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IASB publishes a draft Interpretation of IAS 12 Income Taxes – Uncertainty over income tax treatments

Why does the IASB propose this Interpretation?

The IFRS Interpretations Committee received a request for clarification on the recognition of an asset when there are uncertainties as to how tax law should be applied in a particular transaction or circumstance.

The request focused on whether IAS 12 Income Taxes should be applied to recognise an asset (using a probability threshold), when an entity has made a payment to the tax authority but expects to recover some or all of that amount, or whether the guidance in IAS 37 Provisions, Contingent Liabilities and Contingent Assets should be applied (using a virtually certain approach) similar to the accounting requirement for contingent assets.

In its analysis, the Committee concluded that IAS 12 is the relevant standard to deal with tax uncertainties. However, it found evidence of diversity in practice and also that IAS 12 does not provide enough guidance on how those uncertainties should be recognised and measured.

Accordingly, the Committee decided to develop an Interpretation to address these issues more broadly irrespective of whether or not an entity has made a payment to the tax authorities.

How will the proposed Interpretation impact the accounting of income taxes?

The proposed Interpretation will provide guidance in accounting for uncertainties in income tax liabilities or assets focusing on (i) unit of account for tax uncertainties; (ii) assumptions regarding the examination by the tax authorities of the amounts reported; (iii) recognition of tax uncertainties; (iv) measurement of tax uncertainties; and (iv) disclosures.

Unit of account for uncertainties:

An entity would be required to apply judgement to determine whether each uncertainty should be consider independently or together with other uncertainties to a tax asset or liabilities. As explained in the illustrative examples, there could be situations that are case-specific and need to be considered individually, while there could be cases in which tax authorities make decisions that affect other transactions and accordingly those transactions should be analysed as a single unit of account.

Assumptions regarding the examination by the tax authorities of the amounts reported

As part of the assessment for recognition of a tax uncertainty an entity should assume that the tax authorities will examine the tax returns, and will have full knowledge of all relevant information.

Observations

An entity would be required to reassess its judgement on tax examination whenever there are changes in facts and circumstances. For example, if a tax authority has accepted (implicitly or explicitly) an entity's tax position in a particular matter, then an entity should not reassess its position. However, if the entity is aware that the tax authorities have challenged a similar position with another entity, this could be an indication that the entity needs to reassess its tax position.

Recognition of tax uncertainties

An entity would reflect a tax uncertainty in income tax liabilities or assets if it is probable that it will pay or recover the amount considered uncertain, consistent with the objective of IAS 12 which refers to a probability threshold. For example, IAS 12.14 states that current tax assets are recognised to the extent that it is probable that they will be recovered, and IAS 12.46 states that current tax assets are measured at the amount 'expected' to be recovered from the tax authorities.

Observations

Under U.S. GAAP, an entity is required to apply a recognition threshold to determine whether a tax dispute will be resolved favourably in the court of last resort (being the Supreme Court in the United States). As IFRS is applied in a wide range of jurisdictions, it is not possible to have detailed guidance on how an entity can determine that it will be able to sustain its tax position. Accordingly, an entity would be required to apply judgement in determining its probability threshold depending on the specific regulatory environment in which it operates.

Measurement of tax uncertainties in an income tax liability or asset

An entity would be required to apply one of the two following approaches in measuring tax uncertainties:

(i) The most likely amount, which is the single most likely amount in a range of possible outcomes. An example would be a dispute which is considered a single unit of measurement that could be either deductible or non-deductible.

(ii) The expected value, which is the sum of probability weighted amounts in a range of possible amounts. An example would be if the possible outcomes are widely dispersed with low probabilities.

An entity should select a method that best reflects the amount that it will pay or recover.

The judgements and estimates applied in measuring an uncertain tax liability or asset should be reassessed whenever facts and circumstances change.

Disclosures

An entity would be required to determine whether it should disclose the estimates and judgements applied in accordance with IAS 1 Presentation of Financial Statements, even if the entity did not recognise an uncertainty as a tax liability or asset.

Observations

IAS 1 already includes disclosure requirements related to the judgements made in relation to accounting policies. Particularly relevant are paragraphs 122 and 125 which require an entity to disclose the judgements made in applying its accounting policies and have the most significant effect on the amounts recognised in the financial statements and the requirements to disclose the major sources of estimation uncertainty. Accordingly, the judgements made on whether or not an uncertain tax liability or asset should be recognised are required to be disclosed even when an entity did not recognise any tax uncertainty in their financial statements.

Effective date, transition requirements and comment period

The draft Interpretation does not specify an effective date. The Committee will propose an effective date as part of considering the comments they receive on this draft interpretation.

An entity would be required to apply the amendments prospectively and to recognise the cumulative effect of initially applying the Interpretation in retained earnings at the start of the reporting period in which an entity first applies the Interpretation. Retrospective application would be permitted if an entity can apply the Interpretation without hindsight. Earlier application would be permitted.

The draft Interpretation does not provide any specific relief for first time adopters.

Comments on the ED are due by 19 January 2016.

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