European Securities and Markets Authority

The Chair

Date: 14 January 2016
ESMA/2016/34

Ms Françoise Flores
European Financial Reporting Advisory Group (EFRAG)
35 Square de Meeûs
1000 Brussels
Belgium

Ref: Draft IFRIC Interpretation: Uncertainty over Income Tax Treatments

Dear Mrs Flores,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to the EFRAG's due process. ESMA has considered EFRAG's draft comment letter to the IFRS Interpretation Committee's (IFRS IC) draft IFRIC Interpretation *Uncertainty over Income Tax Treatments*. We are pleased to provide you with the following comments with the aim of improving the enforceability of IFRSs and the transparency and decision usefulness of financial statements.

Like EFRAG, ESMA agrees with the draft Interpretation as it addresses the existing diversity in practice. ESMA is of the view that this draft Interpretation would enhance consistent application and enforceability of requirements of IAS 12 *Income Taxes.*

Our detailed comments on the draft Interpretation are set out in the Appendix I to this letter. Please do not hesitate to contact us should you wish to discuss all or any of the issues we have raised.

Yours sincerely,

Steven Maijoor

Appendix I – ESMA's detailed answers to the questions in the ED

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?

1. ESMA agrees with the scope of the draft Interpretation as it is focused on providing guidance on uncertain income tax treatments. We note that this area is not explicitly addressed by IAS 12.

2. ESMA points to the existing diversity in practice for the recognition and measurement of uncertain income tax assets and liabilities, for which some issuers apply the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and others those of IAS 12. We are of the view that this draft Interpretation will adequately address this diversity in practice.

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

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?

3. ESMA agrees 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.

4. In particular, ESMA agrees that if an entity concludes that it is probable that the taxation authority will accept an uncertain income tax treatment, the entity should determine its taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the income tax treatment included in its income tax filings. This is because the income tax filings provide the best estimate of the impact on income tax-related cash flows.

5. ESMA equally agrees that if an entity concludes that it is not probable that the taxation authority will accept an uncertain income tax treatment, the entity should 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 entity should use the method that it concludes will provide better prediction of the resolution of the uncertainty. Consistent with the arguments of the IFRS IC in paragraph BC 18, we are of the view that in absence of other guidance in IAS 12, the use of the principle consistent with the guidance on estimating variable consideration in IFRS 15 *Revenue from Contracts with Customers* is appropriate for these circumstances.

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?

6. ESMA agrees that entities are required to use judgement to determine whether each uncertain tax treatment should be considered independently, or whether some uncertain tax treatments should be considered on a collective basis.

7. ESMA believes that where disputes with the tax authority in a specific case relate to other uncertain income tax positions, the group of uncertain income tax treatments should be viewed as a single unit of account. Accounting for similar uncertain income tax positions as separate units of account may not provide consistent or comparable information.

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?

8. ESMA agrees with the assumption 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 (100 per cent detection risk).ESMA also agrees with the requirement to consider changes in facts and circumstances and the related guidance.

Question 5 – Other topics

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.

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?

9. ESMA agrees with the proposed way the draft Interpretation refers to the existing disclosure requirements in IAS 1, IAS 12 and IAS 37. In our view this provides an adequate and appropriate way to address disclosures related to uncertain income tax positions.

10. ESMA agrees with the proposal to apply the modified retrospective method on transition. ESMA also agrees that the draft Interpretation permits full retrospective application in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* if this information is available without the use of hindsight.

11. Furthermore, ESMA notes that paragraphs BC 17 and BC 18 refer to the requirements of the existing Conceptual Framework. However, the Basis for Conclusions neither includes a reference to the Exposure Draft on Revisions of the Conceptual Framework nor discusses possible implications of the new recognition criteria on the draft Interpretation. ESMA points that paragraph BC 26 of the draft IFRIC Interpretation *Foreign Currency Transactions and Advance Considerations* includes such analysis.