IFRS

STAFF PAPER

March 2018

IFRS Interpretations Committee Meeting

Project	**Payments relating to taxes other than income tax**		
Paper topic	Initial consideration		
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Introduction

1. The IFRS Interpretations Committee (Committee) received a request to address how an entity accounts for voluntary payments relating to uncertain tax treatments that are outside the scope of IAS 12 *Income Taxes* (ie relating to taxes other than income tax). The submitter asks the Committee about how the entity accounts for such voluntary payments.

2. The objective of the paper is to:

   (a) provide the Committee with a summary of the matter;

   (b) present our research and analysis; and

   (c) ask the Committee whether it agrees with our recommendation not to add this matter to its standard-setting agenda.

Structure of the paper

3. This paper includes:
   (a) background information;
   (b) summary of outreach;
   (c) staff analysis; and
   (d) staff recommendation.

4. There are 2 appendices to the paper:
   (a) Appendix A—Proposed wording of the tentative agenda decision; and
   (b) Appendix B—Submission.

Background information

5. The submitter describes a situation in which an entity is in dispute with the tax authority. In some circumstances and depending on the jurisdiction, the entity may decide to voluntarily pay the disputed amount to the tax authority in order to avoid possible penalties or interest. The payment is often held in escrow by the tax authority pending the resolution of the dispute. Upon resolution, either the tax authority returns the payment to the entity (if the outcome of the dispute is favourable to the entity) or the payment is used to settle the tax liability (if the outcome of the dispute is unfavourable to the entity). The entity determines that it is not probable that an outflow of future economic benefits will be required in relation to the disputed amount. Consequently, the entity does not recognise a liability in this regard applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The question in the submission is limited to the accounting treatment for the voluntary payment made by the entity; the submitter is clear that it is not asking the Committee about the appropriateness of not recognising a liability for the disputed tax amount.

6. The submitter has identified two views:

   (a) **View 1**—*The voluntary payment is recognised as an asset*

   The payment is an asset for the entity because it will either be refunded by the tax authority or be used to settle the tax liability arising from the resolution of the dispute. There is no uncertainty about the existence of the asset. Rather, the uncertain future event—resolution of the dispute—will confirm only the means of recovery of the asset (ie receipt of a refund or settlement of the future liability), but not its existence.

   (b) **View 2**—*The voluntary payment is recognised as an expense*

   The amount paid is considered a contingent asset of the entity applying paragraph 10 of IAS 37. The uncertainty about the outcome of the dispute creates uncertainty about the existence of the asset, rather than only the means of recovery. The entity would recognise an asset only to the extent that reimbursement is virtually certain.

7. We have reproduced the submission in **Appendix B** to this paper, which explains each of the views in more detail.

Summary of outreach

Outreach performed

8. To gather information about the matter described in the submission, we sent requests to securities regulators, members of the International Forum of Accounting Standard-Setters and the large accounting firms.

9. The request asked those participating to provide information, based on their experience, about the prevalence of the matter, and the predominant accounting treatment(s) observed in practice.

10. We received twelve responses—six from the large accounting firms, five from national standard-setters and one from an organisation representing a group of regulators. The views received represent informal opinions, rather than formal views of those responding.

Findings from outreach

11. Ten of the twelve respondents said this transaction is common in jurisdictions in which they have observed practice. Two of these respondents said, in their respective jurisdictions, such payments are not voluntary in nature. One respondent did not comment on the prevalence of the transaction.

12. Ten respondents said entities recognise such payments as an asset (ie View 1) consistent with the rationale included in the submission. Two respondents said recognising voluntary payments as an expense (ie View 2) is the prevalent accounting treatment in their respective jurisdictions. One of these respondents said recognising the payment as an asset is not unreasonable. The other respondent said, in its jurisdiction, there is diversity in the reporting methods applied.

Staff analysis

13. The submission asks:

    (a) whether the entity recognises a voluntary payment made to the tax authority as an asset or expense (see paragraphs 14–25 of this paper); and

    (b) if the entity recognises the payment as an asset, how does the entity measure the asset after initial recognition (see paragraphs 26–28 of this paper).

Should the entity recognise an asset or an expense?

Does the voluntary payment meet the definition of an asset?

14. Paragraph 4.4(a) of the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*)[1] defines an asset as:

> A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

15. Paragraph 4.8 explains in greater detail the meaning of future economic benefits within the definition of an asset:

> The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.

16. Paragraph 4.10 describes how future economic benefits embodied in an asset might flow to an entity (*emphasis added*):

> The future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be:
>
> (a) used singly or in combination with other assets in the production of goods or services to be sold by the entity;
>
> (b) exchanged for other assets;
>
> (c) *used to settle a liability*; or
>
> (d) distributed to the owners of the entity.

[1] The Board expects to issue the revised *Conceptual Framework* around the end of the first quarter of 2018. The outcome of our analysis would not change applying the definition of an asset in the revised *Conceptual Framework*.

17. In our view, the voluntary payment meets the definition of an asset in the *Conceptual Framework*. It results from a past event—the voluntary payment being made. It is a resource that the entity controls, and from which future economic benefits are expected to flow to the entity. This is because, upon resolution of the dispute, the entity has the right to either (a) receive cash as a refund from the tax authority (if the outcome is favourable to the entity), or (b) use the payment to settle the tax liability (if the outcome is unfavourable to the entity). There is uncertainty about the form of the future economic benefits that will flow to the entity (ie cash or settlement of a liability). There is no uncertainty, however, that the entity controls the resource from which future economic benefits will flow to the entity.

Does the voluntary payment meet the definition of a contingent asset?

18. Paragraph 10 of IAS 37 defines a contingent asset as:

> A possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

19. In our view, the voluntary payment is not a contingent asset. As explained above, it is an asset, and not a possible asset.

20. In the fact pattern in the submission, there is uncertainty about the existence of the tax liability to the extent that the entity does not recognise a liability applying IAS 37. Nonetheless, there is no uncertainty about the existence of the asset. As noted above, future economic benefits will flow to the entity either in the form of cash or the settlement of the liability that will otherwise arise upon resolution of the dispute.

21. View 2 in the submission views the voluntary payment as a contingent asset. In support of View 2, the submission refers to the example in paragraph 32 of IAS 37 of a contingent asset—'a claim that an entity is pursing through legal processes, where the outcome is uncertain', and says it is analogous to the fact pattern in the submission. In our view, the example in paragraph 32 of IAS 37 is not analogous to the fact pattern in the submission. That example is one in which

the entity is pursuing a legal claim against another party, the outcome of which may (or may not) result in an inflow of future economic benefits to the entity—in that example, the entity has not made a payment. The fact pattern in the submission is different because the entity has paid an amount to the tax authority and any uncertainty relates to the tax obligation, and not to the existence of the asset. To be analogous to the fact pattern in the submission, the lawsuit example would need to be one in which (i) another party has a claim against the entity that it is pursuing through legal processes (and not the opposite as is the case in the example in paragraph 32 of IAS 37); and (ii) the entity has made a payment that, upon completion of the legal processes, will either be repaid to the entity or could be used to settle amounts owing to the third party.

Staff Conclusion

22. Based on the fact pattern in the submission, we think the entity recognises an asset when it makes the voluntary payment to the tax authority (ie View 1).

23. Responses to our outreach request noted that, in some jurisdictions, payments made to the tax authority in this situation are not voluntary. In our view, the voluntary nature of a payment, in isolation, would not change the analysis. Consequently, for example if the facts were the same as those in the submission (summarised in paragraph 5 of this paper) except that the entity were required to make the payment to the tax authority, then our conclusion would remain the same. In that case, we think the entity would also recognise an asset when it makes the payment to the tax authority.

24. This conclusion is consistent with the Committee's observations in a previous agenda decision[2] on a similar matter, although related to income taxes within the scope of IAS 12. That agenda decision addressed a situation in which tax laws require an entity to make a payment when a tax examination results in an additional income tax charge, even if the entity intends to appeal against the additional charge. In that agenda decision, the Committee noted the following:

[2] Agenda decision IAS 12 *Income Taxes—recognition of current income tax on uncertain tax position*, July 2014.

(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.

25. Consistent with the Committee's observation in that previous agenda decision, we think the timing of payment to the tax authority in the fact pattern in this submission should not affect the recognition of an expense. Applying View 2 in the submission, the timing of payment would affect that recognition. For example, applying View 2, if the entity voluntarily makes a payment to the tax authority, the entity would recognise an expense for the amount paid when the payment is made, whereas if it decided not to make that payment it would not recognise such an expense until at least a future date. We think such a conclusion would be inappropriate.

Measurement after initial recognition

26. The asset that the entity recognises on making the payment to the tax authority represents the entity's right to receive future economic benefits either (a) in a form of cash (if the outcome of the dispute is favourable to the entity) or (b) by using the payment to settle the tax liability (if the outcome of the dispute is unfavourable to the entity). In our view, this asset is not clearly captured within the scope of any IFRS Standard.

27. Paragraph 10 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires that in the absence of an IFRS Standard that specifically applies to

a transaction, other event or condition, an entity uses its judgement in developing and applying an accounting policy that results in information that is relevant and reliable. Paragraphs 11 and 12 of IAS 8 specify requirements for how an entity would do so. Consequently, in the fact pattern in the submission, the entity would apply IAS 8 in developing an accounting policy for the asset recognised.

28. In the fact pattern in the submission, the entity has not recognised a liability for the disputed amount. We think the possible tax obligation would meet the definition of a contingent liability in paragraph 10 of IAS 37. Paragraph 30 of IAS 37 states that an entity assesses contingent liabilities continually to determine whether an outflow of resources embodying economic benefits has become probable. Accordingly, if it becomes probable that an outflow of future economic benefits will be required for the disputed amount, the entity would recognise a provision in the period in which the change in probability occurs. At that time, the entity would consider any implications of the payment already made to the tax authority in accounting for the asset and liability.

Question 1 for the Committee
1. Does the Committee agree with our analysis of the requirements in IFRS Standards that, in the fact pattern in the submission, the entity (a) recognises an asset when it makes the payment to the tax authority, and (b) applies IAS 8 in developing an accounting policy for subsequent measurement of the asset?

Should the Committee add this matter to its standard setting agenda?

Is it necessary to add to or change IFRS Standards to improve financial reporting?[3]

29. Based on our analysis, we think that the requirements in existing IFRS Standards provide an adequate basis for the entity to account for payments relating to taxes other than income tax.

[3] Paragraph 5.16(b) of the *Due Process Handbook*.

Staff recommendation

30. Based on our assessment of the Committee's agenda criteria in paragraphs 5.16-5.17 of the *Due Process Handbook* (discussed in paragraph 29 above), we recommend that the Committee does not add this matter to its standard-setting agenda. Instead, we recommend publishing an agenda decision that outlines how an entity applies the relevant requirements of IFRS Standards to payments relating to taxes other than income tax.

31. Appendix A to this paper outlines the proposed wording of the tentative agenda decision. The tentative agenda decision refers to payments made by an entity, and not specifically to voluntary payments made. Although the submission asks only about voluntary payments, as noted earlier we think the voluntary nature of a payment, in isolation, would not change our analysis. Accordingly, we have removed this aspect of the fact pattern from the tentative agenda decision.

Questions 2 and 3 for the Committee
2. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda? 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 37 *Provisions, Contingent Liabilities and Contingent Assets*—Payments relating to taxes other than income tax

The IFRS Interpretations Committee (Committee) received a request about how to account for payments relating to uncertain tax treatments that are outside the scope of IAS 12 *Income Taxes* (ie the payments are for taxes other than income tax). In the fact pattern in the request, the entity is in dispute with the tax authority. Applying IAS 37, the entity does not recognise a liability for the disputed amount because it determines that it is not probable that an outflow of resources embodying economic benefits will be required. The entity nonetheless pays the disputed amount to the tax authority. Upon resolution of the dispute, either the tax authority returns the payment to the entity (if the outcome of the dispute is favourable to the entity) or the payment is used to settle the tax liability (if the outcome of the dispute is unfavourable to the entity).

The Committee observed that the payment made by the entity gives rise to an asset as defined in the *Conceptual Framework for Financial Reporting*, ie the payment creates a resource controlled by the entity as a result of a past event and from which future economic benefits are expected to flow to the entity[4]. On making the payment, the entity has the right to receive future economic benefits either in a form of cash or by using the payment to settle the tax liability. The payment is not a contingent asset as defined by IAS 37 because it is an asset, and not a possible asset, of the entity.

Consequently, the Committee concluded that in the fact pattern in the request the entity recognises an asset when it makes the payment to the tax authority.

The Committee also observed that the asset recognised is not clearly captured within the scope of any IFRS Standard. In the absence of a Standard that specifically applies to a transaction, an entity applies paragraphs 10 and 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in developing and applying an

[4] The Board expects to issue the revised *Conceptual Framework* around the end of the first quarter of 2018. If an agenda decision is published after the revised *Conceptual Framework* has been issued, references to the *Conceptual Framework* will be updated to refer to the revised *Conceptual Framework*.

accounting policy that results in information that is (i) relevant to the economic decision-making needs of users of financial statements and (ii) reliable.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to account for payments relating to taxes other than income tax. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Appendix B—Submission

B1. The detailed description is reproduced from the Appendix of ESMA's request to the IFRS Interpretations Committee. The full request can be accessed here.

Description of the issue

An [entity (issuer)] is involved in a dispute with a tax authority. Voluntarily (e.g. in order to avoid possible penalties or interest based on the applicable tax code), it decides to make a payment of the disputed amount to the respective tax authority. In some circumstances, depending on the jurisdiction, the money paid is held in escrow by the tax authority, pending the resolution of the dispute, at which point, it will be either returned to the issuer or used to settle the tax liability from the dispute. From a legal perspective, the payment of the amount to the tax authority does not change the legal situation but represents a way to avoid the penalties or interests on the disputed amount.

The issuer does not believe that it is probable that any tax liability will arise in relation to the disputed amount and, consequently, it did not recognise any obligation in this regard when applying the respective requirements of IAS 37. As IFRS does not include explicit guidance regarding the recognition and measurement of uncertain tax positions concerning other taxes (it was also explicitly excluded from the scope of IFRIC 23 - Uncertainty over Income Tax Treatments during deliberations on that Interpretation), this submission assumes that the liability was correctly assessed and not recognised using the criteria and requirements of IAS 37.

Consequently, this submission is limited to the recognition of the asset resulting from the payment concerning this uncertain tax position rather than the appropriateness of the recognition of the liability concerning the disputed amount.

View 1: The paid amount should be recognised as an asset

Paragraph 10 of IAS 37 defines a contingent asset as a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

Under View 1, there is no uncertainty regarding the existence of the asset. The payment represents an asset, as it will be either refunded from the tax authority or it will be used to settle the tax liability arising from the resolution of the dispute. Accordingly, proponents of View 1 assert that the asset arising from the payment is not a contingent asset as the uncertain future event will merely confirm the means of recovery of this asset (i.e. refund or use to settle the future liability) rather than its existence.

Furthermore, proponents of View 1 believe it would be inconsistent with the IFRS to make the recognition of an expense with regards to the uncertain tax position dependent only on the payment of cash. In their view, recognition of an expense (instead of an asset) would be inconsistent whenever the issuer assesses that it is not probable that any tax liability will arise in relation to the disputed amount. Consequently, the accounting treatment of the cash payment would inappropriately override the requirement not to recognise any liability in respect of the uncertain tax position stemming from the requirements of IAS 37.

As soon as the issuer considers probable that the dispute will result in some or all of the payments being retained by the tax authority to settle any tax liability arising from the dispute, it should recognise an expense and use the (part of the) asset to settle the arising liability.

As IFRS does not include any specific guidance on recognition and measurement of these types of assets[5], in the view of the proponents of View 1, the issuer can develop an accounting policy analogising to recognition and measurement criteria for intangible assets[6] or using paragraphs 10-12 of IAS 8. Such accounting policy would be based on the definition of an asset in the Conceptual Framework for Financial Reporting[7] [8] (thereafter the Conceptual Framework").

In accordance with paragraph 4.4 of the Conceptual Framework (equivalent to paragraph 8 of IAS 38), an asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Proponents of this view believe that this asset meets the definition of an asset in the Conceptual Framework as the payment is a resource:

a. stemming from the cash payment that occurred in the past;
b. embodying future economic benefits that are expected to flow to the issuer in form of either a refund from the tax authority or decrease of tax liability that will arise from the resolution of the dispute;
c. economic benefits which the issuer has the capacity to control. The capacity of the issuer to control benefits is the reflection of the existing legal rights of the issuer (cf. paragraph 4.12 of the Conceptual Framework). In this case it can be argued that the issuer has legal rights to the future economic benefits (refund of payment or payment of the liability arising from the dispute) even if the mode of recovery of these benefits is outside of its control.

Proponents of this view argue that the asset meets the criteria to be recognised in accordance with the Conceptual Framework, and consequently, it should be initially recognised in the amount of cash paid (considering that no IFRS precludes the value of this asset). However, subsequent measurement of such asset remains unclear (i.e. it is not clear which guidance would apply to its measurement).

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[5] As it is not a contingent asset. IAS 37 does not apply.

[6] If the payment is considered to be a prepayment, some argue that the recognition and measurement criteria of IAS 38 *Intangible Assets* might be relevant. However, as paragraph 70 of IAS 38 provided guidance on prepayments in relation to payments for goods and services, it seems that requirements of IAS 38 can be applied only by analogy.

[7] In line with the IFRS Interpretations Committee agenda decision on *Interest and penalties related to income taxes* from September 2017, entitles do not have an accounting policy choice between applying IAS 12 and applying IAS 37 to interest and penalties. Instead, if an entity considers a particular amount payable or receivable for interest and penalties to be an income tax, then the entity applies IAS 12 to that amount. If an entity does not apply IAS 12 to a particular amount payable or receivable for interest and penalties, it applies IAS 37 to that amount. Using the rationale of this agenda decision, as the issuer assessed that the uncertain tax positions relates to taxes other than Income taxes in scope of IAS 12, requirements of IAS 12 are unlikely to used in these circumstances, thus leading the issuer to revert to the underlying criteria of asset recognition in the Conceptual Framework.

[8] Similarly, the requirements of *IAS 32 Financial Instruments Presentation* do not seem to be applicable as the voluntary payment is not linked to a contract as required by paragraph 11 of IAS 32 thus reducing the relevance to apply this guidance by analogy.

View 2: The prepaid amount should not be recognised as an asset but as an expense

Proponents of View 2 are of the opinion that the amount paid should be considered a contingent asset under paragraph 10 of IAS 37. In their view, the uncertain future event is a favourable outcome of a tax dispute and this uncertainty affects the existence of the asset rather than only the mode of its recovery.

Proponents of View 2 analogise this with the accounting treatment of a lawsuit of which the outcome is uncertain. In the context of such an analogy, paragraph 32 of IAS 37 states that contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the entity. According to IAS 37, an example of a contingent asset 'is a claim that an entity is pursuing through legal processes, where the outcome is uncertain'.

As a consequence, taking into account that the decision on the reimbursement or use of the payment is not within the control of the entity as referred to in IAS 37, it could be argued that the payment itself represents a contingent asset.

In particular, proponents of View 2 believe that IAS 37 introduces asymmetry in the recognition of an asset and recognition of a liability. The threshold for the recognition of a liability from the Mother taxes" uncertain tax position is assessed with reference to whether the outflow of economic benefits from the dispute is more likely than not. On the other hand, any asset resulting from the payment to avoid any additional interest or penalty payment can be recognised only to the extent that the reimbursement is virtually certain.

Finally, when assessing the recognition of the asset, proponents of View 2 dispute that the future economic benefit are controlled by the entity, as the right to be reimbursed is dependent of a court decision which is outside the control of the issuer. Consequently, this, contrary to argument in paragraph 11(c) above, precludes the recognition of an asset in these circumstances.

Request

ESMA seeks clarification on whether and on which basis the amounts related to voluntary payments to tax authorities in relation to uncertain tax positions should be recognised. Furthermore, in light of the absence of explicit IFRS guidance and the fact that such payments are common in a number of jurisdictions, ESMA requests clarification on the subsequent measurement (or re-assessment) of these amounts.

ESMA is aware of divergent practices in various European jurisdictions. Accordingly, ESMA kindly suggests that the IFRS Interpretations Committee considers clarifying the accounting requirements in this respect.