KPMG IFRG Limited
15 Canada Square
London E14 5GL
United Kingdom

Tel +44 (0)20 7694 8871
mark.vaessen@kpmgifrg.com

Mr Wayne Upton
Chairman, IFRS Interpretations Committee
IFRS Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

Our ref MV/288
Contact Mark Vaessen

19 January 2016

Dear Mr Upton

Comment letter on DI/2015/1 *Uncertainty over Income Tax Treatments*

We appreciate the opportunity to comment on the IFRS Interpretations Committee's (Committee) Draft Interpretation DI/2015/1 *Uncertainty over Income Tax Treatments*. We have consulted with, and this letter represents the views of, the KPMG network.

We support the Committee's decision to address the long-standing diversity in practice regarding the accounting for uncertainty over income tax treatments. We note that this diversity also affects the accounting for interest and penalties arising from uncertain income tax treatments, and we are surprised by the statement in paragraph BC9 of the Draft Interpretation that the Committee has not identified any current evidence of significant diversity in practice in this regard. We believe that there is sufficient evidence of existing diversity, as indicated in our detailed comments included in the Appendix to this letter, and we urge the Committee to expand the scope of the Draft Interpretation to address the accounting for interest and penalties.

We agree with the Committee that issuing an Interpretation is the appropriate way to address the accounting for uncertain income tax treatments, because the proposals expand guidance on the existing measurement requirements in IAS 12 *Income Taxes*. We also agree with the statement in paragraph 9 of the Draft Interpretation that the proposals do not change any existing requirements. However, the Draft Interpretation includes no clear link to those requirements in IAS 12 that require interpretation or clarification and hence some may argue otherwise. Therefore, we recommend explicitly stating in paragraph 7 and/or paragraph 9 that the Interpretation provides guidance on the *measurement* requirements of paragraphs 46 and 47 of IAS 12.

Overall, we agree with the proposals in the Draft Interpretation. However, we believe that further clarifications in relation to the following areas are necessary to support consistent application of the proposals.

- *Collective assessments of uncertain tax treatments:* We note that in practice the analysis of tax treatments may be rather complex. We also understand that there may be different interpretations of what is meant by 'considering uncertain tax treatments *collectively*' and we

include some examples in the Appendix to this letter. We recommend enhancing Example 2 of the Draft Interpretation or including an additional example to explain what the Committee intended to cover.

- *Term 'probable':* Although the term 'probable' is generally defined in IFRS as 'more likely than not', it is not explicitly defined in IAS 12. Therefore, we recommend that the Committee clarify that the term 'probable' is defined as 'more likely than not' to ensure consistent application of the proposals.

- *Events after the end of the reporting period:* Some read the proposals to imply that potentially all events occurring after the end of the reporting period are treated as non-adjusting events under IAS 10 *Events after the Reporting Period*. We recommend clarifying the interaction of the proposals with the requirements in IAS 10.

The Appendix to this letter contains our responses to the specific questions raised in the Draft Interpretation.

Please contact Mark Vaessen +44 (0)20 7694 8871 or Sanel Tomlinson + 85 221 43 8694 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

Appendix: Responses to specific questions

Question 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?

Overall, we agree that the draft interpretation should provide guidance on accounting for current and deferred tax liabilities and assets in which there is uncertainty over income tax treatments. However, as noted in the cover letter, we believe that there is diversity in practice in respect of accounting for interest and penalties arising from uncertain income tax treatments, and we are surprised by the statement in paragraph BC9 of the Draft Interpretation that the Committee has not identified any current evidence of significant diversity in practice.

In our experience, in the absence of clear guidance, entities account for interest and penalties arising from uncertain income tax treatments under IAS 12 *Income Taxes* or under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. As a result, different recognition thresholds and measurement principles may be applied to similar items under IAS 12 and under IAS 37, and the respective amounts are presented differently in the statement of financial position and in the statement of profit or loss and OCI. This diversity was acknowledged by the IASB in developing its proposals for the revised IAS 12 (paragraph 39 of ED/2009/2) and is further evidenced by guidance of the large accounting networks on this matter. For example, three out of four large accounting networks allow an accounting policy choice between IAS 12 and IAS 37, whilst the fourth large accounting network states a preference for the IAS 37 approach.

Therefore, we believe that there is sufficient evidence of the diversity in practice in respect of accounting for interest and penalties arising from uncertain income tax treatments and we urge the Committee to expand the scope of the Draft Interpretation to address the matter.

Question 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 to clarify that uncertainty over income tax treatments is reflected in the measurement of current and deferred taxes. We also agree with the statement in paragraph 9 of the Draft Interpretation that the proposals do not change any existing requirements. However, the Draft Interpretation includes no clear link to those requirements in IAS 12 that require interpretation or clarification and hence some may argue otherwise. Therefore, we recommend explicitly stating in paragraph 7 and/or paragraph 9 that the Interpretation provides guidance on the *measurement* requirements of paragraphs 46 and 47 of IAS 12.

We read the proposals in paragraph 16 of the draft interpretation as requiring that the effects of uncertainties over income tax treatments be reflected in the measurement of current and deferred tax assets and liabilities. This is supported by paragraph BC20 of the draft interpretation. Therefore, we understand that under the proposals the effects of uncertainties over income tax treatments could not be presented as a separate asset or liability from current or deferred tax assets or liabilities, as applicable. We suggest explicitly stating so to improve the clarity of the proposals related to presentation – e.g. in paragraph BC20.

We also agree with the proposal to consider whether it is probable that the taxation authority will accept an uncertain tax treatment in determining when and to what extent uncertainty should be reflected in measurement of the related current and deferred taxes. However, we note that although the term ‘probable’ is generally defined in IFRS as ‘more likely than not’, it is not explicitly defined in IAS 12. Therefore, we recommend that the Committee clarify that the term ‘probable’ is defined as ‘more likely than not’ to ensure consistent application of the proposals.

Question 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?

Overall, we agree with the proposal that an entity should use judgement to determine whether to consider each uncertain tax treatment individually or together with other uncertain tax treatments.

We note that in practice the analysis of tax treatments may be rather complex and not limited to individual items. This could lead to different interpretations of what is meant by 'considering uncertain tax treatments collectively'. The following are a few examples of different interpretations.

- Considering similar transactions in the same tax return or within the same group of entities. In addition, assessing related tax treatments within different group entities (e.g. transfer prices) together if an adjustment at one group entity may trigger an adjustment at the other group entity.

- Considering different tax treatments together if the taxation authority will assess them in one tax inspection and its report will state a single amount payable (receivable). This may be further complicated if the tax authority examines different types of taxes during the same examination and imposes a single amount payable (receivable) for all of them.

Because of the variety of possible interpretations of what is meant by 'considering uncertain tax treatments collectively', we recommend enhancing Example 2 of the Draft Interpretation or including an additional example to clarify what the Committee intended to cover by the collective assessment.

Question 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?

We agree with the proposal to require 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 the examinations.

We also agree with the proposal in paragraph 5 of the Draft Interpretation that the definition of 'taxation authority' should be sufficiently broad and that it might include a court. However, we note some internal inconsistencies in the Draft Interpretation that may result in different interpretations. For example, contrary to the wording in paragraph 5, the wording in paragraphs 4 and 12 of the Draft Interpretation may imply that 'taxation authority' does not include a court. We recommend reviewing the wording throughout the Draft Interpretation to remove any inconsistencies and to avoid any misinterpretations.

In addition, we agree with the proposal to require an entity to reassess its judgements and estimates if facts and circumstances change. However, the interaction of the proposed guidance on changes in facts and circumstances with the requirements in IAS 10 *Events after the Reporting Period* may not be clear. Some read the proposals to imply that potentially all events occurring after the end of the reporting period are treated as non-adjusting events based on the following:

- paragraph 18 of the Draft Interpretation states that changes in facts and circumstances are reflected in the period of the change; and

- paragraph A4 states that the results of examinations by taxation authorities are *new* facts and circumstances.

It is not clear whether the Committee intended that all events in relation to uncertain tax treatments that occur after the reporting date would be treated as non-adjusting events regardless of whether they would qualify as adjusting events in accordance with IAS 10 – e.g. a settlement of a tax court case. Therefore, we recommend clarifying the interaction of the proposals with the requirements in IAS 10 in relation to events that occur after the end of the reporting period.

Question 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 generally agree with the proposals on transition and disclosures.

We also agree with the Committee's decision not to introduce any new disclosure requirements, but to highlight the relevance of the existing disclosure requirements. Having said that, we note that the existing drafting of paragraph 88 of IAS 12, which to some extent contributed to the divergence that triggered the Draft Interpretation, may continue to cause confusion because it refers to "tax-related contingent liabilities and contingent assets". We appreciate that the Draft Interpretation is intended to clarify that all uncertainties related to income taxes are accounted under IAS 12; however, we are concerned that some may continue to use this wording in paragraph 88 of IAS 12 to argue otherwise. Therefore, we recommend amending that paragraph to incorporate the requirements of paragraph 86 of IAS 37 and refer to the disclosure requirements about estimation uncertainty in IAS 1 *Presentation of Financial Statements*. For the same reason, we strongly recommend removing reference to IAS 37 from paragraph 21 of the Draft Interpretation.

In addition, we refer to our comments in respect of Question 4 about the interaction of the proposals with the requirements in IAS 10. In considering that interaction, we recommend that the Committee takes into account the disclosure requirements in IAS 10.

Finally, the Committee may want to consider adding a reference to the requirements in paragraph 39 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. These disclosure requirements may become relevant if there is a change in facts and circumstances that triggers an adjustment to the amounts recognised for uncertain tax treatments.

Other comments

We note that there are diverging interpretations as to whether the exception to the recognition and measurement principles of acquisition accounting included in paragraph 24 of IFRS 3 *Business Combinations* applies to current income taxes, including uncertain tax treatments. Although we appreciate that the Draft Interpretation does not intend to address this point, we would like to bring it to the attention of the Committee, so that the Committee considers the best way to address it – e.g. recommend that the Board address this issue as part of the post-implementation review of IFRS 3.