

IFRIC 23 : Impact on Investment Funds

IFRIC 23 is a new IFRS interpretation which clarifies the accounting treatment in relation to uncertain tax positions. It is similar but not identical to ASC 740-10 under US GAAP (commonly known as FIN 48).

IFRIC 23 places an obligation on investment managers to consider whether any of the positions held by the funds which they manage give rise to 'uncertain tax treatment' and whether it is 'probable' the treatment adopted would be accepted by a tax authority. Practically, it can require provisions to be recognised, impacting the NAV of the fund in respect of a liability which may not ultimately become payable.

This obligation is effective for accounting periods beginning on or after 1 January 2019 and applies retrospectively.



How will IFRIC 23 impact investment funds?

IFRIC 23 clarifies how to apply the recognition and measurement requirements in respect of current and deferred tax which are outlined in IAS 12, relating to Income Taxes. For investment funds, it will apply to capital gains (realised and unrealised), interest income and dividend income. That said, uncertain tax positions are more likely to arise for an investment fund in the context of capital gains tax rather than withholding taxes (which are generally applied at source).



What is the effective date for IFRIC 23?

IFRIC 23 is effective for accounting periods beginning on or after 1 January 2019 (early adoption was permitted).

The interpretation applies retrospectively, meaning investment funds need to identify the cumulative effect of IFRIC 23 (which could go back to inception of the fund or the date which any tax legislation giving rise to an 'uncertain tax treatment' came into effect in relevant investment jurisdictions).



How can uncertain tax positions arise for investment funds?

Uncertain tax positions can arise where a fund invests in a jurisdiction with domestic tax legislation that imposes a capital gains tax payment and / or filing obligation on a non-resident (in this case a fund) deriving investment return from the jurisdiction.

For example, where a fund disposes of Spanish equities, Spanish tax legislation imposes a technical obligation to register and pay tax in Spain in relation to any gains realised unless a specific exemption applies.

Although there is no mechanism for the Spanish tax authorities to enforce collection of tax or non-filing penalties on a non-resident, the failure to pay tax or file a return would be regarded as an uncertain tax treatment under IFRIC 23. Practically speaking, this could require a provision to be booked, reducing the overall NAV.



Practical impact for investment managers

In order to ensure that a fund satisfies its accounting obligations for an accounting year ended on or after 1 January 2019, investment managers will need to consider the following in relation to the funds they manage:

- Will any capital gains tax or other tax exposure arise for the fund in any investment jurisdiction?
- Is there uncertainty in relation to whether the tax authorities in each investment jurisdiction will accept the tax treatment adopted (e.g. a decision not to file a return or pay tax)?
- Is there any adjustment to reserves required in light of the retrospective application?
- Is it probable that the relevant tax authority would accept such uncertain tax treatment?

Under IFRIC 23, it is possible a tax liability may be recorded but never collected by a tax authority. This gives rise to an ongoing need to monitor any provisions which are booked, to ensure they are released once the statute of limitations expires in the investment jurisdiction.

How can KPMG assist

The need to consider investment jurisdiction tax treatment is likely a new requirement for many investment managers. Therefore, appropriate consideration should be given to the possible impact of IFRIC 23 and a process should be put in place to appropriately document any conclusions to support the position adopted in the financial statements of each fund.

KPMG can support investment managers with this process, leveraging significant expertise we have advising on investment level and general tax risk applicable to funds.

Based on our experience to date, there is no one size fits all approach adopted by investment managers in respect of tax risk. We have a range of potential solutions which can be tailored to suit specific requirements in the context of any type of fund.



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