

Accounting alert



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Financial reporting impacts of recent or proposed tax changes

In this issue:

- Summary of financial reporting impacts
- Income tax accounting
- Impairment
- Fair value
- Disclosure.

Similar to IFRS, changes to Australian tax law continues unabated with widespread impacts across many industries. The interaction of these tax changes with IFRS creates numerous new financial reporting challenges, ranging from impacts on effective tax rates to impairment and disclosure considerations – even though some of the changes have not yet been made into law.

In this accounting alert, we focus on the near-term financial reporting implications of some of these changes, such as the 'rights to future income' amendments to the tax consolidation rules and the Federal Government's response to the Henry Review.

Key messages

- The impact of 'substantively enacted' tax changes must be recognised in financial reports at 30 June 2010 – this is a key consideration for the recent tax consolidation changes
- There is a lack of guidance under IFRS how to account for government incentives and similar programs administered through the tax system
- Although not yet law, the Federal Government's response to the Henry Review (particularly the proposed Resources Super Profits Tax (RSPT)) may impact the carrying amounts of assets in the current reporting period
- How the various changes have been taken into account in the financial statements, along with the individual financial impacts, is likely to be a key disclosure in the upcoming reporting period.



Summary of financial reporting impacts

The table below highlights the key tax law changes considered in this accounting alert, together with a high-level summary of the potential financial reporting impacts arising from each in the current reporting period.

Each of the potential financial reporting impacts is then further explored in more detail on the following pages.

Overview of tax measure	Income tax accounting	Impairment	Fair values	Disclosure
<p>'Small and general business tax break' investment allowance</p> <p>A short-term stimulatory investment allowance permitting an immediate additional tax deduction for eligible capital expenditure, rates are dependent upon when the expenditure is incurred and the nature of the entity.</p>	■	■		■
<p>Tax consolidation amendments (particularly RTFI)</p> <p>Numerous amendments to the operation of tax consolidation in Australia, many retrospective to the commencement of the regime on 1 July 2002.</p> <p>The 'rights to future income' (RTFI) amendments may provide entities the ability to claim revenue deductions in relation to certain rights to future income acquired in business combinations.</p>	■	■	■	■
<p>Resources Super Profits Tax (RSPT)*</p> <p>A proposal to introduce a new 40% tax on profits earned from exploitation of Australia's mineral resources. A refundable credit is proposed for State royalties. RSPT will be deductible for corporate income tax purposes.</p>		■	■	■
<p>Resource Exploration Rebate (RER)</p> <p>A proposal to provide a refundable tax offset at the company level for exploration expenditure (including geothermal exploration) carried out in Australia.</p>			■	■
<p>Change in corporate tax rate</p> <p>Proposed phased-in change in corporate tax rate from 30% to 29% for 2013–14 and then to 28% from 2014–15, in conjunction with the introduction of the RSPT.</p> <p>Eligible small business companies are proposed to move to a 28% tax rate from the 2012–13 tax year (it is unclear whether this measure is to be linked to the RSPT and overall corporate tax rate reduction measures).</p>		■	■	■

Key:

- Pervasive impact expected for all affected entities
- Moderate impact
- Minor or indirect impact/consideration

* For detailed analysis of the near-term financial reporting impacts of the proposed Resources Super Profits Tax (RSPT), see *Extracting Value Issue 8*, available at www.deloitte.com/au/ExtractingValue

Income tax accounting

Key concepts

AASB 112 *Income Taxes* requires current and deferred tax to be measured using the tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period.

Accordingly, only those tax law changes which have been enacted or substantially enacted by the end of the reporting period are taken into account when calculating taxes. The corollary is that all enacted or substantively enacted tax law changes at reporting date *must* be taken into account in measuring taxes – it is not ‘optional’ to account for such changes.

Interpretation 1039 *Substantive Enactment of Major Tax Bills in Australia* requires that a tax bill be taken into account in the recognition and measurement of deferred tax assets and liabilities when and only when, the bill has been enacted or substantively enacted prior to or on the reporting date.

Under Interpretation 1039, substantive enactment of a tax bill must be taken to have occurred once the bill has been tabled in the Parliament and there is majority support for the passage of the bill through both Houses of Parliament. However, where the commencement of the bill is linked to the enactment or commencement of another bill, the first bill must not be taken to be enacted or substantively enacted until the second bill has been enacted or substantively enacted.

AASB 112 does not apply to government grants or investment tax credits. In addition, AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance* does not apply to government assistance provided in the form of benefits available in determining taxable income, or are determined or limited on the basis of income tax liability.

The interaction of the scope exemptions from AASB 112 and AASB 120 sometimes results in certain government benefits ‘falling through the cracks’ and so not having any specific standard applying to their accounting. In these cases, the entity must use the so-called ‘hierarchy’ in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* to develop an accounting policy that is relevant and reliable.



Application to specific taxes and proposals

Tax measure	Comments
'Small and general business tax break' investment allowance	<p>Legislation to enact this provision was enacted in 2009 and so the investment allowance must be taken into account in the current financial reporting period.</p> <p>This investment allowance is effectively an 'investment tax credit' outside the scope of both AASB 112 and AASB 120 and entities therefore need to choose between treating it as a tax (effectively a permanent difference), a government grant (deferred and recognised as the acquired asset is amortised or impaired) or some other method (following the 'hierarchy' in AASB 108).</p> <p>Anecdotal evidence suggests income tax accounting treatment appears the most common approach adopted in practice.</p>
Tax consolidation amendments (particularly 'rights to future income')	<p>The tax consolidation amendments were passed by both houses of Parliament during May 2010 and so must be taken into account from that date.</p> <p>The 'rights to future income' amendments are retrospective and, accordingly, entities need to estimate the impact for their next financial statements. Even though the measure is retrospective, the full impact would generally be recognised in the accounting period including the date of substantive enactment (i.e. May 2010).</p>
Resources Super Profits Tax (RSPT)	<p>While it is intention of the Federal Government to proceed with the RSPT, at this stage it is still unknown what form it will finally take. Consultation has commenced and the Government's intention is to continue this process with the objective of tabling draft legislation in Parliament in late 2011.</p> <p>There will be no need to <i>directly</i> account for the proposed RSPT until such time as it is 'substantively enacted'. Once passed into law, any current and deferred tax consequences will need to be recognised, which may precede the period in which the tax first applies. Some elements of government grant accounting may also arise for refundable credits.</p>
Resource Exploration Rebate (RER)	<p>As with the RSPT, there will be no need to <i>directly</i> account for the proposed RER until such time as it is enacted, and then only in periods where the rebate is available (proposed to be expenditure incurred after 1 July 2011).</p> <p>The RER may be considered a form of investment tax credit and its proposed refundable nature means it may be treated as a form of government grant if enacted in its proposed form. This treatment will however depend upon the final form and nature of the RER.</p>
Change in tax rate	<p>The changes to the corporate tax rate have been stated by the Federal Government to be dependent upon (and so linked) to the RSPT. Accordingly, will only be considered 'substantively enacted' once the RSPT legislation is enacted, unless the legislation is passed without being linked to the RSPT legislation.</p> <p>Once enacted, the phased reduction in tax rate will require the 'scheduling' of temporary differences and tax losses to determine the appropriate rate to apply. The effect of this revised calculation will be recognised immediately.</p>

The 'rights to future income' amendments to the tax consolidation regime can potentially be beneficial for entities. There is now greater certainty about potentially significant deductions for tax costs allocated to relevant assets. The changes affecting these assets are mandatory, and are retrospective to 1 July 2002.

With a short time frame to the June reporting season, entities need to begin work now to determine the impact on financial reports at 30 June 2010 and beyond.

In many cases, specialist tax and valuation advice may be necessary to successfully support a claim. Because of the need to recognise the impact of tax changes in the financial statements from substantive enactment, entities with potentially large deductions need to be particularly diligent in developing realistic estimates before their next reporting date.

Impairment

Key concepts

AASB 136 *Impairment of Assets* requires an entity to conduct an impairment test if there is an indication an asset may be impaired. However, intangible assets not yet available for use or with indefinite useful lives and goodwill must be tested for impairment on an annual basis.

Equally, where a previous impairment has been recognised for an asset, the entity is required to assess whether there is an indication of the reversal of that impairment for all assets other than goodwill.

AASB 136 provides a number of 'indicators' of impairment or reversals. In some cases, significant tax law changes may be an indicator in themselves, or impact variables (such as market prices) which are an indicator. Because of these 'indirect' impacts, proposed tax law changes can impact impairment calculations even though the tax law changes have not been enacted.

AASB 136 permits the recoverable amount of an asset or cash-generating unit (CGU) to be determined as the higher of an assets 'fair value less costs to sell' and its 'value in use'. Although AASB 136 requires recoverable amount calculations based on 'value in use' to be performed on a pre-tax basis, tax changes can still indirectly impact impairment calculations in such areas as:

- The derivation of pre-tax discount rates from post-tax rates such as weighted average cost of capital calculations (sometimes referred to as a 'back solving' for the pre-tax rate)
- Impacts on risk margins, e.g. a lower (higher) tax rate may decrease (increase) investors' desired pre-tax returns
- Impacts of major changes on the pricing of market transactions and other market factors.



Application to specific taxes and proposals

Tax measure	Comments
'Small and general business tax break' investment allowance	<p>There is no specific impact of this investment allowance on impairment, save any cash flow impacts where appropriate in recoverable amount models.</p> <p>Indirect impacts may occur where government grant accounting has been adopted (reducing the carrying amount of assets, reducing the likelihood of an impairment) or where investment decisions were made including the effect of the investment allowance (market returns may be insufficient to justify the carrying amount of the asset if tax income has been recognised for the credit received).</p>
Tax consolidation amendments (particularly 'rights to future income')	<p>The impacts of the rights to future income (RTFI) changes may reduce tax outflows in recoverable amount models where the contract remains in existence at reporting date and the RTFI amount has not been fully claimed.</p>
Resources Super Profits Tax (RSPT)	<p>The RSPT should be taken into account in some manner in recoverable amount calculations for affected entities – however, given the uncertainty surrounding the RSPT, the full impact should not be reflected in such calculations.</p> <p>Recoverable amount calculations based on fair value less costs to sell would need to reflect recent market transactions which may be impacted by the uncertainty surrounding the RSPT.</p> <p>Possible deferral of investments may reduce the recoverable amounts of affected projects due to additional discounting. The proposed rebating of State royalties may have a positive impact in some cases.</p>
Resource Exploration Rebate (RER)	<p>There is unlikely to be any direct impact of the proposed RER on impairment calculations until the RER is enacted. In respect of exploration and evaluation assets, any such impacts would need to be considered in light of the modified approach to impairment contained in AASB 6 <i>Exploration for and Evaluation of Mineral Resources</i>.</p> <p>There may be indirect impacts on the valuation of prospective exploration interests or investments in exploration entities that may benefit from a re-rating if the RER is implemented.</p>
Change in tax rate	<p>In the same way as the RSPT discussed above, the changes in tax rates should be taken into account in recoverable amount calculations in some manner – but again, the revised tax rates should not be fully reflected until the legislation is enacted or market based evidence suggests investors are fully expecting the tax rate changes to be implemented.</p> <p>The Federal Government has also linked the tax rate changes and RSPT to an gradual increase in the superannuation guarantee to 12%. This impact should also be taken into account in a similar manner where considered appropriate.</p>

Fair value

Key concepts

A number of Accounting Standards require measurement of assets and liabilities at fair value. For instance, AASB 3 *Business Combinations* (2008) requires an entity to measure identifiable assets acquired and liabilities assumed in a business combination at their acquisition-date fair values.

Fair values reflect market prices and do not consider entity-specific tax, legal, synergistic or other benefits or costs.

The tax environment has indirect impacts on the determination of fair values in many ways, for example:

- Potentially impacting the risk premium investors demand to invest in particular asset classes, e.g. the higher the tax burden and/or uncertainty, the higher the pre-tax return investors might demand
- The so-called 'tax amortisation benefit' (TAB) associated with valuing assets which enjoy a partial shield from tax due to tax depreciation or similar allowances.

Application to specific taxes and proposals

Tax measure	Comments
'Small and general business tax break' investment allowance	As a temporary and non-transferrable measure, the investment allowance is unlikely to have long-term impacts on fair values of assets acquired when the allowance was applicable. Short-term indirect impacts on fair value may have resulted where there was scarcity of supply of an acquired asset (likely to increase transaction prices and so fair values).
Tax consolidation amendments (particularly 'rights to future income')	The rights to future income changes will generally increase the fair values of affected assets due to the tax amortisation benefit.
Resources Super Profits Tax (RSPT)	Market expectations about the affect of the proposed RSPT will be reflected in market prices used as the basis of fair value determinations. Tax amortisation benefits will also require adjustment in some manner.
Resource Exploration Rebate (RER)	There may be indirect impacts on the fair values of prospective exploration interests or investments in exploration entities that may benefit from a re-rating if the RER is implemented.
Change in tax rate	Market expectations about the affect of the proposed tax rate changes will be reflected in market prices used as the basis of fair value determinations. Tax amortisation benefits will also require adjustment in some manner.

Disclosure

Relevant disclosures required by Accounting Standards

The tax measures discussed in this Accounting alert can give rise to disclosures under numerous Accounting Standards. Some of the more relevant disclosures that may be impacted are briefly outlined below.

AASB 112 *Income Taxes*

- Major components of tax expense
- An explanation of the relationship between tax expense and accounting profit
- An explanation of changes in applicable tax rates compared to the previous accounting period.

AASB 101 *Presentation of Financial Statements*

- A summary of significant accounting policies
- The nature and amount of material items of income and expense
- Significant judgements that have the most significant effect on the amounts recognised in the financial statements
- Assumptions made about the future and other sources of estimate uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

AASB 136 *Impairment of Assets*

- Impairment losses recognised or reversed during the period, including the events and circumstances giving rise to them
- Key assumptions, discount rates and sensitivity analyses in relation to cash-generating units containing goodwill or indefinite useful life intangible assets.

Some of these disclosure requirements may be impacted by the AASB's proposed Reduced Disclosure Regime (RDR), which will provide reduced disclosures for eligible entities (in relation to for-profit entities, those without 'public accountability'). More information about the proposed RDR can be found in Accounting alerts 2009/11, 2010/02 and 2010/05, available at www.deloitte.com/au/AccountingAlerts



Application to specific taxes and proposals

The table below does not specifically consider the disclosures required where an impairment loss or reversal has been recognised. The need to make these disclosures, and their nature, will depend upon the particular facts and circumstances arising.

Tax measure	Comments
'Small and general business tax break' investment allowance	Where the impact is significant, the effect of the investment allowance on income tax expense and profit or loss should be separately disclosed. The entity's accounting policy with respect to the treatment of the investment allowance should be disclosed (income tax or government grant).
Tax consolidation amendments (particularly 'rights to future income')	Where the impact is significant, the effect of the tax consolidation amendments (including, in particular, the rights to future income amendments) on income tax expense and profit or loss should be separately disclosed. The amount related to business combinations or the formation of a tax consolidated group in earlier periods should be separately disclosed if significant.
Resources Super Profits Tax (RSPT)	Entities likely to be impacted by the proposed RSPT should disclose the way in which the RSPT has been taken into account in preparing the financial statements. The specific requirements of AASB 136 regarding key assumptions and sensitivity analyses may also need to be considered. 'Boilerplate' disclosure should be avoided, where possible, in favour of transparent disclosure. In the politically charged environment surrounding the RSPT, the nature and content of disclosures will require careful and detailed consideration by the company's audit committee and board of directors.
Resource Exploration Rebate (RER)	Prior to its enactment, there is unlikely to be any direct disclosure required in relation to the RER. However, there may be indirect impacts on disclosure, e.g. in some cases, potential favourable impacts on going concern and capital management. Once enacted, the accounting policies and financial effect of the RER will need to be disclosed where its impact is material.
Change in tax rate	If significant, the potential reduction of the corporate tax rate may trigger the need for disclosure under AASB 101 (potential effect on the carrying amounts of deferred tax assets and liabilities, recoverable amounts and fair values) and AASB 136 (impairment calculation sensitivities). The specific disclosures required by AASB 112 are unlikely to be applied until the relevant legislation has been substantively enacted.

Example disclosure for the change in tax rate

The following example disclosure is provided to illustrate how entities may choose to disclose the impact of the possible phased-in change in tax rate. It should be adapted to suit the entity's specific facts and circumstances, to reflect the current situation in relation to the possible implementation of the changes, and the overall disclosures provided in the financial report:

The Australian Government has announced its intention to reduce the company tax rate to 29% for the 2013–14 tax income year and to 28% from the 2014–15 tax income year. At the date of this financial report, the proposed changes have not been substantively enacted and, accordingly, the direct financial impact of these changes has not been recognised in the financial statements.

In the event the proposed corporate tax rate reductions are substantively enacted, the carrying amount of the Group's deferred tax liabilities and deferred tax assets will be remeasured using the new rates where applicable. As the Group has a net deferred tax liability, this may indicate a reduction in the overall carrying amount of deferred taxes, leading to the recognition of tax income. There may also be other indirect impacts on impairment calculations, the measurement of fair values and other factors.

However, the precise effect of the changes will depend on the final legislation and the expected timing of the reversal of the temporary differences and tax losses in existence at the time it is substantively enacted.

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