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IFRS Notes

IFRIC 23 clarifies the accounting treatment for uncertain income tax treatments

13 June 2017

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Introduction

On 7 June 2017, the International Financial Reporting Standards (IFRS) Interpretations Committee of the International Accounting Standards Board (IASB) issued IFRS Interpretation, IFRIC 23, *Uncertainty over Income Tax Treatments* (the Interpretation) which seeks to bring clarity to the accounting for income tax treatments that have yet to be accepted by tax authorities.

Background

Paragraph 12 of International Accounting Standard (IAS) 12, *Income Taxes* provides guidance on recognition of income tax assets and liabilities. It requires entities to recognise a current tax liability for taxes pertaining to the current and prior periods, to the extent they are unpaid and to recognise an asset if the taxes paid in respect of the current and prior periods exceed the amounts due for those periods, to the extent of such excess amounts paid. However, sometimes it is unclear on how tax law applies to a particular transaction or circumstance. Since interpreting areas of uncertainty in tax law can be complex, entities have adopted different approaches for recognising tax liabilities and assets. This has resulted in diversity in practice for the recognition and measurement of a tax liability or asset in the financial statements of entities.

The Interpretation seeks to bring clarity to the accounting for uncertainties on income tax treatments that have yet to be accepted by tax authorities, and to reflect it in the measurement of current and deferred taxes.

Based on the comments received by the Interpretations Committee, on 7 June 2017, the IASB issued IFRIC 23 and clarified the accounting treatment for uncertainties about the acceptability by a tax authority of a particular tax treatment used by an entity in its income tax filings (uncertain tax treatment), which would provide tax transparency in the financial statements of such entities.

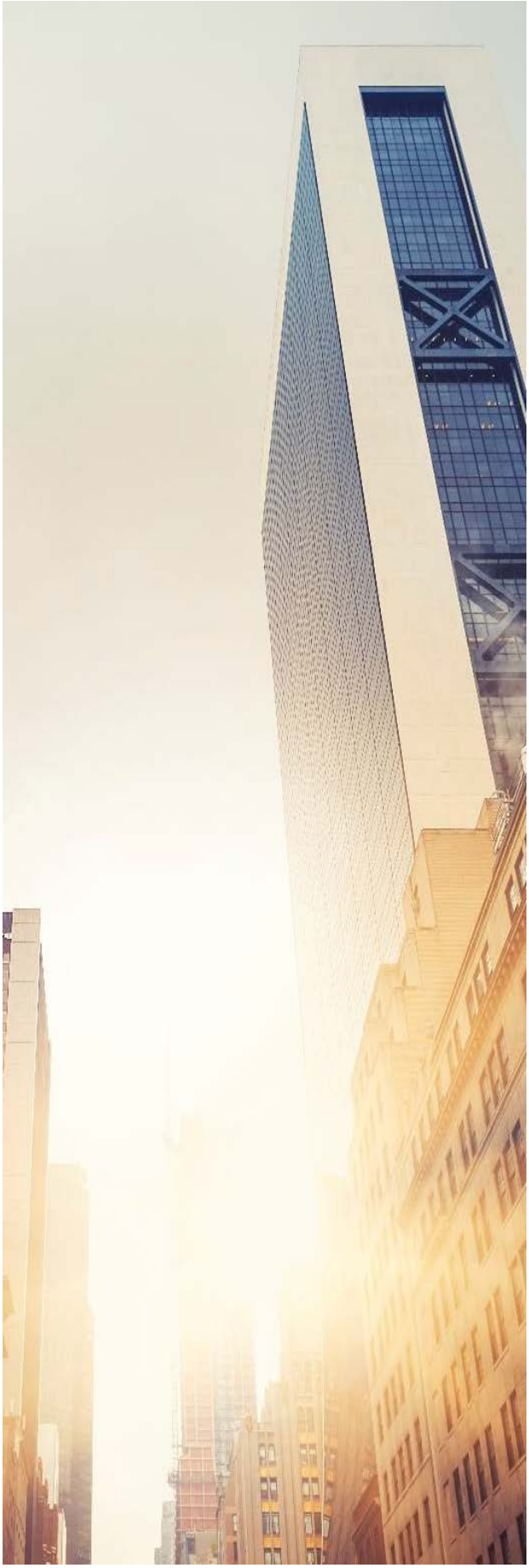
This issue of IFRS Notes provides an overview of IFRIC 23.

Key highlights of IFRIC 23

Assumptions

Entities applying the Interpretation, need to consider the following assumptions:

- The taxation authorities have the right to examine the amounts reported to them
- The taxation authorities will examine the amounts reported to them and
- The taxation authorities will have full knowledge of all relevant information in assessing a proposed tax treatment.



Key highlights of IFRIC 23 (cont.)

Consideration of uncertain tax treatments individually/collectively

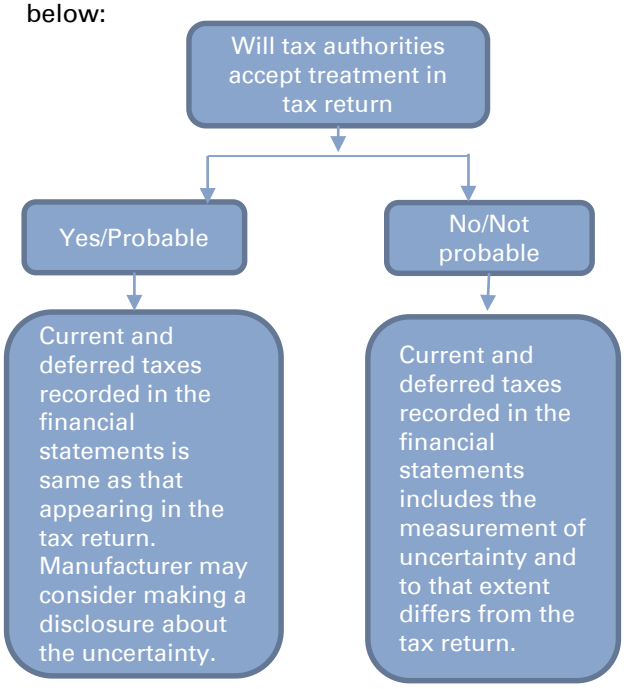
The Interpretation requires entities to first determine whether they should consider uncertain tax treatments individually or collectively, with other uncertain tax treatments, depending on which approach would provide a better prediction of the resolution of the uncertainty.

The key test

Under IFRIC 23, the key test is whether it's probable that the taxation authority would accept the tax treatment used or planned to be used by the entity in its income tax filings. If yes, then the amount of taxes recognised in the financial statements would be consistent with the entity's income tax filings. Otherwise, the effect of uncertainty should be estimated and reflected in the financial statements. This would require the exercise of judgement by the entity. This is further explained below with the help of an example.

Consider a manufacturer that engages a consultant to improve the efficiency of its production process. The manufacturer believes that deducting the full expenses 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, the manufacturer is not sure whether the tax authorities will agree.[1]

To determine the current tax liability to be recognised by the manufacturer in its financial statements, it needs to consider whether it's probable that the taxation authority will accept the treatment in the tax return. This can be evaluated as below:



(Source: KPMG in India's analysis read with Income tax exposures: IFRIC 23 clarifies the accounting treatment, KPMG IFRG Limited's publication, June 2017)

Recognition and measurement of uncertainty

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

- The most likely amount – being the single most likely amount in a range of possible outcomes; or
- The expected value – the sum of probability-weighted amounts in a range of possible outcomes.[1]

The measurement of uncertainty is reflected in the overall measurement of tax, and no separate provision is required to be made.

The Interpretation requires companies to reassess the judgements and estimates applied, and update the amounts in the financial statements, if facts and circumstances change as below:

- As a result of examination or action by tax authorities
- Following changes in tax rules
- When a tax authority's right to challenge a treatment expires
- Any other new facts and circumstances, including adjusting events occurring after the reporting period under IAS 10, *Events after the Reporting Period*, that may affect an entity's conclusion about the acceptability of tax treatments.

Interest and penalties

The Interpretation does not specifically address interest and penalties associated with uncertain tax treatments. 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 the Interpretation. However, if a company applies IAS 12 to these amounts, then IFRIC 23 also applies.

Accounting impact and disclosures

Depending on their current practice, entities may need to increase their tax liabilities or recognise an asset. The timing of derecognition may also change.

The Interpretation does not introduce any new disclosure requirements, but reinforces the need to comply with the meaningful disclosure requirement under IAS 1, *Presentation of*

[1] *IFRIC 23 clarifies the accounting treatment, KPMG IFRG Limited's publication, June 2017.*

Key highlights of IFRIC 23 (cont.)

Financial Statements and the existing disclosure requirements under IAS 12, which include disclosure requirements of:

- Judgements made
- Assumptions and other estimates used; and
- The potential impact of uncertainties that are not reflected.

Key challenges

It would be challenging for entities to estimate the income tax due with respect to tax inspections, when tax authorities examine different types of taxes together and issue a report with a single amount due therein.[1]

Effective date and transition

The Interpretation is applicable for annual periods beginning on or after 1 January 2019. Earlier adoption is permitted.

On transition, a company may apply the standard retrospectively, by restating the comparatives (i.e. period beginning 1 January 2018), if this is possible without the use of hindsight, or apply it prospectively by adjusting equity on initial application, without adjusting comparatives.

Our comments

- The actual taxes payable (receivable) as finalised by the tax authorities, may differ from the amounts recognised as current tax liabilities (assets) in the financial statements on account of uncertainties on income tax treatment of items or transactions.

  As a result of this Interpretation, the effect of uncertainties on income tax treatment of items or transactions should be assessed by the entity. Depending on the probability of the taxation authorities accepting the treatment in the tax return, the entity would either disclose the uncertainty in the financial statements or include an adjustment for the same in the tax provision for that year.
- The Interpretation does not specifically address tax assets and liabilities acquired or assumed in a business combination. IFRS 3, *Business Combinations* requires entities to apply IAS 12 to account for deferred tax assets and liabilities acquired or assumed in a business combination, hence the interpretation would apply, when there is uncertainty over income tax treatments that affect deferred taxes.
- Absence of an explicit agreement or disagreement by the taxation authorities on its own is unlikely to represent a change in facts and circumstances, or new information that affects the judgements and estimates made. Accordingly, this has to be assessed in accordance with other available information.
- When the key test of the Interpretation would result in the entity recognising tax assets (i.e. based on the probability that the taxation authorities would accept the entity's tax treatment), the entity is not required to demonstrate the 'virtual certainty' of the tax authority accepting the entity's tax treatment in order to recognise such a tax asset.

Relevance to companies transitioning to Ind AS

We expect this interpretation issued by the IASB to be incorporated as an amendment to Indian Accounting Standard (Ind AS) 12, *Income Taxes* within the next year.

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KPMG in India's IFRS institute

Visit KPMG in India's IFRS Institute - a web-based platform, which seeks to act as a wide-ranging site for information and updates on IFRS implementation in India.

The website provides information and resources to help board and audit committee members, executives, management, stakeholders and government representatives gain insight and access to thought leadership publications that are based on the evolving global financial reporting framework.

Voices on Reporting

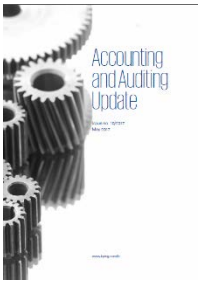
KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

In our recent call on Wednesday, 5 April 2017, we covered key financial reporting and regulatory matters that are expected to be relevant for stakeholders as they approach the quarter ending 31 March 2017.

Our call included updates from the Ministry of Corporate Affairs (MCA), the Securities and Exchange Board of India (SEBI), the Reserve Bank of India (RBI), etc.

In our VOR yearly updates, we have summarised key updates relating to the year ended 31 March 2017 from the MCA, the SEBI, the RBI, the Institute of Chartered Accountants of India (ICAI), the Insurance Regulatory and Development Authority of India (IRDA) and the Central Board of Direct Taxes (CBDT).

Missed an issue of our Accounting and Auditing Update or First Notes



Issue no. 10/2017 – May 2017

Continuing with our series of articles on the revised requirements of the Companies Act, 2013 (2013 Act), this month's edition of the Accounting and Auditing Update (AAU) carries an article highlighting the role and responsibilities of independent directors.

From this edition, we are starting with a series of articles that will provide insights into key Ind AS implementation issues for entities in the financial services sector. In this issue, we describe the computation of effective interest rate for loans advanced by banks.

This edition carries an article on accounting for enabling assets, both under accounting standards and Ind AS.

Our article on sale and leaseback arrangements highlights the concept of substance over form with the help of an example.

The publication also carries regular round up of regulatory updates in India and internationally.

MCA issues draft Companies (Registered Valuers and Valuation) Rules, 2017

9 June 2017

Section 247 of the Companies Act, 2013 (2013 Act) governs the provisions relating to the valuation by registered valuers under the 2013 Act. It requires that wherever valuation with respect to any property, stocks, shares, debentures, securities or goodwill or any other assets or net worth of a company or its liabilities is required to be made under the provisions of the 2013 Act, it should be valued by a registered valuer, appointed by the audit committee or by the Board of Directors (in the absence of audit committee) of that company.

The registered valuer has been entrusted with various significant responsibilities under the 2013 Act.

On 26 May 2017, the MCA has issued the draft Companies (Registered Valuers and Valuation) Rules, 2017 (Valuation Rules). The Valuation Rules provide detailed guidance on various aspects of a registered valuer.

Comments on the draft Valuation Rules could be submitted up to 27 June 2017.

This issue of First Notes provide an overview of the key requirements of the Valuation Rules.

Previous editions are available to download from: www.kpmg.com/in