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## IFRIC 23 *Uncertainty over Income Tax Treatments* Illustrative Examples

*These examples accompany, but are not part of, IFRIC 23.*

- IE1 These examples portray hypothetical situations illustrating how an entity might apply some of the requirements in IFRIC 23 based on the limited facts presented. In all the examples, as required by paragraph 8 of IFRIC 23, the entity has assumed that the taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations.

### Example 1—The expected value method is used to reflect the effect of uncertainty for tax treatments considered together

- IE2 Entity A's income tax filing in a jurisdiction includes deductions related to transfer pricing. The taxation authority may challenge those tax treatments. In the context of applying IAS 12, the uncertain tax treatments affect only the determination of taxable profit for the current period.
- IE3 Entity A notes that the taxation authority's decision on one transfer pricing matter would affect, or be affected by, the other transfer pricing matters. Applying paragraph 6 of IFRIC 23, Entity A concludes that considering the tax treatments of all transfer pricing matters in the jurisdiction together better predicts the resolution of the uncertainty. Entity A also concludes it is not probable that the taxation authority will accept the tax treatments. Consequently, Entity A reflects the effect of the uncertainty in determining its taxable profit applying paragraph 11 of IFRIC 23.
- IE4 Entity A estimates the probabilities of the possible additional amounts that might be added to its taxable profit, as follows:

	Estimated additional amount, CU <sup>(a)</sup>	Probability, %	Estimate of expected value, CU
Outcome 1	–	5%	–
Outcome 2	200	5%	10
Outcome 3	400	20%	80
Outcome 4	600	20%	120
Outcome 5	800	30%	240
Outcome 6	1,000	20%	200
		100%	650

(a) In these Illustrative Examples, currency amounts are denominated in 'currency units' (CU)

- IE5 Outcome 5 is the most likely outcome. However, Entity A observes that there is a range of possible outcomes that are neither binary nor concentrated on one value. Consequently, Entity A concludes that the expected value of CU650 better predicts the resolution of the uncertainty.
- IE6 Accordingly, Entity A recognises and measures its current tax liability applying IAS 12 based on taxable profit that includes CU650 to reflect the effect of the uncertainty. The amount of CU650 is in addition to the amount of taxable profit reported in its income tax filing.

## Example 2—The most likely amount method is used to reflect the effect of uncertainty when recognising and measuring deferred tax and current tax

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- IE7 Entity B acquires for CU100 a separately identifiable intangible asset that has an indefinite life and, therefore, is not amortised applying IAS 38 *Intangible Assets*. The tax law specifies that the full cost of the intangible asset is deductible for tax purposes, but the timing of deductibility is uncertain. Applying paragraph 6 of IFRIC 23, Entity B concludes that considering this tax treatment separately better predicts the resolution of the uncertainty.
- IE8 Entity B deducts CU100 (the cost of the intangible asset) in calculating taxable profit for Year 1 in its income tax filing. At the end of Year 1, Entity B concludes it is not probable that the taxation authority will accept the tax treatment. Consequently, Entity B reflects the effect of the uncertainty in determining its taxable profit and the tax base of the intangible asset applying paragraph 11 of IFRIC 23. Entity B concludes the most likely amount that the taxation authority will accept as a deductible amount for Year 1 is CU10 and that the most likely amount better predicts the resolution of the uncertainty.
- IE9 Accordingly, in recognising and measuring its deferred tax liability applying IAS 12 at the end of Year 1, Entity B calculates a taxable temporary difference based on the most likely amount of the tax base of CU90 (CU100 – CU10) to reflect the effect of the uncertainty, instead of the tax base calculated based on Entity B's income tax filing (CU0).
- IE10 Similarly, as required by paragraph 12 of IFRIC 23, Entity B reflects the effect of the uncertainty in determining taxable profit for Year 1 using judgements and estimates that are consistent with those used to calculate the deferred tax liability. Entity B recognises and measures its current tax liability applying IAS 12 based on taxable profit that includes CU90 (CU100 – CU10). The amount of CU90 is in addition to the amount of taxable profit included in its income tax filing. This is because Entity B deducted CU100 in calculating taxable profit for Year 1, whereas the most likely amount of the deduction is CU10.

## Basis for Conclusions on IFRIC 23 *Uncertainty over Income Tax Treatments*

*This Basis for Conclusions accompanies, but is not part of, IFRIC 23. It summarises the considerations of the IFRS Interpretations Committee (the Committee) in reaching its consensus.*

### Background

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- BC1 The Committee received a question asking when it is appropriate for entities to recognise a current tax asset if tax laws require entities to make payments in respect of a disputed tax treatment. In the circumstance the question described, the entity intended to appeal a tax ruling.
- BC2 IAS 12 *Income Taxes* includes requirements on recognition and measurement of tax assets and liabilities, but does not specify how to reflect uncertainty. The Committee observed that entities apply diverse reporting methods when the application of tax law is uncertain.
- BC3 Accordingly, in October 2015 the Committee published a draft Interpretation *Uncertainty over Income Tax Treatments* for public comment. It received 61 comment letters. The Committee considered the comments received in developing this Interpretation.

### Scope

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- BC4 The question that the Committee received related to a particular circumstance in which an entity is required to make a payment to a taxation authority in respect of a disputed income tax treatment. However, in discussing the issue, the Committee noted that a similar question could arise in other circumstances in which there is uncertainty over income tax treatments. Consequently, the Committee decided that the Interpretation should address the accounting for income taxes whenever tax treatments involve uncertainty that affects the application of IAS 12. Respondents to the draft Interpretation generally supported the scope that the Committee proposed.
- BC5 Uncertainty over income tax treatments may affect both current and deferred tax. For example, the timing of deductibility of the cost of an intangible asset under tax law may be uncertain and this may affect both taxable profit and the tax base of the asset, which in turn affects the determination of current and deferred tax respectively. The Committee decided to require a consistent approach to reflecting the effect of uncertainty for both current and deferred tax; therefore, the Interpretation applies in determining both current and deferred tax.
- BC6 The Committee developed the Interpretation as an interpretation of IAS 12, ie the requirements in the Interpretation add to, and complement, the requirements in IAS 12. The Committee decided not to expand the scope of the Interpretation to taxes or levies outside the scope of IAS 12 because it was concerned that a wider scope might create conflicts within IFRS Standards.

### Interest and penalties

- BC7 IAS 12 does not explicitly refer to interest and penalties payable to, or receivable from, a taxation authority, nor are they explicitly referred to in other IFRS Standards.
- BC8 A number of respondents to the draft Interpretation suggested that the Interpretation explicitly include interest and penalties associated with uncertain tax treatments within its scope. Some said that entities account for interest and penalties differently depending on whether they apply IAS 12 or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to those amounts.
- BC9 The Committee decided not to add to the Interpretation requirements relating to interest and penalties associated with uncertain tax treatments. Rather, the Committee noted that if an entity considers a particular amount payable or receivable for interest and penalties to be an income tax, then that amount is within the scope of IAS 12 and, when there is uncertainty, also within the scope of this Interpretation. Conversely, if an

entity does not apply IAS 12 to a particular amount payable or receivable, then this Interpretation does not apply to that amount, regardless of whether there is uncertainty.

## Consensus

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### Whether an entity considers uncertain tax treatments separately

- BC10 The amount of a tax asset or liability could be affected by whether an entity considers each uncertain tax treatment separately or together with one or more other uncertain tax treatments. Consequently, the Committee decided to include the requirement in paragraph 6 of the Interpretation in this respect. The Committee noted that an entity may need to use judgement in applying that requirement.

### Examination by taxation authorities

- BC11 The Committee decided that an entity should assume a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information. In making this decision, the Committee noted that paragraphs 46–47 of IAS 12 require an entity to measure tax assets and liabilities based on tax laws that have been enacted or substantively enacted.
- BC12 A few respondents to the draft Interpretation suggested that an entity consider the probability of examination, instead of assuming that an examination will occur. These respondents said such a probability assessment would be particularly important if there is no time limit on the taxation authority's right to examine income tax filings.
- BC13 The Committee decided not to change the examination assumption, nor create an exception to it for circumstances in which there is no time limit on the taxation authority's right to examine income tax filings. Almost all respondents to the draft Interpretation supported the examination assumption. The Committee also noted that the assumption of examination by the taxation authority, in isolation, would not require an entity to reflect the effects of uncertainty. The threshold for reflecting the effects of uncertainty is whether it is probable that the taxation authority will accept an uncertain tax treatment. In other words, the recognition of uncertainty is not determined based on whether a taxation authority examines a tax treatment.

### Determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates

#### When to reflect the effect of uncertainty

- BC14 Paragraph 24 of IAS 12 requires the recognition of deferred tax assets to the extent that it is probable that an entity will be able to use deductible temporary differences against taxable profit. The objective of IAS 12 also refers to a probable threshold in the context of deferred tax. In addition, although IAS 12 does not include an explicit recognition threshold for current tax, paragraph 14 of IAS 12 implies that a probable threshold applies to current tax assets arising from a tax loss.
- BC15 Consequently, the Committee decided that an entity should reflect the effect of uncertainty in accounting for current and deferred tax when the entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment (and thus, it is probable that the entity will receive or pay amounts relating to the uncertain tax treatment).
- BC16 The Committee concluded that setting this explicit threshold for the recognition of the effect of uncertainty will increase comparability among entities and reduce some of the costs of measurement.

#### How to reflect the effect of uncertainty

- BC17 To reflect the effect of uncertainty, the Committee decided that an entity should use the expected value or the most likely amount, whichever method better predicts the resolution of the uncertainty. This approach is

similar to the approach used in IFRS 15 *Revenue from Contracts with Customers* to estimate the amount of variable consideration in a revenue contract.

- BC18 The Committee considered whether to permit or require the use of a third measurement method, such as a ‘cumulative-probability approach’ (ie the measurement method used to reflect uncertainty over income tax treatments in US Generally Accepted Accounting Principles). The Committee observed that the inclusion of a third method would have complicated the judgements that need to be made in applying the Interpretation. This is because an entity would have had to assess which of three measurement methods best predicts the resolution of the uncertainty. The Committee also noted that IFRS Standards do not use the cumulative-probability approach, whereas the expected value and the most likely amount are used elsewhere in the Standards. Including a measurement method not used elsewhere in the Standards might have reduced comparability.
- BC19 Consequently, the Committee decided not to permit or require a third measurement method to reflect the effects of uncertainty.

## Changes in facts and circumstances

- BC20 Considering uncertainty over income tax treatments means it is necessary to make estimates, and such estimation involves judgements based on available information. The information available to an entity about uncertain tax treatments can change over time. Consequently, the Committee decided that an entity should reassess a judgement or estimate required by the Interpretation when related facts and circumstances change.
- BC21 The Committee also decided that an entity should reflect the effect of any changes in its judgements or estimates consistently with the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for changes in accounting estimates.

## Disclosure

- BC22 IAS 1 *Presentation of Financial Statements* and IAS 12 provide disclosure requirements that may be relevant when there is uncertainty over income tax treatments. Consequently, instead of introducing new disclosure requirements, the Committee decided to highlight those existing requirements in the Interpretation.

## Business combinations

- BC23 The Committee considered whether the Interpretation should address the accounting for tax assets and liabilities acquired or assumed in a business combination when there is uncertainty over income tax treatments. The Committee noted that IFRS 3 *Business Combinations* applies to all assets acquired and liabilities assumed in a business combination. Consequently, the Committee concluded that the Interpretation should not explicitly address tax assets and liabilities acquired or assumed in a business combination.
- BC24 Nonetheless, paragraph 24 of IFRS 3 requires an entity to account for deferred tax assets and liabilities that arise as part of a business combination applying IAS 12. Accordingly, the Interpretation applies to such assets and liabilities when there is uncertainty over income tax treatments that affect deferred tax.

## Transition

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- BC25 The Committee observed that retrospective application of the Interpretation without the use of hindsight would often be impossible for entities. Consequently, the Committee decided not to require the restatement of comparative information when an entity first applies the Interpretation. However, the Committee concluded that an entity should not be prevented from applying the Interpretation retrospectively if it is able to do so without the use of hindsight. Consequently, the Committee decided to permit retrospective application if that is possible without the use of hindsight.

## First-time adopters

- BC26 The Committee observed that if a first-time adopter's date of transition to IFRSs is before the date the Interpretation is issued, the first-time adopter may face the same hindsight difficulties as entities that already apply IFRS Standards. Consequently, the Committee decided not to require first-time adopters whose date of transition to IFRSs is before 1 July 2017 to present in their first IFRS financial statements comparative information that reflects this Interpretation.