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IFRIC 23: Simplifying the treatment of uncertain tax position in Nigeria.

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EDITORIAL NOTE

The IFRS Interpretations Committee (IFRS IC) issued IFRIC 23 seeking to provide clarifications on the recognition and measurement requirements in IAS 12-Income taxes. The guidance is most applicacable in situations where there is uncertainty over income tax treatments, on how to recognize and measure deferred and current income tax assets and liabilities including taxable profit and loss, tax credits, tax bases of assets and liabilities, and tax rates. IFRIC 23 is effective for annual reporting periods beginning on or after 1 January 2019.
As the effective date for the implementation of IFRIC 23 has commenced, this edition of the Bulletin seeks to provide practice guidance to aid members of the Institute in determining the accounting treatment of uncertain tax positions.

IFRIC 23: Simplifying the treatment of uncertain tax position in Nigeria.

INTRODUCTION

The Federal Inland Revenue Service (FIRS) generated N5.32 trillion in 2018 as tax revenue from businesses and individuals in Nigeria.
In 2019, FIRS is targeting generating N8.3 trillion, a 56% increase over last year's tax revenue made by the government.
The 2019 tax revenue target in a period of weak economic growth is worrisome as a lot of businesses in Nigeria will be:

- exposed to intense scrutiny of their accounting records,
- experience increased number of tax audits,
- invest more time and resources in settling tax disputes; and
- exposed to potential tax investigations from the tax authorities arising from lack of clarity or uncertainty on the treatment of certain transactions included in the income tax returns.

The issue has become burdensome for the professional accountant and preparers of financial statements due to lack of clear guidance on how to account for uncertain tax positions in the financial statements. The lack of clarity triggers diversity in practice and the value of comparability of financial statements is lost due to the divergent methods used in accounting for uncertain tax treatments.

To help professional accountants address the above issue, International Financial Reporting standards Interpretation Committee (IFRIC) issued IFRIC 23 Uncertainty over Income tax treatments (IFRIC 23) on 7 June 2017 with objective of providing a set of principles to guide the judgments and assumptions made by management in the treatment of uncertain tax position in the financial statements of the business.

What is in the Scope of IFRIC 23?

Transactions (including interest and penalties) that are recognised and measured under the requirements of IAS 12 Income Taxes are under the scope of IFRIC 23. However, levies that fall under the scope of IAS 37 are not covered.
IFRIC 23 clarifies that recognition and measurement of uncertain tax treatment and how it impacts the current and deferred tax position of an entity with specific focus on the following items:
• Taxable profit (tax loss);
• Tax bases;
• Unused tax losses;
• Unused tax credits; and
• Tax rates

How do you recognize and measure uncertain tax position under IFRIC 23?

The following “5 step approach” summarised in the diagram below simplifies the application of IFRIC 23:

1. Identify Complete listing of uncertain tax treatments used or planned to be used by an entity in its income tax filings.

Example of such uncertain tax treatment include:
• Regulatory directives issued by the tax authority that is at variance with the income tax laws
• transfer pricing rules that are judgmental
• grey areas in the tax laws on deductibility of an expense item or tax exemption status of an income item
• company entering in new or complex transactions used to utilize tax losses or unused tax credits
• transactions that could affect an entity's tax exempts status e.g. pioneer tax incentives in Nigeria
• Unresolved tax disputes between the entity and relevant tax authority

2. Determine The unit of account

An entity considers if the list of uncertain tax treatment(s) identified above should be evaluated separately or together as a group. The key driver is which of the approach better predicts the resolution of the uncertainty with the tax authority.
Examples of factors to be considered in concluding on the appropriate unit of account include:
• How an entity prepares its income tax filings and supports its tax treatments – per item or group of items?
• How the entity expects the tax authority to make it’s examination of and resolve tax issues arising from the examination.

3. Recognize the probability that an uncertain tax treatment may or may not be recognised by the tax authority

• Underlying the recognition requirement is an underlying assumption that the tax authority has the right to examine or audit the entity. It also has full knowledge of all related information when making those examinations or performing the tax audit. This assumption is required to be made by all entities applying IFRIC 23.
• When the entity concludes that Yes, it is probable that the tax authority will accept the uncertain treatment then tax amounts in the financial statements are equal to the amounts reported or planned to be reported in the income tax return.
• When the entity concludes that No, it is not probable that the tax authority will accept the uncertain treatment then tax amounts in the financial statements reflect the uncertainty.

4. Measure the impact of the uncertain tax treatment

• IFRIC 23 allows the following measurement approach for recognizing effect of uncertain tax treatment where it is not probable that the tax authority will accept such treatment:
• Most likely method approach: the single most likely amount in a range of possible outcomes. Applicable where the possible outcomes are binary or are concentrated on one value.
• Expected value approach: the sum of the probability-weighted amounts in a range of possible outcomes. Applicable where the possible outcomes are not binary nor concentrated on one value.

• The resulting amount from any of the approach noted above is adjusted as part of the current and deferred tax balance recognised. IFRIC 23 prohibits the presentation of uncertain tax treatment adjustments as a separate line item in the financial statements.

5. Disclose the judgments and assumptions made on uncertain tax treatments

No new disclosures. Entities however are requiredto disclose:
• judgements made in determining the current and deferred tax for uncertain income tax treatment in accordance with IAS 1 paragraph122
• information about the assumptions and estimates made in determining current and deferred tax in accordance with IAS 1 paragraph 125-129
• For cases where the entity concludes that an uncertain tax treatment will be accepted by the tax authority then discloses the potential effect of the uncertainty as a tax- related contingent assets and liabilities in accordance with the IAS12 paragraph 88.

Illustrative Example – Expected Value method

AL - haji Plc takes NGN1 million deduction related to an intercompany transaction which is subject to challenge by the tax authority. The tax rate is 32% AL- haji Plc has determined that the unit of account is the single intercompany transaction and AL- haji Plc concludes that it is not probable that the tax authority will accept the deduction. The Company estimates the probabilities of the possible amounts that might be added to its taxable profit, as follows:

Outcome	Probability (a)	Estimated tax deduction accepted by FIRS (NGN) (b)	Estimated of expected value (NGN) c = a*b
Outcome 1	30%	250,000	35,000
Outcome 2	30%	600,000	180,000
Outcome 3	40%	100,000	40,000
			295,000

Although outcome 3 is the most likely outcome, the spread of the possible outcomes suggests that the expected value method provides a better prediction of the resolution of the uncertainty and therefore AL – haji Plc recognizes and measures its current tax liability based on taxable profit that include NGN 0.295 million.

Al- haji Plc will increase its income tax expense and income tax liability in its financial statements by N 0. 226million (NGN 1 million – NGN 0.295 million) * 32%).

When do you perform a re-assessment?

An entity shall assess the relevance and effect of change in facts and circumstances of new information in the context of applicable tax laws.

Examples include of changes in facts or circumstances or new information that can result in re-assessment of judgement and estimate made in the financial statements include:
- Examination or action taken by the tax authority (a significant factor in the arriving at the conclusion that there is a change in facts and circumstances)
- Changes in tax rules Irregulation
- Expiry of the tax authority right to audit prior tax years that have become statute barred.

Changes in facts and circumstances are accounted as a change in estimates in accordance with IAS 8. Entities are also required to determine if it is an adjusting or non- adjusting event for a change that occurs after the reporting period.

When is the effective date of the transition?

IFRIC 23 is effective for annual reporting period beginning on or after 1 January 2019. Earlier application of IFRIC 23 is permitted. An entity shall apply IFRIC 23 either:

• Retrospectively in accordance with IAS 8 i.e. the financial statements are restated at the beginning of the comparative period for the effects of IFRIC 23; or
• Retrospectively with the cumulative effect of applying the interpretation recognised on the date of the initial application as adjustment to opening balance of retained earnings (or applicable reserves in equity). The comparative information will not be restated.