Comment Letters
IASB
30 Cannon Street
London EC4M 6XH
United Kingdom

La Défense, January 19th, 2016

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

Dear Sir or Madam,

MAZARS welcomes the opportunity to comment on the International Accounting Standards Board’s draft IFRIC Interpretation, *Uncertainty over Income Tax Treatments*.

We support the idea that clarifications are useful on this issue and agree with the main propositions of the draft Interpretation.

However, this draft Interpretation brings confirmation that the criteria for recognising tax assets in a situation of uncertainty over the applicable tax treatment differ between income tax and other taxes (or levies). We believe that this divergence in accounting treatments does not appropriately reflect the economic similarity of these situations. Consequently, we encourage the IASB to also review the dispositions which apply to other taxes (or levies) in a situation of uncertainty over tax treatments.

On a more detailed level, we have some specific comments on the illustrative examples and some minor editorial comments.

Our answers to the questions raised in the draft IFRIC Interpretation are shown in the appendix to this letter which summarises our concerns and opinion.
We would be pleased to discuss our comments with you and remain at your disposal should you need further clarification or additional information.

Best regards,

Michel Barbet-Massin
Head of Financial Reporting Technical Support
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?

As regards uncertain tax positions related to income tax, we agree with the proposed scope of the draft Interpretation.

1) Uncertain tax positions related to income tax and uncertain tax positions related to other taxes (or levies)

However, we believe that uncertain tax positions related to income tax and uncertain tax positions related to other taxes (or levies) are very similar in nature (they are often subject to the same examination procedures by taxation authorities).

This similarity is not reflected in existing standards, since the recognition threshold to be applied for tax assets in a situation of uncertainty would be different depending on the nature of the tax (a “probable” threshold in the case of income tax in accordance with the present draft Interpretation of IAS 12; a “virtually certain” threshold in the case of other taxes (or levies) in accordance with IAS 37.33).

As an illustration, we propose to analyse a case similar to the one originally submitted to the IFRS IC but which would concern a tax (or levy) outside the scope of IAS 12:

- Consider the initial submission to the IFRS IC:
  
  o following an examination of its tax report, Entity Z has received a claim from the taxation authorities to pay an additional amount of tax;
  
  o Entity Z expects, but is not virtually certain, that the claimed amount will be reduced after appeal procedures.

- Assume this time that the uncertainty relates to a tax (or levy) outside the scope of IAS 12.

- Then, consider two different jurisdictions:
  
  o in Jurisdiction A: when a tax examination results in an additional charge, an entity is required to make a payment only after appeal procedures have confirmed the additional charge;
  
  o in jurisdiction B: when a tax examination results in an additional charge, tax laws require an entity to make an immediate payment, even if the entity intends to appeal against the additional charge.
- The resulting accounting treatments would be the following:

  o in Jurisdiction A, in application of IAS 37, Entity Z examines the probability that it will have to pay some of the claimed amount after appeal procedures: if Entity Z determines that it is probable, it records a provision for its best estimate of the residual amount due after appeal procedures. In any case, Entity Z’s tax expense is lower than the amount initially claimed by the taxation authorities;

  o in Jurisdiction B, Entity Z records a tax expense for the full amount claimed by taxation authorities (only when the appeal procedures have sufficiently progressed, so that Entity Z is virtually certain that it will recover some of the claimed amount, can Entity Z record an asset related to the expected refund from the tax authorities).

- In situations where the amounts at risk and the probability of incurring an additional tax expense are the same, the application of existing standards leads to completely different accounting impacts only because the jurisdiction’s regulations differ on the timing of payment of the amounts initially claimed as a result of a tax examination.

We encourage the IASB to explore ways to remedy this situation in the future by also reviewing the dispositions which apply to other taxes (or levies) in a situation of uncertainty over tax treatments.

In the meantime, complex issues may arise when uncertainties between income tax and other taxes are interrelated (for instance, when uncertainty over the treatment of a particular tax (or levy) impacts the amount which is deductible for income tax purposes). We believe that adding some examples in the present draft Interpretation to illustrate these interactions would be useful.

2) Uncertain tax positions related to income tax in the context of a business combination (IFRS 3)

It was brought to our attention that, in some countries, there is an uncertainty as to the scope of the limited exception from the recognition and measurement principles of IFRS 3 which is granted for income tax assets and liabilities arising from the assets acquired and liabilities assumed in a business combination (paragraph IN 9 of IFRS 3 clearly indicates that “assets and liabilities affected [by this limited exception] are those falling within the scope of IAS 12”, implying both current and deferred income tax assets and liabilities are concerned, while paragraph 24 of IFRS 3 only mentions a “deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination”).

The application of IFRS 3 recognition and measurement principles to current income tax assets and liabilities would create distortions between initial recognition at fair value and measurement after recognition in accordance with IAS 12 and the present draft Interpretation: typically, in case of uncertainty over the acceptable tax treatment, detection risk would be taken into account in the initial measurement at fair value whereas it would be assumed a 100% detection risk after initial recognition.
We recommend that the IASB should clarify the scope of the limited exception from the recognition and measurement principles of IFRS 3.

**Question 2 – When and how the effect of uncertainty over income tax treatments should be included in the 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 proposals in the draft Interpretation.

However, we have some specific comments on the Illustrative Examples, which are detailed below.

1) **Choice between the “most likely amount” and the “expected value”**

We fear the illustrative examples provided by the draft Interpretation might be too straightforward regarding the choice between the “most likely amount” and the “expected value” to reflect the uncertainty in the measurement of income tax.

We recommend adding more examples to illustrate this new area of judgement.

For instance, to illustrate the fact that uncertainties with multiple possible outcomes do not necessarily entail choosing the expected value, we recommend adding an example where:

- there would be multiple possible outcomes,

- unlike the Example 2 (IE3-IE7) of the draft Interpretation, probabilities would not be evenly distributed between the different outcomes but concentrated on one value - see the following template as an example:


**Estimate of what would be added to the taxable profits:**

<table>
<thead>
<tr>
<th>Estimated outcome, CU</th>
<th>Individual probability, %</th>
<th>Estimate of expected value, CU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outcome 1</td>
<td>0</td>
<td>30%</td>
</tr>
<tr>
<td>Outcome 2</td>
<td>200</td>
<td>5%</td>
</tr>
<tr>
<td>Outcome 3</td>
<td>400</td>
<td>60%</td>
</tr>
<tr>
<td>Outcome 4</td>
<td>1000</td>
<td>5%</td>
</tr>
</tbody>
</table>

100% 300

In this case, the “most likely amount” (CU 400) would likely provide a better prediction of the resolution of the uncertainty than the “expected value” (CU 300).

2) **Uncertainty affecting both current and deferred income tax positions**

We welcome the idea of including an example which illustrates the case of an uncertainty affecting both current and deferred income tax positions.

However, we are not convinced by the relevance of Example 3 (IE 8-12). As shown in our computations below, the strict application of the draft Interpretation here only leads to recording entries of opposite signs in current and deferred tax accounts, the sum of which is equal to zero – throughout the period, if no change in circumstance occurs that would cause the entity to reassess its judgment on the uncertainty.

**Assumptions:**
- No change in circumstance causing the entity to reassess its judgment on the uncertainty
- Tax Rate = 10%

**Impacts on the financial statements:**

<table>
<thead>
<tr>
<th></th>
<th>Y1</th>
<th>Y2</th>
<th>Y3</th>
<th>Y4</th>
<th>Y5</th>
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<td>100</td>
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<td>100</td>
<td>100</td>
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<tr>
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<tr>
<td>Deferred</td>
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I  Current Tax Asset (Liability)

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<tr>
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II  Deferred Tax Liability

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I + II  Net financial position

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In other words, the cumulative impact of current and deferred tax is not different from what would have been recorded in the absence of uncertainty.

This example precisely illustrates a case where the strict application of the draft Interpretation provides information of very little relevance in the financial statements (adding unnecessary complexity to a relatively simple situation).

We believe that this example should be completely rethought.

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.

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 assumption that an entity should assume that the taxation authorities will examine the amounts reported to it and have full knowledge of all relevant information (as explained in the reasoning developed in paragraphs BC12-13 of the draft Interpretation).
In our opinion, the fact that an entity considers it probable that the taxation authorities will reject a particular tax treatment (if they examine this treatment and have full knowledge of all relevant information) clearly indicates that the entity’s best expectation of the applicable tax treatment according to tax laws (taking into account all available evidence, such as information about disputes for other entities’ similar transactions, etc.) differs from the treatment it has retained or expects to retain in its tax filings (even though there may also be some arguments in favour of this treatment).

Therefore, in such a situation, we agree that an entity should measure income tax in its financial statements, not on the basis of the tax treatment it has retained or expects to retain its tax filings, but according to the interpretation it expects from the tax authorities if they examine its tax filings and have full knowledge of all relevant information (in other words, assuming, a probability of 100% that this tax treatment will be examined and a probability of 100% that the subject of uncertainty will be detected by taxation authorities).

We also agree that an entity should reassess its judgments and estimates when facts or circumstances change (such as when the right of the taxation authorities to examine the amounts expires).

Other taxes (or levies): assumptions for taxation authorities’ examinations

In addition to our previous remarks (see Question 1) regarding uncertain tax treatments relating to other taxes (or levies), we would like to point out that the assumptions for taxation authorities’ examinations are yet another source of potentially divergent accounting treatments between income tax and other taxes (or levies).

Indeed, in a situation of uncertainty over the acceptable tax treatment for a tax (or levy) outside the scope of IAS 12, an entity shall determine whether it should recognise a liability in accordance with IAS 37 and its interpretation IFRIC 21.

Assuming that the obligation exists at the end of the reporting period due to a past event, the entity must then assess the probability of an outflow of economic resources to settle the obligation. In doing so, we believe that the proper application of existing standards will lead the entity to make its own assessment of the possibility that the taxation authorities examine this particular tax treatment and detect the subject of uncertainty (without necessarily retaining the assumption of a probability of 100% for these two risks).
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?

As regards the disclosure requirements, we agree with the proposals in the draft Interpretation.

As regards the transition requirements, we generally agree with what is proposed in the draft Interpretation, but believe that there may be some uncertainty as to the extent of relief allowed from a full retrospective application as regards the allocation of the initial cumulative effect of first application (see paragraph B2.(a): “[…]recognising the cumulative effect of initially applying the [draft] Interpretation in the opening balance of retained earnings, or other appropriate components of equity[…]”): did the IASB intend (or not) to provide relief from the allocation of the initial cumulative effect of first application between components of equity? Our understanding is that the IASB did not.

In any case, we believe that this should be clarified in the draft Interpretation.
Other comments

We have some minor editorial comments:

**Paragraph 5:**
“In this [draft] Interpretation, the term ‘tax treatments’ refers to the treatments used or planned expected to be used in an entity’s income tax filings. […]”

**Paragraph A2:**
“If applicable laws and regulations impose a time limit on or after which the taxation authority is no longer able to challenge an entity’s tax treatments (sometimes referred to as a statute of limitations), an entity shall reflect this change of circumstances when these rights expire. […]”

**Paragraph IE10:**
“Entity C observes that the most likely amount that the taxation authority will accept as the deductible amount for Year 1 will be CU10. Consequently, the most likely amount for the corresponding tax base for the intangible asset at the end of Year 1 will be CU90.”

**Paragraph IE12:**
“[…] (This is because Entity C deducted CU100 from taxable income for Year 1 in its tax filing, whereas the most likely amount was CU10. Entity C concluded that it is not probable that the tax treatment will be accepted.)”