Nexia Australia

Accounting Update

Accounting for Uncertain Tax Positions

August 2017

Companies may be required to recognise amounts in dispute with the Australian Tax Office (ATO) in their financial reports, under new guidance issued by the Australian Accounting Standards Board (AASB).

AASB Interpretation 23 *Uncertainty over Income Tax Treatments* mirrors new guidance from the IFRS Interpretations Committee (IFRIC). Interpretation 23 provides guidance on applying AASB 112 *Income Taxes*, explaining how entities should respond when they are unsure about how tax law applies to a particular transaction or whether the taxation authority will accept their proposed treatment.

Previously an entity needed to recognise a tax liability if it was probable that it would need to pay additional tax. In making that assessment, it may have considered factors such as whether the tax position taken was reasonably supportable and the likelihood of the tax authority not accepting its income tax filing or conducting a tax audit.

However the new interpretation now requires an entity to assume that the tax authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations. This is regardless of whether the entity has had, or is likely to have, a tax audit.

If an entity concludes it is probable that the taxation authority will accept an uncertain tax treatment, the entity determines its taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used.

However if an entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment, it determines the related tax balances using the method that better predicts the resolution of the uncertainty, being either:

a. the most likely amount - the single most likely amount in a range of possible outcomes; or

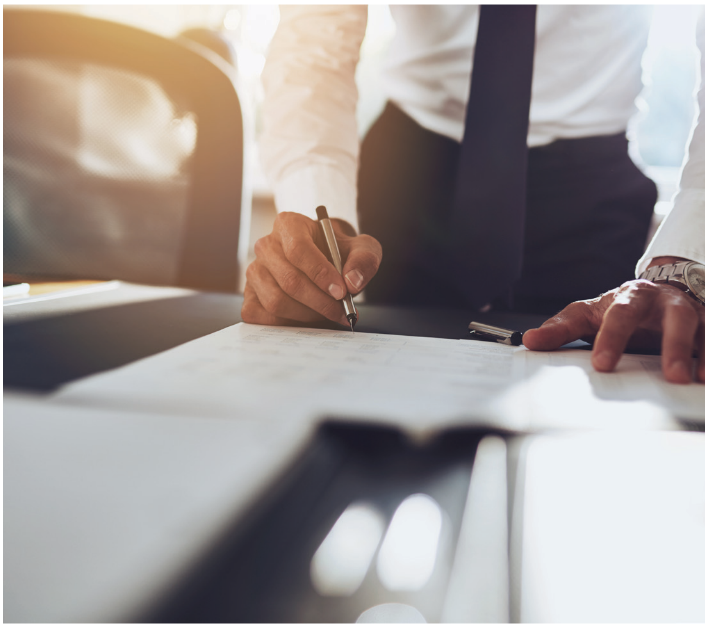
b. the expected value - the sum of the probability-weighted amounts in a range of possible outcomes.

Consequently, the probability threshold is applied at an earlier point in the process. Assuming full knowledge of the facts, if it is probable that the tax authority will not accept the entity's tax treatment, a tax liability (or adjustment to other deferred tax balances) for the expected settlement amount must be recognised in the statement of financial position. Even if it is probable that the tax authority will accept the treatment, directors still need to assess whether disclosure of a tax-related contingent liability is appropriate.

ATO Deputy Commissioner Jeremy Hirschhorn said "In applying the new rules, companies should have regard to ATO public guidance as to what we are likely to dispute, as well as to the ATO's success in disputed matters in determining the likely resolution when we do dispute. When companies are in doubt as to their tax positions, we strongly encourage them to engage with us to obtain certainty rather than be exposed to significant uncertain positions, which rarely improve with time."

If facts and circumstances on which an entity's judgements or estimate was based change or new information affects its conclusions about the acceptability of a tax treatment, such changes are recognised prospectively as a change in accounting estimate.

"Tax is a focus area for ASIC's review of financial reports as at 30 June 2017. Directors should consider the appropriate treatment of uncertain and disputed tax positions in financial reports, including whether there is a need to recognise a liability or disclose a contingent liability", ASIC Commissioner John Price said.



Application

Interpretation 23 applies for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted.

On initial application, Interpretation 23 can be applied either:

a. retrospectively, by applying AASB 108, if that is possible without the use of hindsight; or

b. retrospectively with the cumulative effect of initially applying the Interpretation recognised at the date of initial application. If an entity selects this transition approach, it does not restate comparative information.

Next steps

The introduction Interpretation 23 is likely to impact the recognition of income tax balances of some entities. We recommend directors engage with their Nexia tax advisor and our Financial Reporting Advisory specialists to discuss the extent and current treatment of uncertain tax positions and how Interpretation 23 may affect your financial report.

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