<u>TECHNICAL CIRCULAR</u>:	**11/2021 [TC 11_2021]**
To:	**ALL MEMBERS OF THE INSTITUTE**
From:	**Accounting Standards Committee**
Date:	**24 November 2021**
Subject:	**IFRIC 23 *Uncertainty over income tax treatments* applicable for annual reporting periods beginning on or after 1 January 2019**

The Institute of Certified Public Accountants of Cyprus (ICPAC) wishes with this circular to provide its members with guidance in relation to IFRIC 23 *Uncertainty over income tax treatments* (IFRIC 23 or the Interpretation).

1. INTRODUCTION

The IFRS Interpretations Committee (hereinafter "IFRS IC") observed that IAS 12 *Income Taxes* does not specify how uncertainty in tax treatments is reflected in the measurement of current and deferred tax assets and liabilities. As a result, this has led to diversity in practice.

Accordingly, the IFRS IC developed IFRIC 23 to address how to reflect uncertainty in the recognition and measurement of income taxes. The Interpretation provides guidance on considering uncertain tax treatments separately or together, examination by taxation authorities, the appropriate method to reflect uncertainty and accounting for changes in facts and circumstances.

IFRIC 23 is effective for annual periods beginning on or after 1 January 2019, with early application permitted. The Interpretation should be applied either retrospectively, by applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* if it is possible to do so without the use of hindsight, or by using a modified retrospective approach with an initial catch-up adjustment recorded in the opening equity of the period of initial application.

ΣΥΝΔΕΣΜΟΣ ΕΓΚΕΚΡΙΜΕΝΩΝ ΛΟΓΙΣΤΩΝ ΚΥΠΡΟΥ
Λεωφόρος Βύρωνος 11, 1096 Λευκωσία
Τ.Θ. 24935, 1355 Λευκωσία, Κύπρος
Τ.: +357 22870030, Φ.: +357 22766360

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF CYPRUS
11 Byron Avenue, 1096 Nicosia
P.O. Box 24935, 1355 Nicosia, Cyprus
T.: +357 22870030, F.: +357 22766360

info@icpac.org.cy
www.icpac.org.cy

2. SCOPE OF IFRIC 23

IFRIC 23 was developed as an interpretation of IAS 12 and therefore, it relates only to income taxes within the scope of IAS 12. In addition, IFRIC 23 applies when there is uncertainty over income tax treatments that may affect both current and deferred taxes.

For an entity to define 'uncertainty', the entity only needs to consider whether a certain tax treatment is probable, rather than highly likely or certain, to be accepted by the taxation authorities.

In summary, if an entity determines it is probable that a tax treatment will be accepted, then it will measure its income taxes on that basis. However, if the entity believes the likelihood of acceptance is not probable, would there be an uncertain tax treatment to be addressed by IFRIC 23.

3. RECOGNITION AND MEASUREMENT

Where an entity concludes that there is uncertainty over income tax treatment it should apply the IFRIC 23 guidance. The Interpretation considers the following which are discussed in more detail in this Section:

1. Whether to consider uncertain tax treatments separately;
2. The assumptions regarding the examination of tax treatments by Tax authorities;
3. Determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates (together referred to as 'tax positions')
4. Changes in facts and circumstances.

3.1. Consideration of uncertain tax treatments separately

An entity shall determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments based on which approach better predicts the resolution of the uncertainty [IFRIC 23, paragraph 6].

Therefore, IFRIC 23 requires an entity to make this determination based on a judgement of which approach better makes this prediction. Factors to consider include, but are not limited to, how the entity prepares its income tax filings and supports its tax treatments, its expectation on how the taxation authorities will examine and resolve issues that might arise from that examination, the extent to which the outcomes of uncertain tax treatments are mutually dependent and past resolution of similar tax issues.

3.2. Examination of tax treatments by Tax Authorities

IFRIC 23 requires an entity to assume that the Tax authority can, and will, examine amounts it has a right to examine and have full knowledge of all related information when making those examinations. As such, the Interpretation requires an entity to assume a 100% detection risk. Therefore, the recognition of uncertainty is not determined based on whether a taxation authority examines a tax treatment.

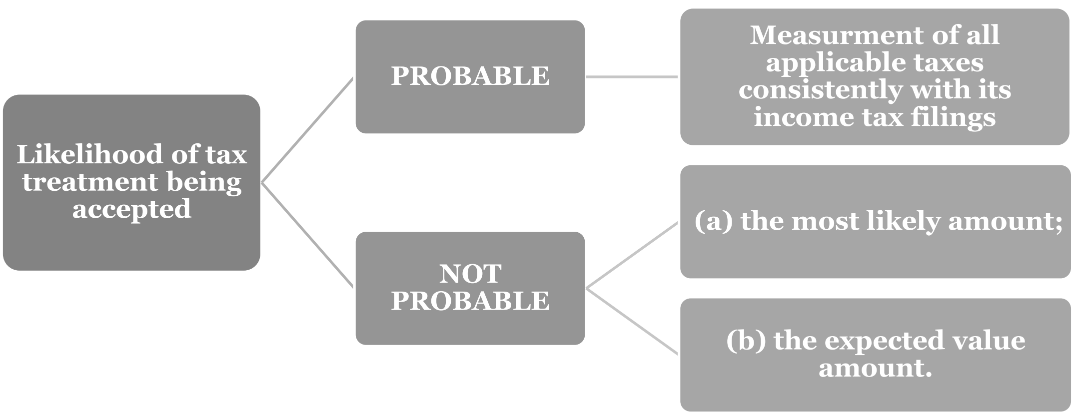
3.3. Determination of Tax positions

Once an entity concludes that there is uncertainty in the tax treatment, it must also consider whether it is probable that the taxation authority will accept such tax treatment. The threshold in IFRIC 23 is 'probable'. The term 'probable' is defined in IFRS as 'more likely than not'.

Under IFRIC 23, if the entity determines that a treatment used in the tax return is more likely than not to be accepted by the taxation authorities, that treatment is applied for the measurement of income taxes.

Therefore, the probable threshold treats all likelihoods beyond that threshold the same way. That is, any likelihood of acceptance by the taxation authority beyond the probable threshold is treated the same way as 100% likelihood of acceptance. If the likelihood of acceptance is determined to be probable, an entity would not reflect the effect of uncertainty in determining the applicable taxes.

If the entity is unable to conclude that acceptance by the taxation authorities is probable, it reflects the uncertainty in the manner that better predicts the resolution of the uncertain tax treatment. Judgement should be applied for an entity to conclude as to whether it is probable that a particular uncertain tax treatment will be acceptable to the taxation authority.



Illustrative Examples

<u>Example 1: Use of the expected value method</u>

Entity A's income tax filing in a jurisdiction includes some deductions which the taxation authority may challenge. In the context of applying IAS 12, the uncertain tax treatments affect only the determination of taxable profit for the current period. Entity A 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. Entity A estimates the probabilities of the possible additional amounts that might be added to its taxable profit, as follows:

Outcome No.	***Estimated additional amount (€)***	***Probability (%)***	***Estimate of expected value (€)***
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***

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 €650 better predicts the resolution of the uncertainty. Accordingly, Entity A recognises and measures its current tax liability applying IAS 12 based on taxable profit that includes €650 to reflect the effect of the uncertainty. The amount of €650 is in addition to the amount of taxable profit reported in its income tax filing.

<u>Example 2: Use of the most likely amount method</u>

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 of Entity B jurisdiction 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.

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 (IFRS 23, paragraph 11). 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. 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).

Similarly, 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.

3.4. Changes in facts and circumstances

IFRIC 23 requires an entity to reassess those judgements and estimates if the facts and circumstances on which the judgement or estimate was based change or new information that affects the judgement or estimate is available. For example, this may include changes in rules established by Taxation Authorities, examination or actions by the Taxation Authority etc.

The absence of agreement or disagreement by a taxation authority with a tax treatment, in isolation, is unlikely to constitute a change in facts and circumstances or new information that affects the judgements and estimates required by this Interpretation [IFRIC 23, Paragraph A3]. In such situations, an entity must consider other available facts and circumstances before concluding that a reassessment of the judgements and estimates is required.

If the judgements and/or estimates have been assessment as changed, then the entity will reflect that change prospectively in accordance with IAS 8 as a change in accounting estimate. If the change takes place after the reporting period and before the financial statements are authorised for issue, the entity must apply IAS 10 *Events after the Reporting Period* to determine whether a change that occurs after the reporting period is an adjusting or non-adjusting event.

4. DISCLOSURES

IFRIC 23 has not introduced any new disclosures. Instead, the application guidance to the Interpretation refers to the existing disclosure requirements in IAS 1 *Presentation of Financial Statements* and IAS 12. To this respect, an entity must disclose, along with its significant policies or other notes related to income taxes, the judgements (apart from those involving estimations) that management has made in the process of applying the entity's accounting policy on uncertain income tax treatments that have the most significant effect on the current and deferred tax amounts recognised in the financial statements [IAS 1, paragraph 122].

Additionally, an entity must disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the current and deferred tax assets and liabilities within the next financial year [IAS 1, paragraph 125].

Finally, an entity must disclose tax-related contingencies that includes a brief description of the nature of the uncertain income tax treatments, an estimate of its financial effect, indication of the uncertainties and reimbursements, if any. Similar disclosures are required for tax-related contingent assets [IAS 12, paragraph 88 and IAS 37, paragraph 86].