KPMG

Income tax exposures

IFRIC 23 clarifies the accounting treatment

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"IFRIC 23 clarifies the accounting for income tax treatments that have yet to be accepted by tax authorities, whilst also aiming to enhance transparency.

Although the filing deadlines for your tax return and financial statements may be months apart, IFRIC 23 may require more rigour when finalising the judgements about the amounts to be included in the tax return before the financial statements are finalised."

IFRIC 23 may change how a company accounts for uncertain tax treatments

Highlights

- Greater clarity on reflecting uncertainty in accounting for income tax
- What's new in IFRIC 23
- Tax amounts in financial statements may change
- Effective date and next steps

Greater clarity on reflecting tax uncertainty

Tax transparency is a sensitive topic and often triggers much debate both within and beyond the boardroom.

Interpreting grey areas in tax law can be complex. IFRIC 23 *Uncertainty over Income Tax Treatments* seeks to bring clarity to the accounting for income tax treatments that have yet to be accepted by tax authorities.

What's new in IFRIC 23

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?

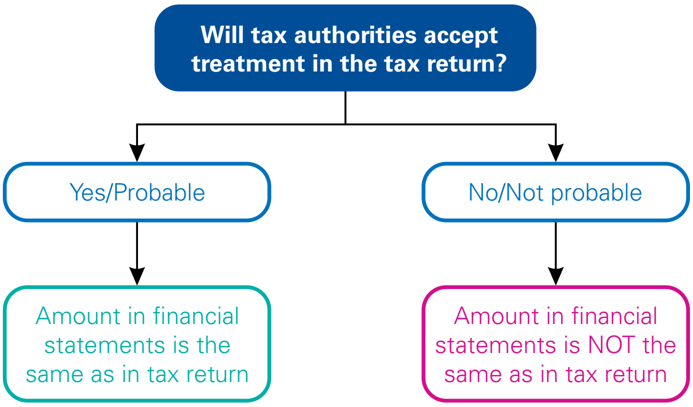
Under IFRIC 23, the key test is whether it's probable that the tax authority will accept the company's chosen tax treatment.

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.



The uncertainty is reflected using the measure that provides the better prediction of the resolution of the uncertainty – either:

- the most likely amount; or
- the expected value.

The Interpretation also requires companies to reassess the judgements and estimates applied if facts and circumstances change – e.g. as a result of examination or action by tax authorities, following changes in tax rules or when a tax authority's right to challenge a treatment expires.

Tax amounts in financial statements may change

Depending on your current practice, you may need to increase your tax liability or recognise an asset. The timing of derecognition may also change.

IFRIC 23 does not introduce any new disclosures but reinforces the need to comply with existing disclosure requirements about:

- judgements made;
- assumptions and other estimates used; and
- the potential impact of uncertainties that are not reflected.

The requirements may also affect how you reflect tax inspections. For example, if a tax authority examines different types of taxes together and issues a report with a single amount due, then it may be challenging to estimate only the income tax due.

Effective date and next steps

IFRIC 23 applies for annual periods beginning on or after 1 January 2019. Earlier adoption is permitted.

You may want to discuss the Interpretation with your advisors and tax specialists to understand fully its potential impact for your company.

View our SlideShare presentation for a high-level visual summary of the new requirements. We've also developed an IFRIC 23 – Q&A, which considers the new requirements in more detail.

For more information, read the new requirements and/or speak to your usual KPMG contact.

IFRIC 23 - Q&As

Question	Answer
Which standard is applied to account for an uncertain tax treatment?	IAS 12 *Income Taxes*
Should an entity provide for all uncertain tax treatments?	**No**. If it is probable that the tax authorities will accept an uncertain tax treatment, then the tax amounts recorded in the financial statements are consistent with the tax return – no uncertainty is reflected in measuring current or deferred taxes.
Can a separate provision be recorded for an uncertain tax treatment?	**No**. Uncertainty about an income tax treatment is reflected in the measurement of current and deferred tax.
Can the US GAAP 'cumulative-probability' approach be used to reflect uncertainty in measurement?	**No**. Only the 'expected value' or the 'most likely amount' approaches can be applied – whichever better predicts the resolution of the uncertainty.
Are tax amounts in the financial statements identical to those in the tax return?	**It depends**. If it is probable that the tax authority will accept the treatment in the tax return, then the same positions are used in the financial statements. Otherwise, the uncertainty is reflected in the measurement of current and deferred tax.
Must the 'virtually certain' threshold be met to recognise an asset related to an uncertain tax treatment?	**No**. Whether it is *probable* that a tax authority would accept a company's tax treatment is the test for reflecting uncertainty in the measurement of current or deferred tax.
Can a 'detection risk' be taken into account?	**No**. It is assumed that the taxation authorities have full knowledge and will examine the amount in question as long as they have the right to do so.
Does a company revisit its assessment of whether a tax authority will accept a tax treatment?	**Yes**. A company reassesses its judgements and estimates whenever there is a change in facts and circumstances – e.g. examinations or actions by a tax authority, changes in tax rules or the expiry of the tax authority's right to examine tax amounts.
How are changes in facts and circumstances occurring after the reporting period treated?	**It depends**. A company determines whether a change in estimates and assumptions is an adjusting or a non-adjusting event under IAS 10 *Events after the Reporting Period*.
If the tax authorities express no explicit agreement or disagreement after an examination, is this a change in facts and circumstances?	**Not in isolation**. The absence of explicit agreement or disagreement by the tax authorities on its own is unlikely to represent a change in facts and circumstances, or new information that affects the judgements and estimates made.
Does IFRIC 23 apply to interest and penalties related to uncertain income tax treatments?	**It depends**. If a company applies IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to account for interest and penalties payable to or receivable from a tax authority, then it does not apply IFRIC 23 regardless of whether there is an uncertainty. However, if a company applies IAS 12 to these amounts and there is uncertainty, then IFRIC 23 also applies.
Are specific disclosures required for tax uncertainties?	**Yes**. Although IFRIC 23 does not introduce any *new* disclosure requirements, meaningful disclosures about judgements, assumptions and estimates are provided under IAS 1 *Presentation of Financial Statements* and IAS 12.
When are the new requirements effective?	1 January 2019. Earlier application is permitted.
Is IFRIC 23 applied retrospectively?	**Yes**. A company can either: – restate the comparatives if this is possible without the use of hindsight; or – adjust equity on initial application, without adjusting comparative information.