

# IAS 12: Interest and Penalties Related to Income Taxes

---

## Extract, IFRS Discussion Group Report on the Meeting – May 30, 2017

The IFRS Interpretations Committee considered whether to add a project on interest and penalties related to income taxes in light of the feedback received to the draft IFRIC Interpretation *Uncertainty over Income Tax Treatments*.<sup>1</sup> The feedback identified that entities apply either IAS 12 *Income Taxes* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to interest and penalties related to income taxes.

The IFRS Interpretations Committee published a tentative agenda decision in its [March 2017 IFRIC Update](#) that concluded a project of this nature is not a higher priority than other projects already on the IASB's or Committee's agenda.

The IFRS Interpretations Committee also observed that “if an entity determines that amounts payable or receivable for interest and penalties are income taxes, then the entity applies IAS 12 to those amounts. If an entity does not apply IAS 12 to interest and penalties, then it applies IAS 37 to those amounts.”

The Group discussed two fact patterns, taking into consideration the IFRS Interpretations Committee's tentative agenda decision.

### ***Issue: How should an entity account for interest and penalties described in the following two fact patterns?***

#### *Fact Pattern 1*

- An entity has filed its income tax returns for the year end December 31, 20X7 with the Canadian tax authorities. Included within the tax return is a filing position that the entity is taking with relation to where certain sales contracts are originated, approved and a substantial portion of the work is performed.
- It is the entity's position that the contracts are not taxable in Canada as they relate to income sourced in a foreign jurisdiction. There is a level of uncertainty concerning how the Canadian tax authorities will interpret the entity's filing position. The entity has been challenged in the past, with outcomes ruled both in favour and not in favour under various fact patterns.
- On June 30, 20X8, the taxation authority issues a notice of assessment that the entity's income tax return has been assessed as filed. However, on July 15, 20X8, the taxation authority notifies the entity that they will commence tax audit procedures on the return, including its filing position relating to the contracts in question.
- In preparing both its December 31, 20X7 and its December 31, 20X8 financial statements, the entity must consider how it should account for the uncertain tax position, specifically relating to

---

<sup>1</sup> In [June 2017](#), the IASB issued IFRIC 23 *Uncertainty over Income Tax Treatments*.

interest and penalties. The taxation authority has not issued a reassessment as the tax audit is ongoing, though there is a significant chance that they will rule against the entity.

- If the taxation authority were to rule against the entity, it would lead to significant penalties based on a percentage of the income taxes not originally paid, plus interest on the late payment of the income taxes owing.

### *The Group's Discussion*

One Group member noted that interest and penalties related to income taxes may not be that material relative to an entity's financial statements. He observed that in practice, the accounting for these amounts does vary between IAS 12 and IAS 37. However, the important point to highlight is that entities should be consistent in how they treat interest and penalties related to income taxes from period to period. If the amount is material, entities should include accompanying disclosures.

Another Group member observed that an entity should first consider whether it had accounted for the uncertain tax position before determining the accounting for interest and penalties that could arise from that position itself. In addition, an entity should also consider the effect the accounting treatment for interest and penalties would have on the rate reconciliation required in IAS 12.

### *Fact Pattern 2*

- An entity has been reassessed on their tax filing by the taxation authority relating to transfer pricing methodologies over a period of three years. The taxation authority has assessed \$1 million in taxes owing, plus \$200,000 in penalties and \$150,000 in interest, for a total of \$1,350,000.
- The entity initially opposes the assessment from the taxation authority. However, after weighing the legal costs of disputing the filing, the entity enters into discussions with the taxation authority and agrees to settle the issue.
- The taxation authority states that they will close their file on the issue if the entity pays \$800,000 in total, but no specification is given as to how much relates to income tax, penalties and/or interest. The entity accepts this offer and issues payment to the taxation authority.

### *The Group's Discussion*

One Group member thought that the blended tax payment should be presented within current income tax expense in the Statement of Comprehensive Income. However, another Group member noted it was more important to ensure there is adequate disclosure of the blended tax payment than where the amount is presented. That said, if an entity has certain key performance measures (for example, earnings before interest, taxes, depreciation and amortization), the location of where the amount is presented in the Statement of Comprehensive Income could have certain implications.

Another Group member reiterated the importance of consistency in the accounting approach from period to period, but also highlighted how the facts and circumstances could warrant one approach over another. An entity should have some sort of framework (for example, predetermined criteria or factors) that it would consider in determining when interest and penalties relating to income taxes

are accounted for under IAS 12 or IAS 37. Such a framework is important to enable the consistent application of judgment.

A few Group members also shared their experience relating to junior mining entities, indicating how sometimes these interest and penalty amounts could be material if the appropriate filings were not made on time. Often penalties are presented separately for such entities (for example, penalty on flow-through shares).

The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

(For a full understanding of the discussions and views expressed, listen to the [audio clip](#)).