Presentation of liabilities or assets related to uncertain tax treatments

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Uncertain tax positions

Issue

On 7 June 2017, the IFRS Interpretations Committee (IFRS IC) issued IFRIC 23, which clarifies how the recognition and measurement requirements of IAS 12 'Income taxes', are applied where there is uncertainty over income tax treatments.

Highlights

Interpreting grey areas in tax law can be complex, the IFRS IC noted that most of the financial statements fail when it is necessary to reveal an uncertain tax positions, for that reason, they had clarified previously that IAS 12, not IAS 37 'Provisions, contingent liabilities and contingent assets', applies to accounting for uncertain income tax treatments. IFRIC 23 *Uncertainty over Income Tax Treatments* explains how to recognize and measure deferred and current income tax assets and liabilities where there is uncertainty over a tax treatment.

An uncertain tax treatment is any tax treatment applied by an entity where there is uncertainty over whether that treatment will be accepted by the tax authority. For example, a decision to claim a deduction for a specific expense or not to include a specific item of income in a tax return is an uncertain tax treatment if its acceptability is uncertain under tax law. IFRIC 23 applies to all aspects of income tax accounting where there is an uncertainty regarding the treatment of an item, including taxable profit or loss, the tax bases of assets and liabilities, tax losses and credits and tax rates.

The standard

It is sometimes unclear how tax law applies to a particular transaction or circumstance. So how do you decide what to put in your financial statements if you're uncertain about a tax treatment that you've adopted in your tax return?

Under IFRIC 23, the key test is whether it's probable that the tax authority will accept the company's chosen tax treatment.

Consider a manufacturer that engages a consultant to improve the efficiency of its production process. The manufacturer believes that deducting the full expense from profit up-front would be consistent with the principles of its local tax law, and therefore applies that treatment in its tax return; however, it is not sure whether the tax authorities will agree.

Does the manufacturer apply the same treatment in its financial statements? In reaching a decision, it considers whether it's probable that the tax authority will accept the treatment in the tax return.

- If yes, then the manufacturer records the same amount in the financial statements and considers making a disclosure about uncertainty.

- If no, then the amount recorded in the financial statements differs to that in the tax return because its measurement reflects the uncertainty.

Key to the Interpretation is the assumption that tax authorities will have full knowledge of all relevant information in assessing a proposed tax treatment. This is an area where the new requirements bring clarity.

IFRIC 23 focuses in the following matters:

What is the unit of account?

Each uncertain tax treatment is considered separately or together as a group, depending on which approach better predicts the resolution of the uncertainty. The factors that an entity might consider to make this determination include:

(1) how it prepares and supports the tax treatment; and
(2) the approach that it expects the tax authority to take during an examination.

What should an entity assume about the examination of tax treatments by taxation authorities?

An entity is required to assume that a tax authority with the right to examine and challenge tax treatments will examine those treatments and have full knowledge of all related information. Detection risk is not considered in the recognition and measurement of uncertain tax treatments.

When should an entity account for any uncertain tax treatments?

If an entity concludes that it is probable that the tax authority will accept an uncertain tax treatment that has been taken or is expected to be taken on a tax return, it should determine its accounting for income taxes consistently with that tax treatment. If an entity concludes that it is not probable that the treatment will be accepted, it should reflect the effect of the uncertainty in its income tax accounting in the period in which that determination is made (for example, by recognizing an additional tax liability or applying a higher tax rate).

How is the effect of uncertainty recognized?

The entity should measure the impact of the uncertainty using the method that best predicts the resolution of the uncertainty (that is, the entity should use either the most likely amount method or the expected value method when measuring an uncertainty).

The most likely amount method might be appropriate if the possible outcomes are binary or are concentrated on one value. The expected value method might be appropriate if there is a range of possible outcomes that are neither binary nor concentrated on one value. Some uncertainties affect both current and deferred taxes (for example, an uncertainty over the year in which an expense is deductible). IFRIC 23 requires consistent judgements and estimates to be applied to current and deferred taxes.

What about changes in circumstances?

The judgements and estimates made to recognize and measure the effect of uncertain tax treatments are reassessed whenever circumstances change or when there is new information that affects those judgements. New information might include actions by the tax authority, evidence that the tax authority has taken a particular position in connection with a similar item, or the expiry of the tax authority's right to examine a particular tax treatment. IFRIC 23 states specifically that the absence of any comment from the tax authority is unlikely to be, in isolation, a change in circumstances or new information that would lead to a change in estimate.

What about the disclosures?

There are no new disclosure requirements in IFRIC 23. However, entities are reminded of the need to disclose, in accordance with IAS 1, the judgements and estimates made in determining the uncertain tax treatment.

Effective date and transition

The Interpretation is effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted. An entity can, on initial application, elect to apply this Interpretation either:
(1) retrospectively applying IAS 8, if possible without the use of hindsight; or
(2) retrospectively, with the cumulative effect of initially applying the Interpretation recognized at the date of initial application as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate).