



European Securities and
Markets Authority

The Chair

Date: 19 December 2017

ESMA32-63-413

**Sue Lloyd
Chair of the IFRS Interpretations
Committee
30 Cannon Street
London EC4M 6XH
United Kingdom**

Agenda Item Request: Voluntary tax payments related to uncertain tax positions

Dear Mrs Lloyd,

DEAR SUE,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to enhancing the protection of investors and promoting stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. In the context of its convergence work in the area of financial reporting, I would like to raise the following issue with you.

As a result of the reviews of financial statements carried out by national competent authorities and ESMA's co-ordination activities, we have identified divergent practices across the EU regarding the application of IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets* in the area of the recognition and measurement of voluntary payments to tax authorities. Accordingly, ESMA kindly suggests that the IFRS Interpretations Committee considers clarifying the relevant accounting requirements.

A detailed description of the case is set out in the appendix to this letter.

In case you have any questions or comments regarding this letter, I suggest you contact Evert van Walsum, Head of the Investors and Issuers Department (Evert.vanWalsum@esma.europa.eu).

Yours sincerely,



Steven Maijoor

APPENDIX – DETAILED DESCRIPTION OF THE ISSUE

1. As part of their monitoring and supervisory activities, ESMA and national enforcers have identified divergent accounting treatment for uncertain tax positions with respect to taxes other than income taxes in scope of IAS 12 – *Income Taxes* (thereafter ‘other taxes’). This particular issue relates to the recognition and measurement of a voluntary payment of these taxes to a tax authority in respect to uncertain tax position(s).

Description of the issue

2. An issuer is involved in a dispute with a tax authority. Voluntarily (e.g. in order to avoid possible penalties or interest based on the applicable tax code), it decides to make a payment of the disputed amount to the respective tax authority. In some circumstances, depending on the jurisdiction, the money paid is held in escrow by the tax authority, pending the resolution of the dispute, at which point, it will be either returned to the issuer or used to settle the tax liability from the dispute. From a legal perspective, the payment of the amount to the tax authority does not change the legal situation but represents a way to avoid the penalties or interests on the disputed amount.
3. The issuer does not believe that it is probable that any tax liability will arise in relation to the disputed amount and, consequently, it did not recognise any obligation in this regard when applying the respective requirements of IAS 37. As IFRS does not include explicit guidance regarding the recognition and measurement of uncertain tax positions concerning other taxes (it was also explicitly excluded from the scope of IFRIC 23 - *Uncertainty over Income Tax Treatments* during deliberations on that Interpretation), this submission assumes that the liability was correctly assessed and not recognised using the criteria and requirements of IAS 37.
4. Consequently, this submission is limited to the recognition of the asset resulting from the payment concerning this uncertain tax position rather than the appropriateness of the recognition of the liability concerning the disputed amount.

View 1: The paid amount should be recognised as an asset

5. Paragraph 10 of IAS 37 defines a contingent asset as a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
6. Under View 1, there is no uncertainty regarding the existence of the asset. The payment represents an asset, as it will be either refunded from the tax authority or it will be used to settle the tax liability arising from the resolution of the dispute. Accordingly, proponents of View 1 assert that the asset arising from the payment is not a contingent asset as the uncertain future event will merely confirm the means of recovery of this asset (i.e. refund or use to settle the future liability) rather than its existence.
7. Furthermore, proponents of View 1 believe it would be inconsistent with the IFRS to make the recognition of an expense with regards to the uncertain tax position dependent only on the payment of cash. In their view, recognition of an expense (instead of an

- asset) would be inconsistent whenever the issuer assesses that it is not probable that any tax liability will arise in relation to the disputed amount. Consequently, the accounting treatment of the cash payment would inappropriately override the requirement not to recognise any liability in respect of the uncertain tax position stemming from the requirements of IAS 37.
8. As soon as the issuer considers probable that the dispute will result in some or all of the payments being retained by the tax authority to settle any tax liability arising from the dispute, it should recognise an expense and use the (part of the) asset to settle the arising liability.
 9. As IFRS does not include any specific guidance on recognition and measurement of these types of assets¹, in the view of the proponents of View 1, the issuer can develop an accounting policy analogising to recognition and measurement criteria for intangible assets² or using paragraphs 10-12 of IAS 8. Such accounting policy would be based on the definition of an asset in the Conceptual Framework for Financial Reporting^{3,4} (hereafter “the Conceptual Framework”).
 10. In accordance with paragraph 4.4 of the Conceptual Framework (equivalent to paragraph 8 of IAS 38), an asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
 11. Proponents of this view believe that this asset meets the definition of an asset in the Conceptual Framework as the payment is a resource :
 - a. stemming from the cash payment that occurred in the past;
 - b. embodying future economic benefits that are expected to flow to the issuer in form of either a refund from the tax authority or decrease of tax liability that will arise from the resolution of the dispute;
 - c. economic benefits which the issuer has the capacity to control. The capacity of the issuer to control benefits is the reflection of the existing legal rights of the issuer (cf. paragraph 4.12 of the Conceptual Framework). In this case it can be argued that the issuer has legal rights to the future economic benefits (refund of payment or payment of the liability arising from the dispute) even if the mode of recovery of these benefits is outside of its control.

¹ As it is not a contingent asset, IAS 37 does not apply

² If the payment is considered to be a prepayment, some argue that the recognition and measurement criteria of IAS 38 *Intangible Assets* might be relevant. However, as paragraph 70 of IAS 38 provided guidance on prepayments in relation to payments for goods and services, it seems that requirements of IAS 38 can be applied only by analogy.

³ In line with the IFRS Interpretations Committee agenda decision on *Interest and penalties related to income taxes* from September 2017, entities do not have an accounting policy choice between applying IAS 12 and applying IAS 37 to interest and penalties. Instead, if an entity considers a particular amount payable or receivable for interest and penalties to be an income tax, then the entity applies IAS 12 to that amount. If an entity does not apply IAS 12 to a particular amount payable or receivable for interest and penalties, it applies IAS 37 to that amount. Using the rationale of this agenda decision, as the issuer assessed that the uncertain tax positions relates to taxes other than income taxes in scope of IAS 12, requirements of IAS 12 are unlikely to be used in these circumstances, thus leading the issuer to revert to the underlying criteria of asset recognition in the Conceptual Framework.

⁴ Similarly, the requirements of IAS 32 *Financial Instruments Presentation* do not seem to be applicable as the voluntary payment is not linked to a *contract* as required by paragraph 11 of IAS 32 thus reducing the relevance to apply this guidance by analogy.

12. Proponents of this view argue that the asset meets the criteria to be recognised in accordance with the Conceptual Framework, and consequently, it should be initially recognised in the amount of cash paid (considering that no IFRS precludes the value of this asset). However, subsequent measurement of such asset remains unclear (i.e. it is not clear which guidance would apply to its measurement).

View 2: The prepaid amount should not be recognised as an asset but as an expense

13. Proponents of View 2 are of the opinion that the amount paid should be considered a contingent asset under paragraph 10 of IAS 37. In their view, the uncertain future event is a favourable outcome of a tax dispute and this uncertainty affects the existence of the asset rather than only the mode of its recovery.
14. Proponents of View 2 analogise this with the accounting treatment of a lawsuit of which the outcome is uncertain. In the context of such an analogy, paragraph 32 of IAS 37 states that contingent assets usually arise from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the entity. According to IAS 37, an example of a contingent asset *'is a claim that an entity is pursuing through legal processes, where the outcome is uncertain'*.
15. As a consequence, taking into account that the decision on the reimbursement or use of the payment is not within the control of the entity as referred to in IAS 37, it could be argued that the payment itself represents a contingent asset.
16. In particular, proponents of View 2 believe that IAS 37 introduces asymmetry in the recognition of an asset and recognition of a liability. The threshold for the recognition of a liability from the "other taxes" uncertain tax position is assessed with reference to whether the outflow of economic benefits from the dispute is more likely than not. On the other hand, any asset resulting from the payment to avoid any additional interest or penalty payment can be recognised only to the extent that the reimbursement is virtually certain.
17. Finally, when assessing the recognition of the asset, proponents of View 2 dispute that the future economic benefit are controlled by the entity, as the right to be reimbursed is dependent of a court decision which is outside the control of the issuer. Consequently, this, contrary to argument in paragraph 11(c) above, precludes the recognition of an asset in these circumstances.

Request

18. ESMA seeks clarification on whether and on which basis the amounts related to voluntary payments to tax authorities in relation to uncertain tax positions should be recognised. Furthermore, in light of the absence of explicit IFRS guidance and the fact that such payments are common in a number of jurisdictions, ESMA requests clarification on the subsequent measurement (or re-assessment) of these amounts.
19. ESMA is aware of divergent practices in various European jurisdictions. Accordingly, ESMA kindly suggests that the IFRS Interpretations Committee considers clarifying the accounting requirements in this respect.