afme/
Finance for Europe

International Accounting Standards Board
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Submitted electronically via go.ifrs.org/comment

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Dear Sirs,

IFRIC Interpretation on Uncertainty over Income Tax Treatments

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the draft IFRIC Interpretation DI/2015/1, Uncertainty over Income Tax Treatments ("the Consultation"). AFME represents a broad range of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks and other financial institutions. AFME advocates stable, competitive and sustainable European financial markets, which support economic growth and benefit society.

We support the Interpretations Committee's decision to develop an Interpretation on how to account for tax balances when there is uncertainty over income tax treatments. We do however also raise some concerns regarding the limitation of acceptable measurement methods. We believe this aspect of the draft Interpretation to be overly prescriptive and would instead suggest a solution more in line with the principles-based nature of IFRS requirements.

Please see below for our responses to the individual questions in the consultation document.

1. **Scope of the draft Interpretation:**

   The draft interpretation provides guidance on accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments. Such uncertain tax treatments may affect taxable profit (tax loss), tax bases, tax credits or tax rates that are used to recognise and measure current or deferred tax liabilities or assets in accordance with IAS 12 *Income Taxes.*

   Do you agree with the proposed scope of the draft Interpretation? If not, why and what alternative do you propose?

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We agree with the proposed scope of the draft Interpretation. In particular, we agree with the reasoning set out in paragraphs BC5 to BC7 of the consultation document. We welcome the Interpretation providing guidance for both current and deferred tax as, for example, the uncertainty over income tax treatments may relate to the timing of the deductibility of an expense in computing taxable profits.

2. **When and how the effect of uncertainty over income tax treatments should be included in determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates:**

The draft Interpretation requires an entity to consider whether it is probable that a taxation authority will accept an uncertain tax treatment, or group of uncertain tax treatments, that it used or plans to use in its income tax filings.

If the entity concludes that it is probable that the taxation authority will accept an uncertain tax treatment, the draft Interpretation requires the entity to determine taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment included in its income tax filings.

If the entity concludes that it is not probable that the taxation authority will accept an uncertain tax treatment, the draft Interpretation requires the entity to use the most likely amount or the expected value in determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates. The method used should be the method that the entity concludes will provide the better prediction of the resolution of uncertainty.

Do you agree with the proposal in the draft Interpretation on when and how the effect of uncertainty should be included in the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates? If not, why and what alternative do you propose?

We agree with the proposal in the draft Interpretation regarding when the effect of uncertainty should be included in the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates. In particular, we agree with the proposal in paragraph 15 of the consultation document which requires that *"if an entity concludes that it is probable that the taxation authority will accept an uncertain tax treatment, or group of uncertain tax treatments, it shall determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings"*.

Paragraph 16 of the consultation document states that:

"If an entity concludes that it is not probable that the taxation authority will accept an uncertain tax treatment, or group of uncertain tax treatments, it shall reflect the effect of uncertainty in determining the related taxable profit (tax loss), tax bases, unused tax

losses, unused tax credits or tax rates. It shall reflect the effect by using one of the following methods:

(a) The most likely amount—the single most likely amount in a range of possible outcomes. The most likely amount may provide the better prediction if the possible outcomes are binary or are concentrated on one value.

(b) The expected value—the sum of the probability-weighted amounts in a range of possible amounts. The expected value may provide the better prediction if the possible outcomes are widely dispersed.

The entity shall use the method that it concludes will provide the better prediction of the resolution of the uncertainty."

Given the principles-based nature of IFRS requirements, we believe that the draft Interpretation should allow entities to use on a consistent basis the method that they consider to be the best estimate of "*the amount to be paid to (recovered from) the taxation authorities*" (IAS 12, paragraph 46). We also do not fully agree with the rationale set out in the consultation document stating that *"the introduction of [the cumulative-probability approach] would make an entity's judgements to be required by this [draft] Interpretation more complex*" (BC 22). Where a firm already uses an alternative method, such as the cumulative-probability approach (which some preparers will already be applying in US and European entities), that method should be available to be considered for the purposes of measuring the relevant tax items in so far as doing so results in a measurement that is relevant and reliable. Furthermore, the data necessary for determining an estimate using the expected value approach can also easily be used to determine an estimate using the cumulative-probability approach.

We therefore support the removal of the proposed list of acceptable methods from the IFRIC Interpretation. This would avoid unnecessary prescription and emphasise that the measurement method used should be consistent with the principles of financial reporting. This approach would also have the additional benefit of avoiding the creation of a GAAP difference (which would otherwise arise from the exclusion of the 'cumulative-probability approach').

3. Whether uncertain tax treatments should be considered collectively:

The draft Interpretation requires an entity to use judgement to determine whether each uncertain tax treatment should be considered independently, or whether some uncertain tax treatments should be considered together, in order to determine taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates.

Do you agree with the proposal in the draft Interpretation on the determination of whether uncertain tax treatments should be considered collectively?

If not, why and what alternative do you propose?

Paragraph BC 10 of the consultation document explains that IFRIC has "*concluded that an entity should determine whether it should consider uncertain tax treatments individually or together, based on the approach that would provide the better predictions of the resolution of the uncertain tax treatments*."

We agree with the proposal in the draft Interpretation to require an entity to determine whether uncertain tax treatments should be considered individually or collectively. We think that examples 1 and 2 set out in IE 2 and IE 3 are helpful in illustrating how an entity might apply the interpretation and we agree with the above statement in paragraph BC 10.

4. Assumptions for taxation authorities' examinations and the effect of changes in facts and circumstances:

The draft Interpretation requires an entity to assume that a taxation authority with the right to examine any amounts reported to it will examine those amounts and will have full knowledge of all relevant information when making those examinations.

The draft Interpretation also requires an entity to reassess its judgements and estimates if facts and circumstances change. For example, if an entity concludes that new information indicates that it is no longer probable that the taxation authority will accept an uncertain tax treatment, the entity should reflect this change in its accounting. The expiry of the period in which the taxation authority may examine the amounts reported to it would also be an example of a change in circumstances.

Do you agree with the proposal in the draft Interpretation on the assumptions for taxation authorities' examinations and on changes in facts and circumstances? If not, why and what alternative do you propose?

Paragraph 13 of the consultation document states that "*In assessing whether and how an uncertain tax treatment affects the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, an entity shall assume that a taxation authority with the right to examine amounts reported to it will examine those amounts and have full knowledge of all relevant information when making those examinations*".

We agree with the principle that financial statements should be prepared on the basis of tax authorities examining amounts reported and having full knowledge of all relevant information when making those examinations.

We also view the reassessment of judgements and estimates in response to changes in circumstances as naturally flowing from the above principle. We therefore agree with the statement in paragraph 18 of the consultation document that "*a change in circumstances might change an entity's conclusion about the acceptability of tax treatments or its estimates*".

5. Other proposals:

Disclosure

The draft Interpretation does not introduce any new disclosure requirements, but highlights the relevance of the existing disclosure requirements in paragraphs 122 and 125–129 of IAS 1 *Presentation of Financial Statements*, paragraph 88 of IAS 12 and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Transition

The draft Interpretation requires an entity to apply its requirements by recognising the cumulative effect of initially applying them in retained earnings, or in other appropriate components of equity, at the start of the reporting period in which an entity first applies them, without adjusting comparative information. Full retrospective application is permitted, if an entity can do that without using hindsight.

Do you agree with the proposals in the draft Interpretation on the disclosure and the transition requirements? If not, why and what alternative do you propose?

We agree with the proposals in the draft Interpretation on the disclosure and transition requirements.

In relation to disclosure, we support the draft Interpretation in not aiming to introduce new prescriptive disclosure requirements, but instead highlighting the relevance of existing standards. We view in particular the reference to paragraphs 125-129 of IAS 1 (setting out the requirements for the disclosure of information relating to estimation uncertainty) as relevant to the topic covered by the draft Interpretation. We also view the reference to IAS 37, which in paragraph 36 states that "*the amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period*" as an appropriate one in determining the disclosures necessary for uncertain tax positions.

In relation to transition, we also support the wording in paragraph B2 of the draft Interpretation, which states that:

"On initial application, an entity shall apply this [draft] Interpretation either:

(a) without adjusting comparative information, recognising the cumulative effect of initially applying the [draft] Interpretation in the opening balance of retained earnings, or other appropriate components of equity, of the annual reporting period that includes

the date of initial application of the [draft] Interpretation. The date of initial application is the date when an entity first applies this [draft] Interpretation and must be the beginning of the annual reporting period.

(b) retrospectively to each prior reporting period presented in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

The retrospective application in accordance with IAS 8 is permitted if the entity has the information necessary to do so and this information is available without the use of hindsight."

We support the requirements of paragraph B2 of the draft Interpretation, and in particular the option to apply the interpretation without adjusting comparative information. The task of determining the effects of uncertainty over tax treatments is susceptible to hindsight bias and it is not clear that the disclosure of the impact this Interpretation would have had on past reports would provide useful information to users.

We are grateful for the opportunity to comment on the draft IFRIC Interpretation on Uncertainty over Income Tax Treatments. We would be pleased to discuss any of the comments above in greater detail if that would be helpful.

Yours sincerely,

R D Middleton

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