Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Sent electronically through the IASB Website (www.ifrs.org)

30 December 2015

Mr Hans Hoogervorst
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Hans,

Draft IFRIC Interpretation DI/2015/1 *Uncertainty over Income Tax Treatments*

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing, and ethics for professional accountants, in Hong Kong. We are grateful for the opportunity to provide you with our comments on DI/2015/1.

We appreciate the IASB's efforts to reduce the diversity in practice on the recognition and measurement of a tax liability or asset in circumstances where there is uncertainty in the application of tax law.

We broadly support the draft Interpretation. However, we have concerns as to whether it goes far enough in certain respects. In this regard, we have provided recommendations to improve the scope of the draft Interpretation, to clarify the recognition threshold for uncertain tax positions and to clarify the application of IAS 10 as to whether changes in facts and circumstances relating to uncertain tax positions that occur between the end of the reporting period and the date when the financial statements are authorised for issue should be regarded as adjusting or non-adjusting events.

In addition, we have serious concerns about the guidance in paragraph 21 of the draft Interpretation which implies that measurement uncertainty should be regarded as a form of contingent liability. We do not consider that paragraph 21 is consistent with IAS 37 and consider instead that significant measurement uncertainty relating to uncertain tax positions should be disclosed under IAS 1.125.

Our responses to the questions raised in DI/2015/1 are set out in more detail in the Appendix.

If you have any questions regarding the matters raised in this letter, please contact me.

Yours sincerely,

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Encl.

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Detailed comments on DI/2015/1 *Uncertainty over Income Tax Treatments*

<u>Question 1 – Scope of the draft Interpretation</u>

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?

We agree that currently there is diversity in practice as to whether IAS 12 *Income Taxes* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* should be applied to uncertain tax positions. Therefore we broadly agree with the scope of the draft Interpretation and would like to make further recommendations on the scope.

We recommend that the scope of the draft Interpretation be extended to cover the accounting for interest and penalties on uncertain tax positions, as there is also diversity in practice on these matters. We also recommend that the IASB clarifies whether the draft Interpretation is applicable to business combinations in which the acquiree has uncertain tax positions, and to taxes that are not within the scope of IAS 12 (for example, duties and value added tax). If these items are not within the scope of this draft Interpretation, the IASB should explicitly state so in the scope.

<u>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</u>

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 that guidance should be provided about how uncertainty should be taken into account in determining the tax amounts. We also agree that the draft Interpretation should contain an explicit linkage to paragraph 46 of IAS 12, which states that the tax amounts 'shall be measured at the amount expected to be paid to (recovered from) the taxation authorities'.

However, we consider the draft Interpretation contains limited guidance on how the term 'probable', in paragraph 15, should be applied in practice. Although the term 'probable' is defined in the *Glossary* as 'more likely than not', we note that there is no consistent application of this definition. Therefore, the draft Interpretation should clarify how 'probable' is to be applied in measuring the tax amounts within the context of IAS 12.46. We also request that the IASB clarifies how the term 'probable' can be applied in the context of tax assets as well as for tax liabilities as it is not clear whether the recognition threshold for tax assets and tax liabilities are the same.

We strongly suggest that the IASB uses the term 'best estimate' instead of the term 'better prediction' in paragraph 16. We consider it would be more appropriate to use familiar terminology (in this case, by referring to the terminology in IAS 37) given that this is an interpretation of the existing standards. Introducing new terminology without explaining the term could lead to unintended consequences.

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?

We agree with the proposal in the draft Interpretation that entities should use judgement to determine whether each uncertain tax treatment should be considered independently, or whether some uncertain tax treatments should be considered together, as part of arriving at the best estimate of the likely outcome.

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 welcome the emphasis in the draft Interpretation that it should be assumed 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. This would eliminate any possibility of entities considering 'the probability of not being detected' when accounting for uncertain tax positions.

However, we are concerned that the words “in the period of change” at the end of paragraph 18, without further explanation, may cause confusion as to whether changes in facts and circumstances relating to uncertain tax positions that occur between the end of the reporting period and the date when the financial statements are authorised for issue should be regarded as adjusting or non-adjusting events. Currently we understand that it is common to analogise to the guidance in IAS 10.9(a) on court cases when considering uncertain tax positions, and therefore to regard additional information received after the reporting date as “adjusting” information if it relates to uncertain tax positions which existed at the reporting date. However, as currently worded, paragraph 18 of the draft Interpretation implies that such information should always be treated as non-adjusting information.

We strongly recommend that explicit guidance should be included in the Interpretation to clarify the application of IAS 10 to uncertain tax positions, as it is not uncommon that information relating to uncertain tax positions will emerge in the period between the reporting date and the date of approval of the financial statements. We consider that given the examples in IAS 10, the current common analogy to IAS 10.9(a) is a reasonable approach for many uncertain tax positions, except when the particular post period end event or change in circumstances could be said to fall into IAS 10.22(h).

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?

With respect to disclosure, we agree with the emphasis of the draft Interpretation by referring to the disclosure requirements in IAS 1 and IAS 12. We consider those disclosure requirements are adequate and appropriate to provide useful and relevant information to users for assessment of uncertain tax positions.

However, we do not support the reference to disclosure of contingent liabilities under IAS 37 for uncertain tax positions as found in paragraph 21 of the draft Interpretation:

- Firstly, we note that the original intention of this draft Interpretation is to clarify that entities should follow IAS 12 instead of IAS 37 for uncertain tax positions.

- Secondly, we are concerned that paragraph 21 of the draft Interpretation is implying that any significant uncertainty surrounding the measurement of a liability is itself a contingent liability. In our view, such an assertion would amount to a fundamental change in the concept of “contingent liabilities” which is not supported by IAS 37 (we note in particular that IAS 37.44 directs the entity to make disclosure under IAS 37.85(b) when there are uncertainties surrounding the measurement of a provision, and does not direct the entity to IAS 37.86). Instead, we consider that in the circumstances described in paragraph 21 of the draft Interpretation, the entity should refer to IAS 1.125 for the relevant disclosure requirements.

With respect to transition, we support the limited retrospective application (that is, recognising the cumulative effect of initially applying the draft Interpretation in the opening balance of retained earnings instead of adjusting the comparative information). However, the draft Interpretation should be clear that information that was not available in prior periods should not be adjusted for by way of restatement.

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