 12 and the *Conceptual Framework for Financial Reporting*. It also thought that setting an explicit recognition threshold would increase comparability among entities and remove undue costs of measurement in circumstances in which it is not probable that an amount will be payable or receivable from the tax authority.

Consideration of uncertainties in measurement

BC18 The Interpretations Committee observed that an entity should use the expected value or the most likely amount, on the basis of which method it expects to predict better the amount that it will pay or recover.

BC19 The Interpretations Committee observed that this approach would be understandable, because the IASB and the US Financial Accounting Standards Board (FASB) had recently taken this approach when they had developed IFRS 15 *Revenue from Contracts with Customers.*

BC20 The Interpretations Committee considered a 'more-likely-than-not amount (ie an amount using a cumulative-probability approach as used in the 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 current IFRS practice. In addition, it noted that paragraph 46 of IAS 12 requires the best estimate approach but the USGAAP approach does not use it. We think that introducing that US GAAP approach would conflict with the principle described in paragraph 46 of IAS 12.

Transition

BC21 The Interpretations Committee proposes that the [draft] Interpretation should be applied retrospectively. The Interpretations Committee noted that in order to apply this [draft] Interpretation retrospectively, some entities might need to collect the past probabilities for possible outcomes. The Interpretations Committee noted that this might not be possible without the use of hindsight. It thought that paragraphs 50-53 of IAS 8 should be applied in such cases.