

[1852] Reporting Uncertain Tax Positions - ATO takes an interest

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The reporting of so-called uncertain tax positions (UTPs) by companies is an issue that is now attracting attention in Australia - see 2010 WTB 39 [1492]. The US moved on it earlier this year (and has most recently released details of its final compliance reporting requirements - see below), while the ATO is considering a move to ask large companies to disclose uncertain tax positions in their tax returns.

In general, Australia has followed the developments of the International Accounting Standards Board (IASB) which issued Exposure Draft ED/2009/2 (exposure draft) in March 2009, proposing a new IFRS to replace IAS 12 *Income Taxes* (IAS 12). The most significant proposal of the exposure draft was the requirement to measure all UTPs on a weighted probability basis and disclose the same (conceptually similar to FIN 48 in the United States). This is a significant change from current financial reporting of tax positions in Australia.

Consequently, the Australian Accounting Standards Board (AASB) issued its own exposure draft titled ED 178 *Income Taxes* (AASB 112) in April 2009 to replace the existing Australian income taxes standard AASB 112. The proposed new standard would have directed entities to recognise and disclose UTPs based on the probability-weighted average amounts of possible outcomes and required them to make an estimate of the probability of each of the possible outcomes occurring for uncertain material deductions. However, in late 2009, the IASB decided not to continue with the proposals in its exposure draft and as a result, AASB 112 still applies in Australia in its current form.

Generally speaking, Australian accounting standards, which are legally binding under the *Corporations Act 2001* are equivalent to IFRS and enforced by ASIC. Entities that are obligated to report to ASIC will be under an obligation to disclose UTPs in their financial accounts once the new exposure draft is issued and adopted by the IASB and AASB respectively. Presently, AASB 112 does not explicitly address the issue of UTPs and refers to AASB 137 for "tax-related contingent liabilities and contingent assets" that may arise from "unresolved disputes with taxation authorities." AASB 112/IAS 12 and AASB 137/IAS 37 in their present state have led to confusion and divergence in practice of the disclosure of UTPs for entities bound by these accounting standards for reporting purposes. Although there is a broad understanding that UTPs should be accounted for, the disparity of opinion as to how it should be done has left entities struggling due to the lack of guidance.

Two of the more common approaches being used to disclose UTPs are:

- Recognise a liability/asset relating to an uncertain tax position if it is "probable" it will crystallise, measured at the best estimate of the amount the entity expects to pay. This is broadly consistent with the treatment of liabilities under the current version of AASB 137.
- Recognise each uncertain tax position, taking the extent of the uncertainty into account when measuring the liability/asset by using a probability-weighted-average amount of all possible outcomes. This approach is broadly consistent with the ED 178 proposals.

The IASB at its March 2010 Board meeting decided the income tax project should continue with a limited scope which includes the issue of UTPs being addressed. Hence, a revised exposure draft could be issued in late 2010 or early 2011 which undoubtedly will be followed by a corresponding exposure draft by the AASB. It is anticipated that the new exposure draft(s) will provide more specific guidance as to the methodology of recognising and disclosing UTPs. This is expected to occur after the impending revision of AASB 137/IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

ATO view of reporting UTPs

Earlier this year, the Commissioner of Taxation addressed an audience of company directors and business leaders on the importance of good corporate governance and how corporate reporting and disclosure laws have placed greater pressure on directors to be informed about material tax risks. This was reported at 2010 WTB 7 [270]. He mentioned the stricter financial reporting requirements in existence due to US Sarbanes-Oxley legislation and FIN 48 requiring certain US entities to recognise UTPs in their balance sheets. The Commissioner affirmed that discussions on the management of tax risk had begun and that similar changes have been proposed under International IFRS that would impact Australia.

In Australia, the ATO is conducting a pilot project aimed at gathering information in relation to the key tax risks for large business taxpayers that it has categorised as "higher risk". This pilot will seek to highlight the type of information on UTPs that the ATO is seeking to access in its broader compliance programs targeted at corporate Australia.

One might expect that the ATO would also follow the IRS lead to report UTPs as part of Australian corporate taxpayer filings as being a key plank and identifier for the ATO's compliance programs.

In that regard, it is noted that the US IRS recently released details of its final compliance reporting requirements that require business taxpayers to report basic information regarding their UTPs when they file their US tax returns: see 2010 WTB 42 [1606]. The final documentation released includes: (i) a final Schedule UTP (Form 1120); (ii) an Uncertain Tax Position Statement; (iii) instructions for the Schedule, effective for the 2010 tax year; and (iv) details of modifications to the original proposal, including a 5-year phase-in period.

Practical implications for Australian business

Australian entities need to be conscious of their tax risk management systems and ability to analyse, track and document the possible outcomes of UTPs. While the uncertainty remains as to how the accounting for UTPs under AASB 112 / IAS 12 might be amended, what does seem likely is that Australian business will see a more rigorous tax risk measurement methodology coming out of the IASB's current income tax project.

Australian subsidiaries of US corporations should be aware that, while the instructions to file Schedule UTP (US Form 1120) state that the reporting relates to US Federal income tax positions (including those of foreign corporations doing business in the US), a US corporation will still be required to report a US income tax position that arises out of an uncertain foreign tax position if a provision for US income tax was recorded to reflect that uncertainty. For example, if the US entity is relying on a tax treaty concession in relation to income not being taxed in Australia and the same is disputed by the ATO, and a provision is raised in the Australian subsidiary accounts, the US entity's UTP will need to be disclosed on Schedule UTP. Therefore there will be occasions where an Australian UTP will need to be included in the Schedule UTP disclosure.

For these reasons, including the ATO's focus of UTPs and the impending exposure draft(s), it is of critical importance that Australian businesses and directors keep focused on the issue of financial reporting of uncertain tax positions.