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Income Taxes

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The Standard is structured to give prominence to the principles underlying the identification, recognition and measurement of deferred tax liabilities and assets under the balance sheet method of tax-effect accounting (see Section 4). To the extent the Standard provides exceptions to the principles, these are contained in later Sections.

To assist in the implementation of the requirements of the Standard, examples of the effect of the Standard in particular circumstances are included within the body of the Standard following the relevant standard or commentary paragraphs. More general examples are contained in the Appendices.

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Defined words appear in *italics* the first time they appear in a section. The definitions are in Section 15. Standards are printed in **bold** type and commentary in light type.

MAIN FEATURES OF THE STANDARD

The conceptual basis for the requirements of the Standard is significantly different from the conceptual basis for the requirements of the superseded Standard. The superseded Standard focused on the tax effects of transactions and other events that affect amounts recognised in an entity's net profit or loss/result as reported in the statement of financial performance or included in the entity's tax return. The revised Standard focuses on the tax effects of transactions and other events that affect amounts recognised in the statement of financial position or tax-based balance sheet. Because most transactions that affect the statement of financial position or tax-based balance sheet also affect the net profit or loss/result as reported in the statement of financial performance or the tax return, from a practical perspective, the outcome of the two conceptual bases will often be similar. Appendix 4 of the Standard provides an illustration to assist in the understanding of the differences between the requirements of the Standard and the requirements of the superseded Standard.

The Standard is based on the general principle that the current and future tax consequences of all transactions and other events recognised in an entity's statement of financial position give rise to current and deferred tax liabilities and assets. In implementing this principle in relation to deferred tax liabilities and assets, the Standard adopts the notions of "tax base" and "temporary difference" using the following formulae:

Carrying amounts of assets or liabilities	– Tax bases of assets or liabilities	=	Assessable or deductible temporary differences
Assessable or deductible temporary differences	× Tax rates	=	Deferred tax liabilities or assets.

The Standard provides guidance on the calculation of tax base, which is generally the amount that would be shown as an asset or a liability in a balance sheet derived for tax purposes (if such a balance sheet were prepared). An assessable temporary difference gives rise to a deferred tax liability. A deductible temporary difference gives rise to a deferred tax asset.

In applying the formulae, the Standard requires:

(a) deferred tax liabilities to be recognised for all assessable temporary differences, except in certain circumstances relating to: goodwill; the initial recognition of assets or liabilities; and investments in

subsidiaries, branches, associates and joint venture entities, or interests in joint venture operations

(b) a deferred tax asset to be recognised for a deductible temporary difference to the extent, and only to the extent, that it is probable that future taxable amounts within the entity will be available against which the deductible temporary difference can be utilised, unless the deductible temporary difference arises from: the initial recognition of assets or liabilities in certain circumstances; or investments in subsidiaries, branches, associates and joint venture entities, or interests in joint venture operations and it is probable that the temporary difference will not reverse in the foreseeable future

(c) a deferred tax asset to be recognised for the carry forward of unused tax losses to the extent, and only to the extent, that it is probable that future taxable amounts within the entity will be available against which the unused tax losses can be utilised

(d) deferred tax liabilities and assets to be measured having regard to the manner in which the entity expects, at reporting date, to recover or settle the carrying amount of its assets and liabilities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the reporting date

(e) deferred tax liabilities and assets to be measured as temporary differences multiplied by the relevant tax rates, except when another Australian Accounting Standard requires or permits otherwise. For the purposes of Australian Accounting Standards AAS 18 "Accounting for Goodwill" and AAS 21 "Acquisitions of Assets", temporary differences multiplied by the tax rates are deemed to be equal to the fair values of deferred tax liabilities and assets included in the identifiable net assets of an acquired entity or operation in the measurement of goodwill or discount on acquisition. Deferred tax assets are not adjusted for any discount on acquisition

(f) deferred tax to be recognised as expense or revenue in the net profit or loss/result for the reporting period, unless it is required to be recognised as a direct debit or credit to equity or as a direct adjustment to goodwill. Generally, deferred tax must be recognised as a direct debit (credit) to equity if the tax relates to an amount that is recognised as a direct credit (debit) to equity. Deferred tax must be recognised as an adjustment to goodwill at the date of acquisition where, for example, an acquiring entity recognises a deferred tax liability or asset in the consolidated financial report as a result of the acquisition of another entity or operation and that liability or asset was not recognised by the acquirer or acquiree prior to the acquisition. Additionally, deferred tax must be recognised as an

adjustment to goodwill where a deferred tax asset of an acquired entity or operation which is not recognised at the date of acquisition by the acquiring entity is subsequently recognised

(g) deferred tax liabilities and assets to be presented separately from other liabilities and assets and from current tax liabilities and assets in the statement of financial position. Where a distinction is made between current and non-current liabilities and assets, deferred tax liabilities and assets are classified as non-current

(h) deferred tax liabilities and assets to be offset in certain circumstances

(i) income tax expense (income tax revenue) to be presented on the face of the statement of financial performance

(j) certain disclosures in relation to income tax expense (income tax revenue) and deferred tax liabilities and assets.

The Standard also prescribes the accounting treatment of current tax liabilities and assets.

AUSTRALIAN ACCOUNTING STANDARD

AAS 3 "INCOME TAXES"

1 Application

1.1 This Standard applies to:

(a) ***general purpose financial reports* of each *reporting entity* to which Accounting Standards operative under the Corporations Law do not apply; or**

(b) financial reports that are held out to be general purpose financial reports by an *entity* which is not a reporting entity, and to which Accounting Standards operative under the Corporations Law do not apply.

1.1.1 Accounting Standards operative under the Corporations Law apply to companies and to other entities required by legislation, ministerial directive or other government authority to apply such Standards. Reporting entities which are not required to apply Accounting Standards operative under the Corporations Law are required to apply this Standard.

1.1.2 The standards specified in this Standard apply to the financial report where information resulting from their application is material, in accordance with Australian Accounting Standard AAS 5 "Materiality".

2 Operative Date

2.1 This Standard applies to reporting periods beginning on or after 1 July 2002.

2.2 This Standard may be applied to reporting periods beginning before 1 July 2002.

2.2.1 Australian Accounting Standard AAS 3 "Accounting for Income Tax (Tax-effect Accounting)", as issued in November 1989, continues to apply to reporting periods that begin before 1 July 2002. However, where an *entity* elects to apply this Standard early in accordance with paragraph 2.2, it will not also be obliged to

comply with AAS 3, as issued in November 1989, for the reporting periods to which the election applies.

2.3 When operative, this Standard supersedes Australian Accounting Standard AAS 3 "Accounting for Income Tax (Tax-effect Accounting)", as issued in November 1989.

3 Purpose of Standard

3.1 The purpose of this Standard is to:

(a) prescribe the accounting treatment of the current tax consequences of transactions and other events that give rise to *current tax liabilities* and *current tax assets*

(b) prescribe the accounting treatment of the future tax consequences of transactions and other events that give rise to *deferred tax liabilities* and *deferred tax assets*

(c) require certain disclosures to be made about income taxes.

3.1.1 Under Australian income tax legislation, income tax is payable on taxable income derived by a taxable *entity* in a year of income and is calculated in accordance with the legislation after taking into account tax offsets (credits and rebates) under the legislation. For financial reporting purposes, income tax payable or income tax recoverable that arises in an annual reporting period (*current tax*) is *recognised* as an *expense* or a *revenue* in the *net profit or loss/result* of that period or, in certain circumstances, as a *direct debit to equity* or a *direct credit to equity*. In cases where the annual reporting period does not coincide with a year of income, current tax is calculated in accordance with the legislation as if the reporting period is a year of income. In relation to a group of entities, current tax is calculated in accordance with the legislation as if the group of entities is a taxable entity. To the extent that current tax is unpaid as at the *reporting date*, the amount is recognised as a *liability* in the statement of financial position, and is referred to as "current tax liability" in this Standard. Taxes may also be paid in advance and therefore give rise to an *asset* that is referred to as "current tax asset" in this Standard.

3.1.2 Transactions and other events that are recognised in the entity's statement of financial position may give rise to future tax consequences. Those future tax consequences may be required to be

recognised as deferred tax liabilities (assets) and, correspondingly, tax expenses (revenues), or in certain circumstances, direct debits (credits) to equity or adjustments to *goodwill* by this Standard. A deferred tax liability or asset arises in relation to a recognised asset or liability if recovery or settlement of the *carrying amount* of the asset or liability will give rise to a net tax consequence.

3.1.3 The method prescribed in this Standard (the balance sheet method) is conceptually different from the method adopted in the superseded Standard (the income statement method). To assist in the transition from the income statement method to the balance sheet method, Appendix 4 identifies the more common types of transactions and events that give rise to differences between the financial statements prepared under the two methods.

3.1.4 There is a variety of income tax regimes throughout the world. Many features of some tax jurisdictions are not present in Australia. However, Australian entities may have investments in *subsidiaries*, branches, *associates* or *joint venture entities* or interests in *joint venture operations* that operate in these other tax jurisdictions. An Australian entity applies this Standard in addressing the accounting for income tax issues that arise in all the jurisdictions in which it operates.

3.1.5 For the purpose of this Standard, income taxes include all domestic income taxes (including capital gains tax) levied in accordance with Australian income tax legislation and all foreign income taxes that are levied in accordance with comparable foreign income tax legislation. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, branch, associate or *joint venture* on distributions to the entity. The entity may arrange to indemnify itself or others from changes in tax rates or other changes in tax laws. Such indemnity arrangements are accounted for separately and do not affect the requirements in this Standard to account for the income tax that is based on the entity's taxable income.

3.1.6 Many entities are subject to various forms of income tax and therefore apply this Standard. For example, companies, trusts and superannuation plans are subject to income tax under the Australian *Income Tax Assessment Act 1936* (which is being replaced by the *Income Tax Assessment Act 1997*) and some government business undertakings and other public sector entities are subject to income tax (often referred to as "income tax equivalents") under their own enabling legislation or other authority.

4 General Principles relating to Deferred Taxes

This Section focuses on the principles relating to the identification, recognition and measurement of deferred tax liabilities and assets upon which this Standard is based. Section 5 focuses on the concept of tax base, which is of key importance to applying those principles. In addition to the guidance provided in the Appendices, guidance on the effect the Standard's requirements relating to deferred tax liabilities and assets would have on financial reports in particular circumstances is provided in Sections 6, 7 and 8, together with the specification and rationale for the limited exceptions to the recognition principles. Section 9 contains requirements in relation to current tax liabilities and assets. Section 10 contains requirements relating to the recognition of the effect of income tax on equity and goodwill.

4.1 The future tax consequences of transactions and other events *recognised* in the *entity's* statement of financial position give rise to *deferred tax liabilities* and *assets*, and must be calculated in accordance with the following formulae:

Carrying amounts of _assets_ or _liabilities_ - _Tax bases_ of assets or liabilities = Assessable or deductible _temporary differences_

Assessable or deductible temporary differences ´ Tax rates = Deferred tax liabilities or assets.

Deferred tax assets also arise from unused *tax losses* that the income tax law allows to be carried forward, and must be calculated in accordance with the following formula:

Unused tax losses ´ Tax rates = Deferred tax assets.

4.1.1 The notion of temporary differences is central to the requirements of this Standard. An assessable temporary difference gives rise to a deferred tax liability. A deductible temporary difference gives rise to a deferred tax asset. Appendix 1 provides examples of circumstances that give rise to assessable and deductible temporary differences. An assessable or deductible temporary difference arises when the carrying amount of an asset or a liability differs from its tax base. The meaning of "tax base" is of key importance to applying the requirements of this Standard. Tax base is defined in paragraph 15.1 of this Standard and is generally the amount that would be shown as an asset or a liability in a balance sheet prepared

for tax purposes. Unlike the practice in some other countries, it is not customary in Australia for entities to prepare tax-based balance sheets. However, the notion of a tax-based balance sheet is relevant to this Standard and may be used as a basis for working papers developed for the purpose of implementing this Standard. Example 2 in Appendix 2 of this Standard illustrates a tax-based balance sheet. Section 5 of this Standard provides guidance on how tax base is calculated in different circumstances.

4.1.2 This Standard generally requires the entity to recognise the tax consequences of transactions and other events consistently with the way that it recognises the transactions and other events themselves. Thus, for transactions and other events recognised in *net profit or loss/result*, any related tax effects are also recognised in net profit or loss/result. For transactions and other events that are recognised as *direct credits to equity* (*direct debits to equity*), any related tax effects are generally recognised as direct debits to equity (direct credits to equity). These requirements are contained in Section 10.

Deferred Tax Liabilities arising from Assessable Temporary Differences

4.2 Subject to paragraph 6.1, a deferred tax liability must be recognised for all assessable temporary differences that reflect the future tax consequences of transactions and other events that are recognised in the statement of financial position.

4.2.1 It is inherent in the recognition of an asset at its carrying amount that its carrying amount will be recovered in the form of economic benefits that flow to the entity in future periods. The recovery of the carrying amount of many assets gives rise to assessable and deductible amounts. For example, an item of equipment may be used to produce goods that are in turn used to generate *revenue*, and therefore assessable amounts, and give rise to depreciation that is a deductible amount. When the carrying amount of the asset (equipment) exceeds its tax base, the amount of assessable economic benefits (assessable amounts) will exceed the amount that will be allowed as a deduction for tax purposes. This difference is an assessable temporary difference and the obligation to settle the resulting income taxes in future periods is a deferred tax liability. Example 1 illustrates a circumstance in which a deferred tax liability arises that is required to be recognised by this Standard.

EXAMPLE 1

An example of circumstances that give rise to a deferred tax liability that is required to be recognised (paragraph 4.2)

An asset that cost \$150 has a carrying amount of \$100. Cumulative depreciation for tax purposes is \$90 and the tax rate is 30%.

	Carrying Amount	**Tax Base**	**Temporary Difference**
	\$	\$	\$
At acquisition	150	150	
Accumulated Depreciation	50	90	
Net amount	100	60	40
Tax rate			30%
Deferred Tax Liability			12

The tax base of the asset is \$60 (cost of \$150 less cumulative tax depreciation of \$90 – see paragraph 5.1.3). In recovering the carrying amount of \$100, the entity will derive assessable amounts of \$100, but will only be able to deduct tax depreciation of \$60. Consequently, the entity will pay income taxes of \$12 (calculated as \$40 ´ 30%) as a result of recovering the carrying amount of the asset. The difference between the carrying amount of \$100 and the tax base of \$60 is an assessable temporary difference of \$40. Therefore, the entity recognises a deferred tax liability of \$12 (calculated as \$40 ´ 30%) representing the effect on income tax payable as a consequence of recovering the carrying amount of the asset.

4.2.2 A liability is recognised when, and only when, it is probable that the future sacrifice of economic benefits will be required and the amount of the liability can be measured reliably. All assessable temporary differences give rise to deferred tax liabilities that are recognised in the statement of financial position (subject to the limited exceptions in paragraph 6.1) because it is always probable that economic benefits will flow from the entity in the form of tax settlements and the amount can be measured reliably. For example, as the entity recovers the carrying amount of an asset, any related assessable temporary difference will reverse and the entity will have a *taxable amount* which gives rise to a tax sacrifice. Therefore, it is unnecessary to explicitly consider a "probable" recognition criterion for the deferred tax liabilities that arise. Even the expectation of future tax losses will not avoid the recognition of a deferred tax liability. Where an assessable temporary difference is expected to reverse in a reporting period in which there is a tax loss and thereby result in the entity not incurring a tax sacrifice for the reversing temporary difference in that period, the entity will still suffer a sacrifice of future economic benefits because the benefit derived

from the tax loss in future periods will be reduced by the amount of the reversing assessable temporary difference. Accordingly, this Standard requires the recognition of all deferred tax liabilities, except in the limited circumstances described in paragraph 6.1. In contrast, deferred tax assets arising from deductible temporary differences may not satisfy the "probable" recognition criterion (see paragraphs 7.3.3 to 7.3.8).

4.2.3 Under Australian income tax legislation, income tax is determined by reference to the taxable income of separate legal (taxable) entities (although some relief is provided in circumstances where an entity wholly owns another entity). Where the entity is not a separate legal entity but is a group of separate legal (taxable) entities, the carrying amounts of the assets and liabilities in the consolidated financial report include the underlying assets and liabilities of each *subsidiary* (as well as those of the *parent entity*). The carrying amounts as reflected in the consolidated statement of financial position are compared with their corresponding tax bases for the purpose of measuring deferred tax liabilities and assets of the *economic entity* for the purpose of this Standard. Deferred tax liabilities and assets may also arise from the parent entity's investments in the subsidiaries and may be required to be recognised in the economic entity's financial report (and in the parent entity's financial report). Paragraphs 6.1(c) and 7.2, and related commentary paragraphs, identify the circumstances in which a deferred tax liability and a deferred tax asset arising from an investment in a subsidiary is required to be recognised.

4.2.4 Some temporary differences arise or change when revenue or *expense* is included in *pre-tax net profit or loss/result* in one reporting period but is included in the calculation of *taxable amount (tax loss)* in a different reporting period. The following are examples of temporary differences of this kind which are assessable temporary differences and which always result in deferred tax liabilities:

(a) interest revenue is recognised in the statement of financial performance on a time proportion basis but is included in taxable amount when cash is received

(b) depreciation used in calculating taxable amount (tax loss) exceeds that used in calculating pre-tax net profit or loss/result. The temporary difference is the difference between the carrying amount of the asset and its tax base (which is usually the original cost of the asset less all deductions in respect of that asset permitted by the taxation

authorities in calculating taxable amount of the current and prior periods)

(c) development costs are capitalised and amortised over future reporting periods in calculating pre-tax net profit or loss/result but deducted in calculating taxable amount in the reporting period in which they are incurred.

4.2.5 Assessable temporary differences may also arise when:

(a) an entity or operation is acquired and the carrying amounts of the identifiable assets and liabilities acquired are measured by reference to their fair values but no equivalent adjustment is made to their tax bases (see paragraph 6.1.3)

(b) an asset is remeasured upwards and no equivalent adjustment is made to its tax base (see paragraph 6.1.4)

(c) *goodwill* is acquired (see paragraphs 6.1.5 and 6.1.6)

(d) the tax base of an identifiable asset or liability on initial recognition differs from its initial carrying amount (see paragraphs 6.1.7 to 6.1.10)

(e) an entity or operation is acquired and the carrying amount of the net assets (including goodwill) recognised by the acquiring entity (in the acquiring entity's separate financial report or the economic entity's consolidated financial report) differs from the tax base of the investment in the entity or operation on acquisition or subsequently (see paragraphs 6.1.11 to 6.1.18)

(f) exchange differences arise on the translation of the non-monetary assets and liabilities of an *integrated foreign operation* (see paragraph 6.1.19)

(g) the entity issues compound financial instruments and classifies separately the liability and *equity* components (see paragraphs 6.1.20 to 6.1.22).

Deferred Tax Assets arising from Deductible Temporary Differences

4.3 Subject to paragraphs 7.2 and 7.3, a deferred tax asset must be recognised for all deductible temporary differences that reflect the future tax consequences of transactions and other events that are recognised in the statement of financial position to the extent, and only to the extent, that it is probable that future

taxable amounts within the entity will be available against which the deductible temporary differences can be utilised.

4.3.1 It is inherent in the recognition of a liability that the carrying amount will be settled in future reporting periods by the entity sacrificing economic benefits. When the entity recognises an obligation to make a future sacrifice of economic benefits, part or all of the sacrifice may be deductible in calculating the taxable amount of a reporting period later than the reporting period in which the liability is recognised. In such cases, there is a difference between the carrying amount of the liability and its tax base and, therefore, a temporary difference. A deferred tax asset arises in respect of the income taxes that will be recoverable (or the reduction in income taxes that would otherwise be payable) in the future reporting periods when settlement of the liability decreases (increases) the taxable amount (tax loss). Similarly, if the carrying amount of an asset is less than its tax base, the difference gives rise to a deferred tax asset to the extent that income taxes will be recoverable (or reduced) in future reporting periods. Example 2 illustrates a circumstance in which a deferred tax asset arises.

EXAMPLE 2

An example of circumstances that give rise to a deferred tax asset (paragraph 4.3)

An entity recognises a liability of $100 for accrued product warranty costs. For tax purposes, the product warranty costs will not be deductible until the entity meets claims. The tax rate is 30%.

	Carrying Amount	**Tax Base**	**Temporary Difference**
	$	$	$
Accrued Warranty Costs	100	–	100
Tax rate			30%
Deferred Tax Asset			30

The tax base of the liability is nil (carrying amount of $100, less the deductible amount of $100 in respect of that liability in future periods – see item 1 of Example 4 following paragraph 5.3.2). In settling the liability for its carrying amount, the entity will reduce its future taxable amount by $100 and, consequently, reduce its future tax payments by $30 (calculated as $100 ´ 30%). The difference between the carrying amount of $100 and the tax base of nil is a deductible temporary difference of $100. Therefore, the entity recognises a deferred tax asset of $30 (calculated as $100 ´ 30%), provided that it is probable that the entity will earn sufficient taxable amounts in future periods to benefit from a reduction in tax payments.

4.3.2 The following are examples of circumstances in which deductible temporary differences arise and which result in deferred tax assets:

(a) provisions for guarantees and product warranties, or provisions for employee entitlements made for accounting purposes on an estimated basis in the reporting period in which the liability for such items arises, but only allowed as a tax deduction in later reporting periods when payment is made

(b) in an acquisition of an entity or operation, the identifiable assets and liabilities acquired are measured by reference to their fair values as at the date of acquisition. When a liability is recognised on the acquisition but the carrying amount is not deducted in calculating the taxable amount until a later period, a deductible temporary difference arises which results in a deferred tax asset. A deferred tax asset also arises when the fair value of an identifiable asset acquired is less than its tax base. In each case, the resulting deferred tax asset affects goodwill or *discount on acquisition* (see paragraph 10.5)

(c) particular assets may be remeasured and result in a difference between the carrying amounts and the tax bases of the assets (see paragraph 6.1.4). A deductible temporary difference and a deferred tax asset arises if the tax base of an asset exceeds its carrying amount (for example, when an impairment write-down is recognised for an asset carried at cost).

4.3.3 Commentary on the "probable" recognition criterion as it applies to deferred tax assets arising from deductible temporary differences is contained in paragraphs 7.3.3 to 7.3.8.

Deferred Tax Assets arising from Unused Tax Losses

4.4 A deferred tax asset arising from the carry forward of unused tax losses must be recognised to the extent, and only to the extent, that it is probable that future taxable amounts within the entity will be available against which the unused tax losses can be utilised.

4.4.1 Under the approach adopted by this Standard, the grossed-up effect of any unused tax offsets (credits and rebates) that the income tax law allows to be carried forward or refunded, is included as a deductible amount in calculating a tax loss for the purposes of this Standard (see paragraph 15.1.4). Accordingly, the recognition of a

deferred tax asset arising from the portion of a tax loss attributable to unused tax offsets is subject to paragraph 4.4.

4.4.2 Commentary on the "probable" recognition criterion as it applies to deferred tax assets arising from the carry forward of unused tax losses is contained in paragraphs 7.3.9 and 7.3.10. Commentary on the accounting for the transfer of tax losses within the economic entity is contained in paragraphs 7.3.11 to 7.3.17.

Measurement of Recognised Deferred Tax Liabilities and Assets

4.5 Deferred tax liabilities and assets must be measured as:

(a) the temporary differences that give rise to recognised deferred tax liabilities and assets and the unused tax losses that can be carried forward and give rise to recognised deferred tax assets; multiplied by

(b) the tax rates that are expected to apply to the reporting period or periods when the liabilities are settled or assets recovered, based on tax rates (and tax laws) that have been enacted or substantively enacted by the *reporting date* and that will affect the amount of income tax payable (recoverable)

except, subject to paragraph 4.6, to the extent to which another Australian Accounting Standard requires or permits a different measurement method to be adopted.

4.6 For the purposes of Australian Accounting Standards AAS 18 "Accounting for Goodwill" and AAS 21 "Acquisitions of Assets":

(a) the amount calculated in accordance with the formula in paragraph 4.5 is deemed to be equal to the fair values of deferred tax liabilities and assets, unless an Australian Accounting Standard (other than AAS 18 and AAS 21) requires or permits otherwise; and

(b) non-monetary assets, the fair values of which are required to be reduced proportionately by any discount on acquisition in accordance with AAS 18 and AAS 21, do not include deferred tax assets.

4.6.1 Temporary differences are calculated by reference to the carrying amount of an asset or a liability. Accordingly, where that carrying

amount is calculated on a discounted basis, for example in the case of employee entitlements (see Australian Accounting Standard AAS 30 "Accounting for Employee Entitlements") the deferred tax liability or asset would be implicitly discounted. In measuring a deferred tax liability or asset, the entity does not reverse the discounting effect that may be implicit in the deferred tax liability or asset where the carrying amount of an asset or a liability that gives rise to the deferred tax liability or asset has itself been calculated on a discounted basis.

4.6.2 Where Australian Accounting Standards AAS 18 "Accounting for Goodwill" and AAS 21 "Acquisitions of Assets" apply, temporary differences multiplied by the tax rate are deemed to be equal to the fair values of deferred tax liabilities and assets included in the identifiable net assets of an acquired entity or operation as at the date of acquisition. The product of temporary differences and the tax rates is not subsequently discounted in the measurement of goodwill or discount on acquisition.

4.6.3 Paragraphs 4.5 and 4.6 anticipate that another Australian Accounting Standard may require or permit deferred tax liabilities and assets to be measured differently from the way in which this Standard requires them to be measured. For example, although no current Australian Accounting Standard requires or permits a different measurement basis to be adopted, Accounting Standard AASB 1038 "Life Insurance Business" issued by the Australian Accounting Standards Board in November 1998 requires that life insurers discount deferred tax balances.

4.6.4 Deferred tax liabilities and assets are usually measured using the tax rates (and tax laws) that have been enacted and will affect the amount of income tax expected to be settled or recovered. However, in some jurisdictions, announcements of tax rates (and tax laws) by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. For example, an announcement before the reporting date by the Australian Treasurer or other relevant authority of the intention to change the rate of income tax to another specified rate or to change the tax laws that will affect the amount of tax expected to be settled or recovered is substantive enactment where it is probable that the change will be enacted. In these circumstances, deferred tax liabilities and assets are measured using the announced tax rate (and tax laws). A change in tax rates or tax laws that occurs after the reporting date but before the *time of completion* does not provide new information relating to conditions existing at reporting date (see Australian Accounting Standard AAS 8 "Events Occurring After Reporting Date").

4.6.5 In some jurisdictions different tax rates may apply to different levels of taxable amounts. When this is the case, deferred tax liabilities and assets are measured using the average rates that are expected to apply to the taxable amount (tax loss) of the period or periods in which the temporary differences are expected to reverse.

4.6.6 The tax rates applicable to the entity may be affected by the distribution of the net profit or loss/result or retained profits (surplus). For example, the amount of tax paid by a trust may depend on the level of distributions to beneficiaries. In those circumstances, the applicable tax rate is the rate that reflects how it is expected that distributions will be made. Where it is not possible to ascertain whether and how future distributions will be made, tax balances are calculated on the basis that no distributions will be made.

4.7 Subject to paragraph 5.3, the measurement of deferred tax liabilities and assets must reflect the tax consequences that would follow from the manner in which the management or governing body of the entity expects, as at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

4.7.1 The manner in which the entity recovers (settles) the carrying amount of an asset (liability) may affect either or both of:

(a) the statutory tax rate applicable when the entity recovers (settles) the carrying amount of the asset (liability); and

(b) the tax base of the asset (liability).

In such cases, deferred tax liabilities and assets are measured by the entity using the statutory tax rate and the tax base that are consistent with the expected manner of recovery or settlement. Generally, the carrying amount of an asset can be recovered through sale, through use, or through use and subsequent sale. Where the entity's management or governing body expects to recover (settle) an asset (liability) in a way that will have no tax consequence, no deferred tax liability or asset arises in relation to that asset (liability). Paragraph 8.1.2 addresses how the manner of recovery of *depreciable assets* may affect the deferred tax liability that arises. Examples 9, 10 and 11 in Section 8 illustrate the effect of recovering an asset in different ways under different circumstances.

5 Tax Base

This section provides guidance for the calculation of tax base in different circumstances. The concept of tax base is of key importance in implementing the principles in this Standard. A difference between the carrying amount of an asset or a liability and the tax base of the asset or liability is an assessable temporary difference or a deductible temporary difference that gives rise to a deferred tax liability or asset, respectively.

5.1 The *tax base* of an *asset* must be calculated as the asset's *carrying amount* as at *reporting date*, less any future assessable amounts plus any future deductible amounts that are expected to arise from recovering the asset's carrying amount as at the reporting date.

Example 3 following paragraph 5.3.2 provides examples of the calculation of the tax base of assets in accordance with paragraph 5.1.

5.1.1 The formula in paragraph 5.1 calculates the amount at which an asset would generally be recorded in a tax-based balance sheet. The tax base of an asset can be regarded as comprising two parts:

(a) any difference between the asset's carrying amount and the related future assessable amounts, representing the portion of the asset's carrying amount that will not be included in future *taxable amounts* as assessable amounts; and

(b) any future deductible amounts, which will reduce future taxable amounts.

5.1.2 Future assessable and deductible amounts refer to those amounts that will affect future *taxable amounts (tax losses).* Assessable amounts include amounts that are often referred to as assessable income under the income tax law. Although an asset may be expected to give rise to future assessable amounts that exceed the asset's carrying amount, this Standard focuses on the tax consequences of recovering an asset only to the extent of its carrying amount. This is because it is through the carrying amount that the past transactions and other past events that affect the *entity* are *recognised* in the entity's financial report. Deductible amounts include amounts that are often referred to as allowable deductions under the income tax law. For example, deductible amounts may include depreciation that would be allowed for tax purposes and any indexation benefits for an asset that is subject to capital gains tax. In

addition, as explained in paragraph 5.1.4, deductible amounts may include the grossed-up effect of tax offsets (credits and rebates).

5.1.3 In cases where the recovery of an asset's carrying amount is likely to give rise to assessable amounts, the tax base of the asset will normally be the amount that is likely to be deductible for tax purposes (determined as at the reporting date) against assessable amounts that are likely to flow to the entity when it recovers the carrying amount of the asset.

5.1.4 The recovery of the carrying amount of certain assets may give rise to tax offsets (credits and rebates) that may affect the amount of future income tax payable (recoverable). Examples under Australian income tax law are dividends receivable that gives rise to an intercompany dividend rebate, and interest receivable that gives rise to a land transport infrastructure tax offset. Recovery of the carrying amount of such assets is likely to give rise to assessable amounts. In addition, the related tax offset (to the extent that it is likely to be utilised in the current or in a future period) gives rise to a deductible amount that is equal to the tax offset that is likely to be utilised grossed up by the entity's tax rate. Often the effects of the future assessable and deductible amounts exactly counteract each other, resulting in a nil net effect on the entity's taxable amount. Item 5 of Example 3 following paragraph 5.3.2 illustrates the calculation of the tax base of an asset that relates to a tax offset.

5.2 Subject to paragraph 5.3, the tax base of a *liability* must be calculated as the liability's carrying amount as at reporting date, less any future deductible amounts and plus any future assessable amounts that are expected to arise from settling the liability's carrying amount as at the reporting date.

Example 4 following paragraph 5.3.2 provides examples of the calculation of the tax base of liabilities that are not in the nature of "revenues received in advance" in accordance with paragraph 5.2.

5.2.1 The formula in paragraph 5.2 calculates the amount at which a liability would generally be recorded in a tax-based balance sheet. Consistent with the formula for calculating the tax base of assets, the tax base of a liability can be regarded as comprising two parts:

(a) any difference between the liability's carrying amount and the related future deductible amounts, representing the portion of the liability's carrying amount that will not be included in the calculation of future taxable amounts as deductible amounts; and

(b) any future assessable amounts, which will increase future taxable amounts.

5.3 The tax base of a liability that is in the nature of "*revenue* received in advance" must be calculated as the liability's carrying amount less any amount of the "revenue received in advance" that has been included in assessable amounts in the current or a previous reporting period.

Example 5 following paragraph 5.3.2 provides examples of the calculation of the tax base of liabilities that are in the nature of "revenues received in advance" in accordance with paragraph 5.3.

5.3.1 The tax base of a liability that is in the nature of "revenue received in advance" is equal to the carrying amount of the liability where the "revenue received in advance" is taxed in a reporting period subsequent to the reporting period in which it is received. It is equal to zero where the "revenue received in advance" is taxed in the reporting period in which it is received. If a liability that is in the nature of "revenue received in advance" were dealt with in the same way as other liabilities under paragraph 5.2, it would be necessary to ascertain future deductible amounts that would arise from settling the liability. Such a liability can be settled in a number of ways. Settlement through repayment of the amount would typically give rise to deductible amounts equal to the repayment amount to the extent that the amount was treated as an assessable amount when it was received. In those circumstances, the tax base calculated under paragraph 5.2 is the same as the tax base that would be calculated under paragraph 5.3. However, the liability is likely to be settled through the provision of services (for example, rent revenue received in advance is likely to be settled through the provision of accommodation to tenants). In circumstances where the liability is settled through the provision of services, the tax deductions are likely to be less than the amount of the liability, reflecting a profit margin. Paragraph 5.3 effectively assumes that the "revenue received in advance" will be settled through repayment rather than through provision of services and avoids the need to determine future profit margins.

5.3.2 *Temporary differences* are calculated by comparing the carrying amount of assets and liabilities in the statement of financial position with the amount at which assets and liabilities would generally be recorded in a tax-based balance sheet. The tax base of an asset or a liability may depend on the manner in which the entity's management or governing body expects to recover or settle the asset or liability. Examples 3 to 5 below illustrate the calculation of the

tax base in different circumstances. Example 2 of Appendix 2 illustrates a tax-based balance sheet. Temporary differences give rise to *deferred tax liabilities* or *assets* that are required to be recognised in accordance with paragraphs 4.2 and 4.3 of this Standard.

EXAMPLE 3

Examples of the calculation of the tax base of assets in accordance with paragraph 5.1

Circumstances where recovery of an asset's carrying amount gives rise to assessable amounts and deductible amounts

1. A machine cost $100 and is expected to be ultimately disposed of for an amount that is equal to or less than that cost. For tax purposes, depreciation of $30 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the machine (that is, revenue generated from recovering the carrying amount of the machine) is assessable, any gain or loss on disposal will be subject to a balancing adjustment (such as for recouped depreciation) for tax purposes. The machine has been depreciated for accounting purposes by $20.
The tax base of the machine is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$80	-	*$80*	+	*$70*	=	*$70*

2. Land is carried at a revalued amount of $150 (acquired at a cost of $100 more than 12 months ago when the index for capital gains tax purposes was 100). At reporting date the index has moved to 120.
The tax base of the land is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$150	-	*$150*	+	*$120*	=	*$120*

(Indexation affects the tax base because when the $150 is recovered as assessable amounts [that is, as consideration in respect of disposal of the asset], the $120 would be effectively deductible. Alternatively, the amount shown as "deductible amounts" of $120 may be viewed as comprising two components: $100 deductible amount; and $20 non-assessable amount. This view would result in the same tax base.)

3. Land is carried at cost of $100 (acquired when the index for capital gains tax purposes was 100). At reporting date the index has moved to 120. The land has not been revalued.
The tax base of the land is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	*$100*	+	*$100*	=	*$100*

(The tax base is not affected by indexation because the indexed cost base exceeds the carrying amount. Under Australian income tax law the excess of the indexed cost base over consideration in respect of disposal of the asset is not deductible.)

4. Land that is carried at cost of $100 is written down to its recoverable amount of $80. For capital gains tax purposes, the cost base (and reduced cost base) of the land is $100.
The tax base of the land is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$80	-	*$80*	+	*$100*	=	*$100*

(Under Australian income tax law relating to capital gains/losses, the excess of the reduced cost base over the consideration in respect of the disposal of an asset is a capital loss and as such can be offset against capital gains arising in the same income year or can be carried forward to be offset against capital gains of future income years. Hence, in this example the reduced cost base of $100 is a future deductible amount under this Standard.)

5. Dividends receivable from a subsidiary has a carrying amount of $100. Dividends receivable can be viewed as giving rise to two separate income tax consequences. When received it gives rise to an increase in taxable amount equal to the carrying amount. It also gives rise to a rebate (which decreases the taxable amount), but only to the extent the rebate can be utilised. *Assuming the dividends are subject to a rebate that is expected to be fully utilised, the tax base of the dividends receivable is:*

Carrying Amount		*Assessable Amounts*		*Deductible Amounts (Offset)*		*Tax Base*
$100	-	*$100*	+	*$100*	=	*$100*

(This result is consistent with viewing the recovery of the asset's carrying amount as not giving rise to assessable or deductible amounts because the dividends receivable is effectively not taxable.)

Assuming the tax rate is 30%, if the full rebate of $30 will only be half utilised (due to the expectation that income taxes otherwise payable in the period in which the asset's carrying amount is recovered will be $15), the tax base of the dividends receivable is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts (Offset)*		*Tax Base*
$100	-	*$100*	+	*$50**	=	*$50*
				** ($15/30%)*		

6. The carrying amount of a building that is expected to be recovered through use is a revalued amount of $150 (acquired at a cost of $100). At reporting date, accumulated tax deductions for depreciation or other write-offs are $8.
The tax base of the building is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$150	-	*$150*	+	*$92*	=	*$92*

(Because the building is expected to be recovered through use, the effect of indexation on the indexed cost base does not need to be considered in this example. It is not relevant to the calculation of the tax base.)

7. The carrying amount of a building, which forms an integral part of plant, that is expected to be recovered immediately through sale is a revalued amount of $150 (acquired at a cost of $100 when the index for capital gains tax purposes was 100). At reporting date the index has moved to 120 and accumulated tax deductions for depreciation or other write-offs are $8. The indexed cost base of the building is $120. If the building were sold for $150, $8 recouped depreciation or other write-off would give rise to an assessable amount.
The tax base of the building is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$150	-	*$158*	+	*$120*	=	*$112*

(Alternatively, the tax base may be calculated as the carrying amount ($150) less assessable amounts ($150) plus deductible amounts ($112) because, in substance, the indexed cost base ($120) less recouped depreciation ($8) is deductible against the consideration in respect of disposal ($150).)

Circumstances where recovery of an asset's carrying amount will not give rise to assessable amounts or deductible amounts

8. Trade receivables has a carrying amount of $100 and is expected to be recovered through payments from debtors. There are no doubtful debts. The related revenue of $100 has already been included in the calculation of taxable amount (tax loss).
The tax base of the trade receivables is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	*Nil*	+	*Nil*	=	*$100*

9. A loan receivable has a carrying amount of $100 and is expected to be recovered through payments from the borrower. The repayment of the carrying amount of the loan as at the reporting date will have no tax consequences.
The tax base of the loan is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	*Nil*	+	*Nil*	=	*$100*

Circumstances where recovery of an asset's carrying amount will not give rise to assessable amounts and will give rise to deductible amounts

10. Trade receivables has a carrying amount of $100 after deducting doubtful debts of $20 and is expected to be recovered through payments from debtors. The related revenue of $120 has already been included in the calculation of taxable amount (tax loss). The doubtful debts of $20 is expected to give rise to future deductible amounts in the form of bad debts when the carrying amount of trade receivables is recovered.
The tax base of the trade receivables is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	*Nil*	+	*$20*	=	*$120*

Circumstances where recovery of an asset's carrying amount will give rise to assessable amounts and will not give rise to deductible amounts

11. Interest receivable has a carrying amount of $100. The related interest revenue will be taxed on a cash basis.
The tax base of the interest receivable is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	*$100*	+	*Nil*	=	*Nil*

12. Prepaid rent expense has a carrying amount of $100, that was claimed as a deduction when paid. Recovery of the prepayment, whether through using the rented property or receiving a refund of the rent paid, will give rise to assessable amounts.
The tax base of the prepaid rent is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	*$100*	+	*Nil*	=	*Nil*

13. Goodwill on consolidation has a carrying amount of $100 and is not deductible for tax purposes. Recovery of the goodwill, through use, will give rise to assessable amounts.
The tax base of the goodwill is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$100	-	*$100*	+	*Nil*	=	*Nil*

(However, in accordance with paragraph 6.1(a) the deferred tax liability that arises would not be recognised.)

14. Foreign currency trade receivables has a carrying amount of $120 after recognising a $20 foreign currency gain. The carrying amount on initial recognition was $100 and the related revenue of $100 was included in the calculation of taxable amount (tax loss) at that time. Exchange gains are only assessable for income tax purposes when they are realised. Recovery of the $120 will give rise to assessable amounts of $20.
The tax base of the foreign currency trade receivables is:

Carrying Amount		*Assessable Amounts*		*Deductible Amounts*		*Tax Base*
$120	-	*$20*	+	*Nil*	=	*$100*

EXAMPLE 4

Examples of the calculation of the tax base of liabilities that are not in the nature of "revenues received in advance" in accordance with paragraph 5.2

1. Liabilities include employee entitlements with a carrying amount of \$100. The related expense will be deducted for tax purposes on a cash basis.
The tax base of the employee entitlement liability is:

Carrying Amount		*Deductible Amounts*		*Assessable Amounts*		*Tax Base*
\$100	-	*\$100*	+	*Nil*	=	*Nil*

2. Current liabilities include accrued wages with a carrying amount of \$100. The related expense has already been deducted for tax purposes on an accrued basis (that is, the wages were deducted for tax purposes in the same year in which they were recognised as an expense for accounting purposes).
The tax base of the accrued expenses is:

Carrying Amount		*Deductible Amounts*		*Assessable Amounts*		*Tax Base*
\$100	-	*Nil*	+	*Nil*	=	*\$100*

3. Current liabilities include accrued fines and penalties with a carrying amount of \$100. Fines and penalties are not deductible for tax purposes.
The tax base of the accrued fines and penalties is:

Carrying Amount		*Deductible Amounts*		*Assessable Amounts*		*Tax Base*
\$100	-	*Nil*	+	*Nil*	=	*\$100*

4. A loan payable has a carrying amount of \$100. The repayment of the carrying amount of the loan as at the reporting date will not give rise to assessable or deductible amounts.
The tax base of the loan is:

Carrying Amount		*Deductible Amounts*		*Assessable Amounts*		*Tax Base*
\$100	-	*Nil*	+	*Nil*	=	*\$100*

5. A convertible financial instrument with a face value of $100 is classified by the issuer as a liability with a carrying amount of $75 (and a $25 equity component). The taxation authorities allow the interest payments as tax deductions, and thereby treat the instrument as debt.

The tax base of the component classified as a liability is:

Carrying Amount		*Deductible Amounts*		*Assessable Amounts*		*Tax Base*
$75	-	*Nil*	+	*$25*	=	*$100*

(The determination of the tax base of $100 is consistent with the assumption that the taxation authorities would treat any gain on defeasance/redemption as assessable.)

6. A converting financial instrument with a face value of $100 is classified by the issuer as a liability with a carrying amount of $95 (and a $5 equity component). The taxation authorities treat the "interest" payments as dividends, and thereby treat the instrument as equity. There will be no tax consequences on maturity of the instrument.

The tax base of the component classified as a liability is:

Carrying Amount		*Deductible Amounts*		*Assessable Amounts*		*Tax Base*
$95	-	*Nil*	+	*Nil*	=	*$95*

7. A foreign currency loan payable has a carrying amount on initial recognition of $100. Subsequently, the carrying amount is written down to $90 to reflect the change in exchange rates (an unrealised foreign exchange gain). Exchange gains are only assessable for income tax purposes when they are realised. The repayment of the $90 carrying amount of the loan will give rise to assessable amounts of $10.

The tax base of the loan is:

Carrying Amount		*Deductible Amounts*		*Assessable Amounts*		*Tax Base*
$90	-	*Nil*	+	*$10*	=	*$100*

EXAMPLE 5

Examples of the calculation of the tax base of liabilities that are in the nature of "revenues received in advance" in accordance with paragraph 5.3

1. Current liabilities include interest revenue received in advance, with a carrying amount of $100. The related interest revenue was taxed on a cash basis.
The tax base of the interest received in advance is:

Carrying Amount		*Amount of revenue received in advance that has increased taxable amount (or decreased tax loss)*		*Tax Base*
$100	-	*$100*	=	*Nil*

2. Current liabilities include rent revenue received in advance, with a carrying amount of $100. The related rent revenue will be taxed in future periods when accommodation is provided to tenants.
The tax base of the rent revenue received in advance is:

Carrying Amount		*Amount of revenue received in advance that has increased taxable amount (or decreased tax loss)*		*Tax Base*
$100	-	*Nil*	=	*$100*

5.4 The tax base arising from a recognised transaction or other event that does not give rise to or affect the carrying amount of a recognised non-cash non-tax asset or liability and will affect taxable amount (tax loss) in future reporting periods must be calculated as the amount of the effect on taxable amount (tax loss) in future reporting periods. For the purpose of calculating the temporary difference, the carrying amount of an asset or a liability associated with the tax base is zero.

5.4.1 Some transactions or other events give rise to a tax base but do not give rise to recognised assets and liabilities in the statement of financial position. For example, expenditure on mining operations may be *expenses* for accounting purposes but be carried forward for income tax purposes. The difference between the tax base of the costs, being the amount the taxation authorities will permit as a deduction in future periods, and the carrying amount of nil is a deductible temporary difference that gives rise to a deferred tax asset of the entity.

5.5 The tax base of a group of assets and liabilities must be calculated in a manner consistent with paragraph 5.1 if the total

carrying amount of the assets in the group exceeds the total carrying amount of the liabilities in the group, and in a manner consistent with paragraph 5.2 or 5.3 if the total carrying amount of the liabilities in the group exceeds the total carrying amount of the assets in the group.

5.5.1 In some circumstances, a transaction or other event may give rise to a separately identifiable tax base, and a group of separate carrying amounts relating to assets and liabilities rather than a single carrying amount in the statement of financial position. This occurs where a group of assets and liabilities will give rise to tax consequences that are separate from and in addition to those arising from the individual assets and liabilities. In those circumstances, the carrying amount that is compared to the tax base in calculating a temporary difference arising from the group of assets and liabilities is the total of the assets less the total of the liabilities comprising the group. An example of a transaction that gives rise to a group of assets and liabilities that has a separately identifiable tax base is the acquisition of a *subsidiary*, and is explained in paragraphs 6.1.13 to 6.1.15.

5.5.2 Calculation of tax base in accordance with paragraphs 5.1 to 5.5 means that the deferred tax liabilities and assets related to temporary differences required to be recognised by this Standard reflect the future tax consequences of transactions and other events recognised in the statement of financial position. Paragraphs 4.2 and 6.1 identify the deferred tax liabilities that either must be or must not be recognised for the purpose of this Standard. Similarly, paragraphs 4.3, 7.2 and 7.3 identify the deferred tax assets that arise from temporary differences that either must be or must not be recognised for the purpose of this Standard.

6 Recognition and Exceptions to the Recognition of Deferred Tax Liabilities

Paragraph 4.2 requires the recognition of deferred tax liabilities, subject to the limited exceptions specified in paragraph 6.1. Paragraph 6.1.1 provides the rationale for the exceptions being provided. Furthermore, in relation to the exception in paragraph 6.1(b), paragraph 6.1.1 notes that the exception would only be invoked in rare circumstances.

The remainder of Section 6 provides guidance for the calculation and recognition or non-recognition of deferred tax liabilities in particular circumstances.

6.1 A *deferred tax liability* must not be *recognised* for assessable *temporary differences* when, and only when, they arise from:

(a) *goodwill* for which amortisation is not deductible for tax purposes (see paragraphs 6.1.1, 6.1.5 and 6.1.6); or

(b) the initial recognition of an identifiable *asset* or *liability* or a group of identifiable assets or liabilities or identifiable net assets arising from a transaction, unless the assessable temporary differences arise from a transaction that:

(i) is an acquisition of an *entity* or operation that is accounted for in a way that could give rise to goodwill or *discount on acquisition*; or

(ii) affects *pre-tax net profit or loss/result* or *taxable amount (tax loss)* before or at the time of the initial recognition; or

(iii) results in the initial classification of the *equity* component separately from the liability component of a compound financial instrument;

in which case, subject to (c), the deferred tax liability must be recognised in accordance with paragraph 4.2 (see paragraphs 6.1.1 and 6.1.7 to 6.1.10); or

(c) investments in *subsidiaries*, branches, *associates* and *joint venture entities*, or interests in *joint venture operations* where:

(i) **the *parent entity*, investor or *venturer* is able to control the timing of distributions from the subsidiaries, branches, associates, or *joint ventures*; and**

(ii) **it is probable that the temporary differences will not reverse in the foreseeable future.**

(See paragraphs 6.1.1 and 6.1.11 to 6.1.18).

6.1.1 Paragraph 6.1 specifies the circumstances in which deferred tax liabilities are not recognised. As noted in paragraph 6.1.5, the exception referred to in paragraph 6.1(a) avoids the need to gross up goodwill to an amount greater than the amount at which it is initially recognised (see the note at the end of Example 6 following paragraph 6.1.3). The transactions referred to in paragraph 6.1(b) would only arise in rare circumstances, for example where a motor vehicle is acquired that is subject to the car depreciation limit under Australian income tax law, or in relation to a pre-capital gains tax non-deductible building that is expected to be recovered through use. Generally, they are transactions that give rise to the recognition of non-tax assets and liabilities that do not also give rise to goodwill, *revenues*, *expenses*, or equity items that can be related to the *deferred tax* that would otherwise be required to be recognised. The exception provided by paragraph 6.1(c) acknowledges that it would be onerous to require entities to calculate the tax consequences that would arise from temporary differences relating to investments in subsidiaries, branches, associates and joint venture entities, or interests in joint venture operations where it is not probable that the temporary differences will reverse in the foreseeable future.

6.1.2 Paragraphs 6.1.3 to 6.1.22 and the related examples provide guidance for the calculation and recognition of deferred tax liabilities in the following circumstances:

(a) fair value adjustments on the acquisition of an entity or operation

(b) assets that are remeasured

(c) goodwill

(d) initial recognition of an asset or a liability

(e) subsidiaries, branches, associates and joint ventures

(f) translation of *integrated foreign operations*

(g) compound financial instruments.

Fair Value Adjustments on the Acquisition of an Entity or Operation

Paragraph 6.1.3 explains why fair value adjustments on the acquisition of an entity or operation may give rise to recognisable deferred tax liabilities in accordance with paragraph 4.2.

6.1.3 In an acquisition of an entity or operation, the identifiable assets and liabilities acquired are measured by reference to their fair values as at the date of acquisition. Temporary differences arise when the *tax bases* and *carrying amounts* of the identifiable assets and liabilities acquired are affected differently by the acquisition. For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the subsidiary, an assessable temporary difference arises which results in a deferred tax liability that is recognised in the consolidated financial report. The resulting deferred tax liability affects goodwill or discount on acquisition (see Example 6 and paragraph 10.5).

EXAMPLE 6

An example illustrating the calculation of deferred tax liabilities and goodwill that arises on the acquisition of a subsidiary (paragraphs 4.2, 6.1 and 6.1.3)

Entity A acquires 100% of the shares of Entity B at a cost of $600. The tax rate is 30% and amortisation of goodwill is not deductible for tax purposes.

(a) Circumstances where Entity B has no deferred tax liabilities or assets immediately prior to acquisition

Information about the identifiable net assets recognised by Entity B as at the date of acquisition:

Carrying amount	$450
Tax base	450
Fair value	550

Calculation of net deferred tax liability arising on acquisition (ignoring the deferred tax liability arising from goodwill):

Fair value of Entity B's identifiable net assets	550
Less Tax base	450
Temporary difference	100
@ tax rate	30%
Net deferred tax liability arising on acquisition of Entity B	$30

Calculation of goodwill:

Purchase consideration	600
Less Adjusted fair value ($550 – $30)	520
Goodwill	$80

(b) Circumstances where Entity B has net deferred tax liabilities of $12 immediately prior to acquisition (because deferred tax liabilities were recognised on the revaluation of assets)

Information about the identifiable net assets (excluding the net deferred tax liability) recognised by Entity B as at the date of acquisition:

Carrying amount	$490
Tax base	450
Fair value	550

Calculation of net deferred tax liability after acquisition (ignoring the deferred tax liability arising from goodwill):

Fair value of Entity B's identifiable net assets (excluding net deferred tax liability)	550
Less Tax base	450
Temporary difference	100
@ tax rate	30%
Net deferred tax liability after acquisition of Entity B	$30
Less Net deferred tax liability recognised by Entity B immediately prior to acquisition	12
Net deferred tax liability arising on acquisition of Entity B	18

Calculation of goodwill:

Purchase consideration	600
Less Adjusted fair value ($550 – $30)	520
Goodwill	$80

(Note: Because the tax base of goodwill is nil (see item 13 of Example 3 following paragraph 5.3.2), there is an assessable temporary difference relating to the goodwill calculated in (a) and (b) above of $80, which itself gives rise to a deferred tax liability of $24 and therefore a recalculated goodwill amount of $104, which in turn increases the assessable temporary difference. This process continues iteratively. Goodwill ultimately will be $114.30 (calculated as ($80 + .3g = g, where g is goodwill) and the deferred tax liability relating to goodwill is $34.30. In accordance with paragraph 6.1(a), the deferred tax liability arising from goodwill is not recognised – see paragraph 6.1.5.)

Paragraphs 10.5 and 10.6 and related commentary provide further guidance on the treatment of deferred tax arising from the acquisition of an entity or operation.

Assets that are Remeasured

Paragraph 6.1.4 explains why assets that are remeasured may give rise to recognisable deferred tax liabilities in accordance with paragraph 4.2.

6.1.4 Australian Accounting Standards permit certain assets to be carried at fair value (see, for example, Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets"). Other Australian Accounting Standards require certain assets to be carried at net market value (Australian Accounting Standards AAS 26 "Financial Reporting of General Insurance Activities" and AAS 35 "Self-Generating and Regenerating Assets"). Under Australian income tax law the tax base of an asset will generally not change as a result of a remeasurement (although the tax base of the asset may change with the effect of indexation if the asset is subject to capital gains tax). Where the future recovery of the (remeasured) carrying amount will result in assessable amounts of the entity, the amount that will be deductible for tax purposes will differ from the assessable amounts. The difference between the carrying amount of a remeasured asset and its tax base is a temporary difference and gives rise to a deferred tax liability or a *deferred tax asset*. This occurs when:

(a) the entity's management or governing body expects to recover the carrying amount of the asset through use. In such cases, recovery of the remeasured carrying amount of the asset will generate assessable amounts which differ from the depreciation that will be allowable as a deduction for tax purposes in future periods; or

(b) the entity's management or governing body expects to recover the carrying amount of the asset immediately through sale. This is so even if tax on capital gains is deferred if the proceeds of the disposal of the asset are invested in similar assets because in such cases the tax will ultimately be required to be settled on sale of the similar assets; or

(c) the carrying amount of the asset is likely to be recovered through use and subsequent sale. In such cases, recovery of the remeasured carrying amount of the asset will generate assessable amounts equal to the *depreciable amount* plus the residual value which differ from the depreciation and indexed cost base or reduced cost base that will constitute deductible amounts for tax purposes in future periods.

Goodwill

Paragraphs 6.1.5 and 6.1.6 explain why purchased goodwill gives rise to a deferred tax liability that would need to be recognised in the absence of the exception in paragraph 6.1(a).

6.1.5 Purchased goodwill is the excess of the cost of an acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired. Australian taxation authorities do not allow the amortisation of goodwill as a deduction in calculating *taxable amounts*. Moreover, the cost of goodwill recognised for consolidation purposes on the acquisition of a subsidiary would not be deductible if a subsidiary disposes of its underlying business. In such circumstances, goodwill arising on the acquisition of a subsidiary has a tax base of nil (see item 13 of Example 3 following paragraph 5.3.2). Any difference between the carrying amount of goodwill and its tax base of nil is an assessable temporary difference. However, this Standard does not permit the recognition of the resulting deferred tax liability because goodwill arising on the acquisition of a subsidiary is a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill. The carrying amount of goodwill would increase by the related deferred tax liability because the initial carrying amount before the increase is an after tax amount (see the note at the end of Example 6 following paragraph 6.1.3).

6.1.6 Where the cost of purchased goodwill would be deductible for tax purposes against proceeds from disposal (for example, where the entity acquires the underlying assets and liabilities of another entity rather than the shares in that entity) but the acquiring entity's management or governing body expects to recover the goodwill through use, a deferred tax liability arises because the carrying amount of the goodwill exceeds the tax base of nil. In accordance with paragraph 6.1(a), the deferred tax liability that results would also not be recognised where amortisation of goodwill is not deductible for tax purposes. On the other hand, if the entity acquires the underlying assets and liabilities of another entity and, subsequent to the initial recognition of the goodwill, the entity's management or governing body expects to recover the acquired goodwill through sale, a deferred tax asset would be likely to arise subsequent to the initial recognition of the goodwill. This is because the tax base would be the original cost of the goodwill which would be expected to be greater than the carrying amount (the original cost less accumulated amortisation). Paragraph 4.3 specifies the circumstances in which the deferred tax asset would be recognised.

Initial Recognition of an Asset or a Liability

Paragraphs 6.1.7 to 6.1.10 explain the circumstances in which the initial recognition of an asset or a liability gives rise to a deferred tax liability that is required to be recognised in accordance with paragraph 4.2, and the rare circumstances in which paragraph 6.1(b) proscribes a deferred tax liability from being recognised.

6.1.7 An assessable temporary difference may arise on initial recognition of an asset or a liability, for example if part or all of the cost of an asset will not be deductible for tax purposes. The method of accounting for such a temporary difference depends on the nature of the transaction which led to the initial recognition of the asset or liability:

(a) if the transaction is an acquisition of an entity or operation that is accounted for in a way that could give rise to goodwill or discount on acquisition, assets and liabilities of the acquiree are recognised by the acquiring entity for the first time. In those circumstances, the acquiring entity recognises in its financial report any deferred tax liability arising from any assessable temporary differences associated with the underlying assets and liabilities of the acquiree, and this affects the amount of goodwill or discount on acquisition (see paragraph 6.1.3)

(b) if the transaction affects either pre-tax net profit or loss/result or taxable amount (tax loss) (for example, the initial recognition of prepaid rent as an asset that is deductible when paid), the entity recognises any deferred tax liability in the statement of financial position and recognises the related deferred tax expense in *net profit or loss/result* (see paragraph 10.1.1)

(c) if the transaction results in the initial classification of the equity component separately from the liability component of a compound financial instrument, any deferred tax liability that arises is recognised as a *direct debit to equity*, that is, as a debit to the carrying amount of the equity component of the compound financial instrument (see paragraphs 6.1.20 to 6.1.22).

6.1.8 In the rare circumstances that the transaction is not of the kind described in paragraph 6.1.7(a), (b) or (c), and gives rise to an assessable temporary difference on initial recognition of an asset or a liability, recognition of the deferred tax liability would result in an

adjustment to the carrying amount of the asset or liability by the same amount or an amount for tax expense (revenue) recognised in net profit or loss/result. To avoid this accounting consequence, paragraph 6.1(b) of this Standard does not permit the entity to recognise the resulting deferred tax liability, either on initial recognition or subsequently. Furthermore, the entity does not recognise subsequent changes in that deferred tax liability when an asset that gives rise to the deferred tax liability is depreciated. However:

(a) if subsequent to the initial recognition of an asset that falls within the exception in paragraph 6.1(b) the asset is remeasured upwards for accounting purposes and no equivalent adjustment is made to its tax base, the remeasurement would give rise to a temporary difference. Therefore, a deferred tax liability is required to be recognised to the extent it relates to the remeasurement (see Example 7)

(b) if the tax base of an asset for which the exception in paragraph 6.1(b) is invoked on initial recognition subsequently changes (for example, due to a change in legislation or a change in an entity's shareholder group), the assessable temporary difference and therefore the deferred tax liability that arises (if any) is required to be recognised.

Furthermore, a deferred tax liability is recognised in the consolidated financial report in relation to an asset recognised as a result of the acquisition of an entity or operation even where the acquiree does not recognise a deferred tax liability in relation to that asset in accordance with paragraph 6.1(b). The resulting deferred tax liability affects goodwill (see paragraph 10.5).

EXAMPLE 7

Example illustrating paragraph 6.1.8 [and paragraph 6.1(b)]

An entity expects to use an asset (for example, a non-deductible, pre-capital gains tax, building) with a carrying amount of $1,000 at the beginning of year 1 throughout its remaining useful life of five years and then dispose of it for a residual value of nil. The asset is revalued upwards by $100 at the beginning of year 2. The tax rate is 30%. Depreciation (or other write-off) of the asset is not deductible for tax purposes. On disposal, any capital loss would not be deductible.

	Carrying Amount $	Tax Base $	Temporary Difference $
Depreciated amount as at the beginning of year 1	1,000	–	1,000
Depreciation in year 1	200	–	
Net amount at end of year 1	800	–	800
Revaluation at beginning of year 2	100	–	
Net amount at beginning of year 2	900	–	900
Tax rate			30%
Deferred Tax Liability:			
At beginning of year 1			300
At end of year 1			240
At beginning of year 2			270
Deferred Tax Liability recognised in accordance with paragraphs 4.2 and 6.1:			
At beginning of year 1			–
At end of year 1			–
At beginning of year 2			30

As at the beginning of year 1, the entity expects to recover the carrying amount of the asset through use over the next 5 years, and thereby will earn assessable amounts of $1,000 and pay tax of $300. The entity does not recognise the resulting deferred tax liability of $300 because it results from the initial recognition of the asset which arose from a transaction that was not an acquisition of an entity or operation and it did not affect pre-tax net profit or loss/result or taxable amount (tax loss) at the time of the initial recognition.

At the end of the first year, the carrying amount of the asset is $800. In earning assessable amounts of $800 over the next 4 years, the entity will pay tax of $240. The entity does not recognise the deferred tax liability of $240 because it results from the initial recognition of the asset.

At the beginning of the second year, the entity revalues the asset upwards to $900, and will incur tax of $270 over the next 4 years. The entity does not recognise $240 of the deferred tax liability because it results from the initial recognition of the asset. Instead, the $240 will be recognised as tax expense as and when the asset is recovered. The entity would recognise the remaining $30 as a deferred tax liability because it does not arise from the initial recognition of the asset (rather it arises from the subsequent revaluation of the asset). The deferred tax liability that arises on the revaluation of the asset would, in accordance with paragraph 10.2, be recognised as a direct debit to the asset revaluation reserve.

6.1.9 An asset may be recognised in a reporting period subsequent to the reporting period or periods in which the costs related to the asset have been expensed for accounting purposes and deducted for tax purposes (that is, the asset is reinstated). In those circumstances, the tax base of the asset is nil. An assessable temporary difference, and therefore a deferred tax liability, arises because the carrying amount of the asset is greater than its tax base. The deferred tax liability is recognised in those circumstances because it results from a transaction that affected taxable amount (tax loss) and pre-tax net profit or loss/result in an earlier reporting period (see paragraph 6.1(b)(ii)).

6.1.10 A deferred tax liability may also arise at the date that an entity that is not subject to income tax becomes subject to income tax (see Section 11). In determining whether the exceptions to recognising deferred tax liabilities in paragraph 6.1 apply, the assets and liabilities recognised by the entity as at the date of the change in tax status are treated as if the entity had been subject to income tax as at the date the assets and liabilities were initially recognised. For example, where as at the date an entity first becomes subject to income tax the entity holds an asset that is not subject to capital gains tax and the asset is not deductible and the entity's management or governing body expects to recover the asset through use, application of paragraph 6.1(b) would result in the deferred tax liability that exists not being recognised.

Subsidiaries, Branches, Associates and Joint Ventures

Paragraphs 6.1.11 to 6.1.18 explain why deferred tax liabilities may arise from investments in subsidiaries, branches, associates and joint venture entities and interests in joint venture operations and the circumstances in which paragraph 6.1(c) prohibits recognition of a deferred tax liability.

6.1.11 Temporary differences arise when the carrying amount associated with investments in subsidiaries, branches, associates and joint venture entities and interests in joint venture operations recognised in the financial report is different from the tax base (which is often cost or indexed cost) of the investments or interests. Such differences may arise in a number of different circumstances, for example:

(a) when the carrying amount associated with investments in subsidiaries, branches, associates or joint venture entities or interests in joint venture operations includes the

undistributed profits and reserves of the subsidiaries, branches, associates or joint ventures; or

(b) when the carrying amount associated with investments in subsidiaries, branches, associates or joint venture entities or interests in joint venture operations has been reduced to recoverable amount.

The temporary differences relating to investments in subsidiaries, associates or joint venture entities that are recognised in an *economic entity* financial report may be different from the temporary differences relating to those investments or interests that are recognised in the parent entity separate financial report. For example, this would occur if the investment in an associate is carried in a parent entity financial report at cost or revalued amount but is carried at an amount determined using the equity method of accounting in the economic entity consolidated financial report, and the carrying amounts differ. The exception set out in paragraph 6.1(c) applies to deferred tax liabilities that arise in relation to the parent only financial report and the consolidated financial report.

6.1.12 In some cases, the entity may not be able to calculate the amount of income tax that would be payable if it recovers the carrying amount of its investment in a subsidiary, branch, associate or joint venture entity or interest in a joint venture operation other than through immediate sale, but can determine that it will equal or exceed a minimum amount. In such cases, the minimum amount is used to measure the best estimate of the amount of the deferred tax liability. The difficulties in calculating the amount of income tax may arise because of the complexities of corporate structures (paragraph 4.5 prescribes the formula for measuring deferred tax liabilities). For example, an economic entity with many layers of intermediate parent entities may have many alternative routes for recovering an investment, and each route may have different tax consequences. The entity's management or governing body may not be in a position to identify the manner by which it expects to recover the investment. The entity's management or governing body may be able to estimate that the tax rate that will apply to recovery of a particular investment will be between, say, 15% and 45%, depending on the manner and timing of recovery. Because the entity's management or governing body has no way of knowing what the rate is likely to be, the minimum is recognised.

Investments in Subsidiaries – Parent Only and Consolidated Financial Reports

6.1.13 An investment in a subsidiary is carried at cost or revalued amount in the parent entity separate financial report. Any excess of the carrying amount in the parent entity separate financial report over the tax base of the investment gives rise to a deferred tax liability that is recognised, unless the conditions in paragraph 6.1(c) are met.

6.1.14 The economic entity financial report records the underlying assets and liabilities of the subsidiary and goodwill arising on consolidation rather than the parent entity's "one-line" investment in the subsidiary. Accordingly, the economic entity financial report includes deferred tax liabilities that are recognised in the subsidiary's financial report and the deferred tax liabilities arising from fair value adjustments on the acquisition of the subsidiary (see paragraph 6.1.3). In addition, a deferred tax liability attributable to the economic entity may arise where recovery by the parent entity of its investment in the subsidiary will give rise to a tax consequence that affects the economic entity. The potential for this arises where the tax base of the parent's investment (which is the cost of the shares under Australian income tax law, indexed for inflation where relevant) is less than the carrying amount of the net assets of the subsidiary as recognised in the consolidated statement of financial position plus the carrying amount of goodwill on consolidation as recognised in the consolidated statement of financial position, whether the subsidiary was acquired through a step acquisition or in a single transaction. Example 3 of Appendix 2 illustrates the calculation of temporary differences arising from a parent entity's investment in a subsidiary and its potential effect on the consolidated financial report.

6.1.15 The parent entity (and therefore the economic entity) controls the dividend policy of its subsidiary, and is therefore able to control the timing of the reversal of temporary differences arising from that investment (including the temporary differences arising from undistributed profits and reserves). Therefore, when the parent entity (and therefore the economic entity) has determined that a subsidiary's profits and reserves will not be distributed in the foreseeable future and the subsidiary will not be disposed of, the parent entity does not recognise a deferred tax liability that arises from the investment in the subsidiary in the parent entity financial report and the consolidated financial report. However, subject to adjustments on consolidation, the economic entity recognises any deferred tax liability that is recognised in the subsidiary's own

financial report and the deferred tax liability that arises from fair value adjustments on acquisition.

Investments in Branches and Interests in Joint Venture Operations

6.1.16 The assets and liabilities of a branch are recognised in the financial report of the branch operator. Where temporary differences arise in relation to those assets and liabilities, deferred tax liabilities and assets are recognised in accordance with this Standard. In addition, in some jurisdictions the sale of a branch by the branch operator or the distribution of profits and reserves from the branch to the branch operator may give rise to a tax consequence. In those circumstances, the carrying amount of the net assets relating to the branch (including purchased goodwill after amortisation) is compared with the tax base of the branch operator's investment in the branch to determine whether a temporary difference exists and, therefore, whether a deferred tax liability exists. When the branch operator has determined that a branch's profits and reserves will not be distributed in the foreseeable future and the branch will not be disposed of the branch operator does not recognise a deferred tax liability (see paragraph 6.1(c)).

6.1.17 Deferred tax liabilities may also arise in relation to a venturer's interest in a joint venture operation where the sale of the interest or the distribution from the venture gives rise to income tax consequences for the venturer. Those deferred tax liabilities are separate from any deferred tax liability that arises in relation to the recognised assets that arise from the venturer's share in each of the items employed in the joint venture operation and recognised liabilities that arise from its interest in the joint venture operation. The arrangement between the parties to a joint venture operation usually deals with the sharing of the outputs and identifies whether decisions on such matters require the consent of all the venturers or a specified majority of the venturers, which is relevant to determining whether the condition in paragraph 6.1(c)(i) is met. In the absence of an agreement that no distributions be made out of the joint venture operation in the foreseeable future, a venturer recognises a deferred tax liability for assessable temporary differences arising from its interest in the joint venture operation.

Investments in Associates and Joint Venture Entities

6.1.18 An investor in an associate or joint venture entity does not control that entity. Therefore, the investor may not be in a position to determine the distribution policy of the associate or joint venture

entity. Accordingly, in the absence of an agreement requiring that the profits and reserves of the associate or joint venture entity not be distributed in the foreseeable future, an investor recognises a deferred tax liability for assessable temporary differences arising from its investment in the associate or joint venture entity.

Translation of Integrated Foreign Operations

Paragraph 6.1.19 and Example 8 explain why deferred tax liabilities that arise from the translation of integrated foreign operations are required to be recognised in accordance with paragraph 4.2.

6.1.19 Non-monetary assets and liabilities of a foreign operation that is integral to the entity's operations are translated at historical exchange rates (see Australian Accounting Standard AAS 20 "Foreign Currency Translation"). Where a foreign operation's taxable amount (and, hence, the tax base of its non-monetary assets and liabilities) is calculated in the foreign currency, changes in the exchange rate give rise to temporary differences because the carrying amounts of the translated non-monetary assets and liabilities (translated to Australian currency at the historical exchange rates) differ from their tax bases (translated at exchange rates prevailing as at *reporting date*). Such temporary differences relate to the foreign operation's own assets and liabilities. They do not arise from the entity's investment in that foreign operation. Accordingly, the resulting deferred tax liability or (subject to paragraph 4.3) asset is recognised in the consolidated financial report. The related change in cumulative deferred tax is recognised as an expense or a revenue in the consolidated net profit or loss/result (see paragraph 10.1). Example 8 illustrates the tax effects of integrated foreign operations.

EXAMPLE 8

Example illustrating the effect explained in paragraph 6.1.19

An Australian entity (Entity A) controls an integrated foreign subsidiary (Entity B) that is based in the United Kingdom (UK).

Entity B acquires a non-monetary asset (land) for £1,000 when the exchange rate is $1:£0.5 (30 June X0). The land is the only asset of its class held by Entity B and the economic entity. Six months later, the exchange rate has moved to $1:£0.58. Twelve months later, the exchange rate has moved to $1:£0.6 (30 June X1).

As at 30 June X1, Entity B's statement of financial position would show an asset, land, with a carrying amount of £1,000 (which is not greater than its recoverable amount). The tax base of the land is £1,000, therefore no deferred tax asset or liability arises in the financial report expressed in £. Entity B does not have any deferred tax assets or liabilities at the beginning of the reporting period (that is, 1 July X0).

The following considers the accounting treatment under different scenarios:

(a) Entity B does not revalue the land during the year

As at 30 June X1, the economic entity's statement of financial position (expressed in $) would recognise an asset at a translated carrying amount of $2,000 (in accordance with AAS 20). That implies that the economic entity will recover $2,000 from the land. That $2,000 is now equivalent to recovering £1,200 at the 30 June X1 exchange rate. The tax base of the land is £1,000 (or, when translated at current exchange rates, $1,667). Therefore, an assessable temporary difference arises of £200 (£1,200 – £1,000) or $333 ($2,000 – $1,667). If the tax rate is 30% in the UK a deferred tax liability of $99.90 and a corresponding tax expense of $99.90 would be recognised in the economic entity's financial report.

30 June X1	**Carrying Amount** $	**Translated Tax Base** $	**Temporary Difference** $
Land	2,000	1,667	333
Tax Rate			30%
Deferred Tax Liability (credit)			99.90*
Income Tax Expense (debit)			99.90

* the credit to deferred tax liability of $99.90 may be explained as:

	$
Translated deferred tax liability	0
Add: Adjustment arising from the calculation of tax base at the current exchange rate	99.90
	99.90
Less: Deferred tax liability as at 1 July X0	0
Credit to deferred tax liability	99.90

(b) Entity B revalues the land only in the middle of the year

If, as allowed by AAS 10, Entity B has revalued the land as at 31 December X0 to £1,400 by crediting an asset revaluation reserve with £400, then a deferred tax liability of £120 would be recognised by Entity B, with a corresponding debit to an asset revaluation reserve in accordance with paragraph 10.2 of this Standard. As at 30 June X1, the economic entity's translated financial report would recognise a deferred tax liability of $224 and an income tax expense of $24, calculated as follows:

30 June X1	Carrying Amount £		$	Tax Base £		$	Temporary Difference £	$
Land	1,400	/.58	2,414	1,000	/.6	1,667	400	747
Tax Rate							30%	30%
Deferred Tax Liability							120	224
Less: Translated deferred tax liability at current rate (£120/.6)								200
Adjustment to translated deferred tax liability arising from translating the tax base at the current rate								24

The journal entry reflecting the effect of the adjustment on tax expense and deferred tax liability is as follows:

		$	$
Dr	Income Tax Expense	24	
Cr	Deferred Tax Liability		24

(c) Entity B revalues the land only at the end of the year

If, as allowed by AAS 10, Entity B has revalued the land as at 30 June X1 to £1,500 by crediting an asset revaluation reserve with £500, then a deferred tax liability of £150 would be recognised by Entity B, translated to $250 for economic entity financial reporting purposes. A corresponding £150 ($250) would be debited to the asset revaluation reserve in accordance with paragraph 10.2 of this Standard.

30 June X1	Carrying Amount £	$	Tax Base £	$	Temporary Difference £	$
Land	1,000		1,000			
Revaluation	500		–			
	1,500	2,500	1,000	1,667	500	833
Tax Rate					30%	30%
Deferred Tax Liability (credit)					150	250
Asset Revaluation Reserve (debit)					150	250

The translation of Entity B's financial statements in accordance with AAS 20 would yield this result because the revaluation and translation both take place at 30 June X1. Accordingly, the revaluation would not give rise to an additional adjustment as in (a) and (b) above under this Standard.

(d) ***The land is treated as an impaired asset***

If the translated recoverable amount at 30 June X1 is $1,667, the land is written down to $1,667 in the economic entity's financial report. The write down is treated as an expense (in accordance with AAS 10 and AAS 20) and the resulting carrying amount of the land equals the tax base of the land (expressed as cost translated at the current exchange rate) and no deferred tax effect occurs. There is no direct tax consequence of the impairment of the land caused by movements in the exchange rate because it would not be deductible in Australia under Australian income tax laws.

	Carrying Amount		**Tax Base**		**Temporary Difference**	
30 June X1	£	$	£	$	£	$
Land	1,000	2,000	1,000	1,667		
Recoverable amount write down	–	333	–	–		
Net Amount	1,000	1,667	1,000	1,667	–	–

However, there may be an indirect tax consequence of the impairment of the land caused by movements in the exchange rate by virtue of a temporary difference arising from the parent entity's investment in the subsidiary (see paragraphs 7.2 and 7.2.1).

(Note: If the land that is located in the UK were held directly by Entity A, instead of indirectly through Entity B, the journal entries described above under the different scenarios would be recorded by Entity A to the extent that holding the land directly rather than indirectly gives rise to the same income tax consequences.)

Compound Financial Instruments

Paragraphs 6.1.20 to 6.1.22 explain why compound financial instruments may give rise to deferred tax liabilities that are required to be recognised in accordance with paragraph 4.2, and why the exception to the recognition of deferred tax liabilities in paragraph 6.1(b) does not apply.

6.1.20 The issuer of a compound financial instrument (for example, a convertible note) classifies the instrument's components as liabilities or as equity, in accordance with Australian Accounting Standard AAS 33 "Presentation and Disclosure of Financial Instruments". The carrying amount of the component of the instrument that is classified as a liability is less than the face value of the instrument due to the separately recorded carrying amount of the component classified as equity. Subject to Australian income

tax law, the tax base associated with a compound financial instrument that is a simple convertible note is its face value (see item 5 of Example 4 following paragraph 5.3.2). As noted in paragraph 4.1, the principle underlying this Standard is that the future tax consequences of transactions and other events that are recognised in the financial report give rise to deferred tax liabilities and assets that, subject to paragraphs 6.1, and 4.3, 7.2 and 7.3, are required to be recognised in the financial report. When an issuer of a convertible note applies this principle a deferred tax liability arises because settling the carrying amount of the liability component of the convertible note would give rise to future tax consequences. For example, settling the liability for its carrying amount would give rise to an assessable amount in the form of a gain on extinguishment of debt.

6.1.21 Subject to Australian income tax law, the tax base associated with a compound financial instrument that is a simple converting note is equal to the amount that is classified as a liability if there is no effect on the taxable amount (tax loss) that arises on settling that amount (see item 6 of Example 4 following paragraph 5.3.2). Even if the carrying amount is settled early, either with cash or equity, there would be no income tax consequence to the extent that the settlement is treated as a return of equity under the income tax law. Accordingly, no deferred tax liability arises in relation to simple converting financial instruments.

6.1.22 The exception to the recognition of deferred tax liabilities set out in paragraph 6.1(b) is not relevant to deferred tax liabilities arising from compound financial instruments (as noted in paragraph 6.1(b)(iii)) because any assessable temporary difference that arises is a result of the initial classification of a component of the instrument as equity separately from the component that is classified as a liability. Consequently, the entity recognises the resulting deferred tax liability. In accordance with paragraph 10.2, the deferred tax is recognised as a direct debit to equity, that is, debited to the carrying amount of the equity component. In accordance with paragraph 10.4, subsequent changes in the deferred tax liability resulting from the reversal of the related temporary difference are recognised in the calculation of net profit or loss/result as deferred tax expense (revenue). Example 4 of Appendix 2 illustrates the treatment of the tax effects of compound financial instruments where the tax base exceeds the carrying amount of the component classified as a liability.

7 Recognition and Exceptions to the Recognition of Deferred Tax Assets

Re-assessment of Deferred Tax Assets

7.1 The *carrying amount* of a *deferred tax asset* must be reviewed as at each *reporting date*. The *entity* must reduce the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient *taxable amounts* will be available to allow the benefit of that deferred tax asset to be recovered. Any such reduction must be reversed to the extent that it becomes probable that sufficient taxable amounts will be available.

7.1.1 The entity re-assesses whether any deferred tax assets that are not *recognised* that previously did not satisfy the "probable" recognition criterion subsequently satisfy that criterion at each reporting date. The entity also re-assesses unrecognised deferred tax assets at the date of an acquisition of an entity or operation or subsequently (see paragraphs 10.5 and 10.6). The entity recognises a previously unrecognised deferred tax asset to the extent that it has become probable that future taxable amounts will allow the deferred tax asset to be recovered. For example, an improvement in trading conditions may make it probable that the entity will be able to generate sufficient taxable amounts in the future for the deferred tax asset to be recognised. Furthermore, an expectation of a capital gain in the future may make it probable that the entity will be able to realise the benefit of a carry-forward capital loss, thereby justifying recognition of the deferred tax asset arising from the capital loss.

Deferred Tax Assets arising from Deductible Temporary Differences

Investments in Subsidiaries, Branches, Associates and Joint Venture Entities and Interests in Joint Venture Operations

7.2 A deferred tax asset must not be recognised for deductible *temporary differences* to the extent that they arise from investments in *subsidiaries*, branches, *associates* and *joint venture entities*, or interests in *joint venture operations* and it is probable that the temporary difference will continue to exist in the foreseeable future.

7.2.1 A deferred tax asset arises in relation to a single entity or consolidated financial report when the *tax base* associated with an

investment in a subsidiary, branch, associate or joint venture entity or interest in a joint venture operation exceeds the carrying amount associated with that investment or interest. For example, the tax base of an investment in shares of a subsidiary may exceed the carrying amount where the carrying amount is reduced to the investment's recoverable amount. The deferred tax asset that arises is not recognised unless the *parent entity's* management or governing body expects to sell the investment in the foreseeable future (subject to the "probable" recognition criterion). The deferred tax asset that arises is separate from the deferred tax assets that may arise in relation to the underlying recognised *assets* and *liabilities* of subsidiaries, branches and joint venture operations. Those deferred tax assets may be required to be recognised in a financial report of a group, branch operator or *venturer* in accordance with paragraph 4.3.

Initial Recognition of an Asset or a Liability

Paragraph 4.3 requires the recognition of deferred tax assets, subject to the exceptions specified in paragraphs 7.2 and 7.3. Paragraph 7.3.2 provides the rationale for the exception in paragraph 7.3 being provided. It notes that the exception would only be invoked in rare circumstances.

7.3 A deferred tax asset must not be recognised for deductible temporary differences when they arise from the initial recognition of an identifiable asset or liability or a group of identifiable assets or liabilities or identifiable net assets arising from a transaction, unless the deductible temporary differences arise from a transaction that:

(a) is an acquisition of an entity or operation that is accounted for in a way that could give rise to *goodwill* or *discount on acquisition*; or

(b) affects *pre-tax net profit or loss/result* or *taxable amount (tax loss)* before or at the time of the initial recognition;

in which case, subject to paragraph 7.2, the deferred tax asset must be recognised in accordance with paragraph 4.3.

7.3.1 As noted in paragraph 4.3.1, a deferred tax asset arises when an asset's tax base is greater than its carrying amount. Government grants, including government grants that are related to assets, are treated as *revenue* and therefore do not reduce the carrying amounts of the related assets. Accordingly, where a government grant does not affect the tax base of the asset to which it relates, there will be

no difference between the carrying amount and the tax base of the asset, and therefore a deductible temporary difference does not arise.

7.3.2 In limited circumstances a deductible temporary difference may arise on initial recognition of an asset or a liability where the carrying amount of the asset (liability) is less (greater) than the tax base of the asset (liability). For example, initial recognition of a building that is eligible for deductions relating to capital works expenditure or an asset related to water facilities subject to the landcare and water facility offset under Australian income tax law may give rise to a deductible temporary difference and therefore a deferred tax asset because the future deductible amounts that will arise from recovering the carrying amounts of the assets exceed the carrying amounts. However, in accordance with paragraph 7.3, the deferred tax asset is not recognised, either on initial recognition or subsequently.

The "Probable" Recognition Criterion

7.3.3 An asset is recognised when, and only when, it is probable that the future economic benefits embodied in the asset will eventuate and the asset has a cost or other value that can be measured reliably. All deductible temporary differences give rise to deferred tax assets that can be measured reliably. The reversal of deductible temporary differences results in deductions in calculating the taxable amounts of future reporting periods. However, economic benefits in the form of reductions in tax payments will flow to the entity only if it earns sufficient taxable amounts against which the deductions can be offset. Therefore, the entity recognises deferred tax assets relating to deductible temporary differences only to the extent that it is probable that taxable amounts will be available against which the deductible temporary differences can be utilised.

7.3.4 It is probable that taxable amounts will be available against which a deductible temporary difference can be utilised to the extent that there are sufficient assessable temporary differences, relating to the same taxation authority and the same taxable entity, which are expected to reverse:

(a) in the same period as the expected reversal of the deductible temporary difference; or

(b) in periods to which a *tax loss* arising from the reversal of the deductible temporary difference can be utilised.

In such circumstances, the deferred tax asset is recognised in the reporting period in which the deductible temporary differences arise.

7.3.5 There may be insufficient assessable temporary differences relating to the same taxation authority and the same taxable entity against which a deductible temporary difference can be utilised. In those circumstances, the deferred tax asset is recognised to the extent that it is probable that the entity will have sufficient taxable amounts relating to the same taxation authority and the same taxable entity in the same period as the reversal of the deductible temporary difference (or in the periods to which a tax loss arising from the reversal of the deductible temporary difference can be utilised). All available evidence, both positive and negative, is considered to determine whether a deferred tax asset is recognised. Information about an entity's current financial position and its results of operations for the current and preceding reporting periods ordinarily is readily available. That historical information is supplemented by all currently available information about future periods. However, sometimes historical information may not be available (for example, start-up operations) or it may not be relevant (for example, if there has been a significant, recent change in circumstances). In evaluating whether it will have sufficient taxable amounts in future periods, the entity ignores taxable amounts arising from deductible temporary differences that are expected to originate in future periods, because the deferred tax asset arising from these deductible temporary differences will itself require future taxable amounts in order to be utilised.

7.3.6 The entity may be able to take action to create or increase taxable amounts in a particular reporting period before the expiry of a tax loss carry forward. Such actions are most relevant in jurisdictions where tax losses can only be carried forward for a limited period of time. Under Australian income tax laws, tax losses can generally be carried forward indefinitely. Where actions transfer assessable amounts from a later period to an earlier period, the utilisation of a tax loss carry forward still depends on future taxable amounts that do not arise from deductible temporary differences that are expected to originate in future periods.

7.3.7 Forming a conclusion that all deductible temporary differences give rise to recognisable deferred tax assets is difficult when there is negative evidence such as cumulative losses in recent reporting periods. When the entity has a tax loss, it considers the guidance in paragraphs 7.3.9 and 7.3.10 in determining whether deferred tax assets arising from deductible temporary differences satisfy the "probable" recognition criterion.

7.3.8 Judgement is used in considering the relative impact of negative and positive evidence. The weight given to the potential effect of negative and positive evidence is commensurate with the extent to

which it can be objectively verified. The more negative evidence that exists:

(a) the more positive evidence is necessary to overturn that negative evidence

(b) the more difficult it is to support a conclusion that all deductible temporary differences give rise to recognisable deferred tax assets.

Deferred Tax Assets arising from Unused Tax Losses

The "Probable" Recognition Criterion

7.3.9 The criteria for recognising deferred tax assets arising from the carry forward of unused tax losses (whether from trading losses, capital losses or tax offsets) are the same as the criteria for recognising deferred tax assets arising from deductible temporary differences. However, as indicated in paragraph 7.3.7, the existence of unused tax losses is strong evidence that future taxable amounts derived from relevant sources may not be available. Therefore, when the entity has a history of recent tax losses, the entity recognises a deferred tax asset arising from unused tax losses only to the extent that the entity has sufficient assessable temporary differences, or there is convincing other evidence that sufficient taxable amounts will be available, against which the unused tax losses can be utilised by the entity. In such circumstances, paragraph 13.4 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.

7.3.10 The entity considers all relevant factors in assessing the probability that taxable amounts will be available against which the unused tax losses can be utilised. These factors include:

(a) whether the entity has sufficient assessable temporary differences relating to the same taxation authority and the same taxable entity that will result in an increase in taxable amounts within the entity against which the unused tax losses can be utilised before they expire

(b) whether the entity has a record of budget reliability and, based on the entity's budgets, it is probable that the entity will have sufficient taxable amounts derived from relevant sources in the foreseeable future, before the unused tax losses expire

(c) whether the unused tax losses result from identifiable causes that are unlikely to recur in the foreseeable future

(d) whether any actions are available to the entity that will create taxable amounts derived from relevant sources in the period in which the unused tax losses can be utilised

(e) whether favourable opportunities or new developments are likely to give rise to sufficient taxable amounts in the foreseeable future, before the unused tax losses expire

(f) whether existing contracts or firm sales backlog will produce sufficient taxable amounts to realise the deferred tax asset arising from the unused tax losses based on existing sales prices and cost structures

(g) whether there is an excess of unrecognised appreciated asset value over the tax base of the entity's net assets of an amount sufficient to realise the deferred tax asset arising from the unused tax losses

(h) whether there is a strong earnings history exclusive of the loss that created the future deductible amount coupled with evidence indicating that the loss is an aberration (for example, an *extraordinary item*) rather than an item resulting from a continuing condition.

To the extent that it is not probable that sufficient taxable amounts will be available against which unused tax losses can be utilised, the deferred tax asset is not recognised.

Accounting for the Transfer of Tax Losses within the Economic Entity

7.3.11 Under Australian income tax laws, tax losses may be transferred within the *economic entity* from a loss entity to an income entity in particular circumstances. The transferability of tax losses within the economic entity is not a sufficient basis for recognising an asset described as "deferred tax asset" by the loss entity. However, another asset, described as "transferable tax losses", is recognised by the loss entity to the extent that it is probable the loss will be transferred and consideration will be received. In those circumstances, the asset is measured at the fair value of the expected consideration. The asset "transferable tax losses" is not initially measured at its face value and subsequently remeasured to the fair value of the expected consideration.

7.3.12 Where no deferred tax asset or other asset in respect of tax losses is recognised by the loss entity, any consideration received or receivable by the loss entity for losses transferred is recognised and represents a recoupment of the benefit of the losses. This recoupment of the losses is treated by the loss entity as an adjustment to the amount of *income tax expense*.

7.3.13 Where a deferred tax asset or other asset in respect of tax losses is recognised by the loss entity, consideration received or receivable represents a realisation of the deferred tax asset or other asset. Where the deferred tax asset or other asset and the consideration are the same amount, there is no effect on the statement of financial performance of the loss entity. The deferred tax asset or other asset is reduced by the amount of the consideration. However, where the amount of deferred tax asset or other asset differs from the consideration (which may be nil), a difference arises on realisation. The loss entity includes the difference in the calculation of income tax expense in the loss entity's statement of financial performance of the reporting period in which the asset is realised.

7.3.14 Losses transferred from a loss entity to an income entity are included in the calculation of income tax expense by the income entity. Where consideration is not paid or payable to the loss entity for losses transferred, a liability for income tax that would otherwise be payable by the income entity is extinguished by the amount of the tax benefits transferred.

7.3.15 Where consideration is paid or payable to the loss entity for losses transferred, a liability for income tax that would otherwise be payable by the income entity is effectively replaced by a payment or liability to the loss entity at the agreed amount of consideration. Any amount owing for the losses at the end of the reporting period is recognised in the income entity's financial report as an amount owing to the loss entity. In cases where the consideration for losses is not equivalent to the tax benefit that will be derived from the losses by the income entity a difference will arise. In those cases, the difference is adjusted against income tax expense in the statement of financial performance of the income entity.

7.3.16 There may be circumstances in which a deferred tax asset relating to tax losses meets the recognition criteria in the context of an economic entity but not in the context of an individual loss entity. This may occur where group entities other than the loss entity can utilise the loss. Therefore, the situation may arise where deferred tax assets relating to tax losses are not recognised in the loss entity's financial report but are recognised in the consolidated financial report of the economic entity to which that loss entity belongs, on

the basis that it is probable that other entities within the economic entity will realise the benefits through the transfer of those losses. Consolidation adjustments are required to bring these deferred tax assets into the consolidated financial report and to reverse any amounts recognised in relation to the losses in the financial report of the loss entity.

7.3.17 Appendix 3 illustrates the accounting by the income entity and the loss entity for the transfer of tax losses within the economic entity.

8 Measurement of Deferred Tax Liabilities and Assets

8.1.1 Paragraphs 4.5 and 4.7 prescribe how *deferred tax liabilities* and *assets* are to be measured. Paragraph 4.7 notes that the manner of recovery of an *asset* may affect the measurement of deferred tax liabilities and assets relating to that asset and that the *carrying amount* of an asset can only be recovered through sale, use, or use and sale. Examples 9, 10 and 11 (following paragraph 8.1.3) illustrate the effect of recovering an asset in different ways under different circumstances. If the *entity's* management or governing body changes its expectations about the manner of recovery, any tax consequence is *recognised* in the reporting period in which the change occurs (see Example 13 following paragraph 10.2.2).

Measurement of Deferred Tax Liabilities and Assets arising from Depreciable Assets

8.1.2 The recognition of depreciation of an asset in accordance with Australian Accounting Standard AAS 4 "Depreciation" is consistent with the carrying amount of the asset being recovered partially or fully through use. It implies that the carrying amount of a *depreciable asset* that has a residual value greater than zero is expected to be recovered through use to the extent of its *depreciable amount* and through sale at its residual value. Under Australian income tax law, indexation benefits that are available to reduce the tax that would otherwise be payable on capital gains on appreciating assets would typically not be available for depreciable assets because often residual value is less than the cost of the asset. However, where depreciable assets (for example, buildings) are revalued upwards, residual value may be greater than cost. To the extent that the residual value is greater than the indexed cost base calculated in accordance with the Australian income tax law, the full benefit of indexation would be derived. In comparing the expected residual value with the indexed cost base for the purpose of determining the extent to which the benefits of indexation will be derived, the indexed cost base is what it would be if the asset were to be sold at *reporting date*. That is, consistent with the requirements in AAS 4 that residual values do not take into account the effect of expected future inflation on asset prices, the indexed cost base does not take into account the effect of expected future general price changes.

Measurement of Deferred Tax Liabilities and Assets arising from Non-Depreciable Assets

8.1.3 As noted in paragraph 8.1.2, the recognition of depreciation of an asset implies that the carrying amount of the asset is expected to be recovered partially or fully through use. This is consistent with the view adopted in this Standard that the carrying amount of a non-depreciable asset such as land will only be recovered through sale.

EXAMPLE 9

Example illustrating the effect of paragraphs 4.7 and 8.1.1

An asset has a carrying amount of $100 and a tax base of $60 if the asset were sold immediately (reflecting the effect of indexation in a capital gains tax regime) or a tax base of $50 if the asset were recovered through use. A tax rate of 30% applies.

	Carrying Amount	**Tax Base**		**Temporary Difference**	
		Recovery Through Use	Recovery Through Sale	Recovery Through Use	Recovery Through Sale
	$	$	$	$	$
Asset	100	50	60	50	40
Tax Rate				30%	30%
Deferred Tax Liability				15	12

The entity recognises a deferred tax liability of $12 (calculated as $40 ´ 30%) if its management or governing body expects to sell the asset without further use and a deferred tax liability of $15 (calculated as $50 ´ 30%) if its management or governing body expects to retain the asset and recover its carrying amount through use.

EXAMPLE 10

Example illustrating the effect of paragraphs 4.7 and 8.1.1

An asset with a cost of $100 and a carrying amount of $80 is revalued to $150 (that is, an asset revaluation reserve is credited with an amount of $70) and has an expected residual value of zero. No equivalent or other adjustment is made for tax purposes. Cumulative depreciation for tax purposes is $30 and the tax rate is 30%. If the asset were to be sold for an amount greater than or equal to cost, the cumulative tax depreciation of $30 would be included in the taxable amount, but sales proceeds in excess of cost would not be assessable (the asset is not subject to capital gains tax).

Assuming the carrying amount of the asset will be recovered through use:

	Carrying Amount	**Tax Base**	**Temporary Difference**
	$	$	$
Cost	100	100	
Accumulated Depreciation	20	30	
Net Amount	80		
Revaluation	70		
Net Amount	150	70	80
Tax Rate			30%
Deferred Tax Liability			24

If the entity's management or governing body expects to recover the carrying amount of the asset through use, it will generate an assessable amount of $150, but will only be able to deduct depreciation of $70. On this basis, there is a deferred tax liability of $24 (calculated as $80 ´ 30%).

Assuming the carrying amount of the asset will be recovered through sale, the tax base, calculated in accordance with paragraph 5.1, is:

Carrying amount	$150
Less assessable amount (recouped depreciation)	30
Add deductible amount	–
Tax base	120

The deferred tax liability is therefore $150 – $120 = $30; $30 @ 30% = $9

(Note: In accordance with paragraph 10.2, the additional deferred tax that arises on the revaluation is recognised as a debit to the asset revaluation reserve. Thus, if the carrying amount of the asset will be recovered through use, $21 [$24 less the opening balance of deferred tax liability of $3] is recognised as a debit to the asset revaluation reserve. If the carrying amount of the asset will be recovered through sale, $6 [$9 less the opening balance of deferred tax liability of $3] is recognised as a debit to the asset revaluation reserve.)

EXAMPLE 11

Example illustrating the effect of paragraphs 4.7 and 8.1.1

The facts are as in Example 10, except that if the asset were to be sold for more than cost, the sales proceeds in excess of an inflation-adjusted cost of $120 would be included in the taxable amount (taxed at 30% – the asset is subject to capital gains tax).

	Carrying Amount	**Tax Base**		**Temporary Difference**	
		Recovery Through Use	Recovery Through Sale	Recovery Through Use	Recovery Through Sale
	$	$	$	$	$
Cost	100	100	100		
Accumulated Depreciation	20	30	30		
Net Amount	80		70		
Revaluation	70	___	20		
Net Amount	150	70	90	80	60
Tax Rate				30%	30%
Deferred Tax Liability				24	18

If the entity's management or governing body expects to recover the carrying amount by using the asset, it will generate an assessable amount of $150, but will only be able to deduct depreciation of $70. On this basis, the tax base is $70, there is an assessable temporary difference of $80 and there is a deferred tax liability of $24 (calculated as $80 ´ 30%), as in Example 10.

If the entity's management or governing body expects to recover the carrying amount by selling the asset immediately for proceeds of $150, the entity will be able to deduct the indexed cost of $120. The net proceeds of $30 will be taxed at 30%. In addition, the cumulative tax depreciation of $30 will be included in the taxable amount and taxed at 30%. On this basis, the tax base is $90 (calculated as $150 - $180 + $120), there is an assessable temporary difference of $60 and there is a deferred tax liability of $18 (calculated as [$30 ´ 30%] + [$30 ´ 30%]).

(Note: In accordance with paragraph 10.2, the additional deferred tax that arises on the revaluation is recognised as a debit to the asset revaluation reserve. Thus, if the carrying amount of the asset will be recovered through use, $21 [$24 less the opening balance of deferred tax liability of $3] is recognised as a debit to the asset revaluation reserve. If the carrying amount of the asset will be recovered through sale, $15 [$18 less the opening balance of deferred tax liability of $3] is recognised as a debit to the asset revaluation reserve.)

9 Current Tax Liabilities and Current Tax Assets

Identification and Recognition

9.1 To the extent it is unpaid, *current tax* for current and prior reporting periods must be *recognised* as a *liability*. If the amount already paid in respect of current and prior reporting periods exceeds the amount payable for those periods, the recoverable excess must be recognised as an *asset*.

9.2 The benefit relating to a *tax loss* which tax laws in some jurisdictions allow to be carried back to recover income tax paid or payable relating to a previous reporting period must be recognised as an asset to the extent that the tax loss will be carried back.

9.2.1 In some foreign jurisdictions, the tax law allows a tax loss to be carried back to recover income tax paid or payable in a previous period. When this is the case, the *entity* recognises the benefit from the tax loss as an asset in the reporting period in which the tax loss occurs because it is probable that the future economic benefits will eventuate and it can be reliably measured.

Measurement

9.3 *Current tax liabilities* and *assets* for the current and prior reporting periods must be measured at the nominal amount expected to be paid to or recovered from the taxation authorities by the entity, using the tax rates (and tax laws) that have been enacted or substantively enacted by the *reporting date* and that will affect the amount of income tax payable (recoverable), except to the extent to which another Australian Accounting Standard requires or permits a different measurement method to be adopted.

9.4 For the purposes of Australian Accounting Standards AAS 18 "Accounting for Goodwill" and AAS 21 "Acquisitions of Assets" the amount calculated in accordance with paragraph 9.3 is deemed to be equal to the fair values of current tax liabilities and assets, unless an Australian Accounting Standard (other than AAS 18 and AAS 21) requires or permits otherwise.

9.4.1 Current tax liabilities and assets and *deferred tax liabilities* and *assets* are usually measured using the tax rates (and tax laws) that have been enacted and will affect the amount of income tax

expected to be settled or recovered. However, in some jurisdictions, announcements of tax rates (and tax laws) by the government have the substantive effect of actual enactment, which may follow the announcement by a period of several months. For example, an announcement before the reporting date by the Australian Treasurer or other relevant authority of the intention to change the rate of income tax to another specified rate or to change the tax laws that will affect the amount of tax expected to be settled or recovered is substantive enactment where it is probable that the change will be enacted. In these circumstances, current tax liabilities and assets are measured using the announced tax rate (and tax laws). A change in tax rates or tax laws that occurs after the reporting date but before the *time of completion* does not provide new information relating to conditions existing at reporting date (see Australian Accounting Standard AAS 8 "Events Occurring After Reporting Date").

10 Recognition of the Effect of Current and Deferred Tax on Equity and Goodwill

Current and Deferred Tax Recognised in Net Profit or Loss/Result

10.1 Subject to paragraphs 10.2, 10.5, 10.6 and 11.1, *current tax* and *deferred tax* that arise in a reporting period must be *recognised* as an *expense* or a *revenue* in *net profit or loss/result* for the reporting period.

10.1.1 Some *deferred tax liabilities* and *assets* arise or change where an expense or a revenue is included in *pre-tax net profit or loss/result* in one reporting period, but is included in the *taxable amount (tax loss)* in another reporting period. The resulting deferred tax is recognised in net profit or loss/result.

10.1.2 The *carrying amounts* of deferred tax liabilities and assets may change even though there is no change in the amount of the related *temporary differences.* This can result, for example, from:

(a) a change in statutory tax rates; or

(b) a re-assessment of the recoverability of deferred tax assets; or

(c) a change in the expected manner of recovery of an *asset* and the manner of recovery affects the statutory tax rate applicable or *tax base*.

The change in the carrying amounts of deferred tax liabilities and assets that arises from these types of circumstances is recognised in net profit or loss/result, except to the extent that it relates to amounts that were previously recognised as *direct debits to equity* or *direct credits to equity* (see paragraph 10.2).

10.1.3 Example 2 of Appendix 2 provides a comprehensive example illustrating the application of this Standard. It includes an illustration of the calculation of current tax expense and deferred tax expense that are required to be recognised in net profit or loss/result in accordance with paragraph 10.1.

Current and Deferred Tax Recognised as Direct Debits or Credits to Equity

10.2 Subject to paragraph 10.4, current tax and deferred tax that arise in a reporting period must be directly debited to equity (directly credited to equity) if the tax relates to an amount that is or was directly credited to equity (directly debited to equity) in the current or a previous reporting period.

10.2.1 Australian Accounting Standards require amounts to be directly credited or debited to equity in certain circumstances. Examples of such circumstances are:

(a) a change in carrying amount arising from the revaluation of *non-current assets* (see Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets") [Examples 12 and 13 (following paragraph 10.2.2) illustrate the consequences of a revaluation of non-current assets under different circumstances]

(b) an adjustment to the opening balance of retained profits (surplus) or accumulated losses (deficiency) resulting from a change in accounting policy that is applied retrospectively in accordance with an Australian Accounting Standard, or a statutory requirement or a Consensus View of the Urgent Issues Group (see Australian Accounting Standard AAS 6 "Accounting Policies")

(c) exchange differences arising on the translation of the financial statements of a self-sustaining foreign operation (see Australian Accounting Standard AAS 20 "Foreign Currency Translation")

(d) amounts arising on initial classification of the *equity* component of a compound financial instrument (see Australian Accounting Standard AAS 33 "Presentation and Disclosure of Financial Instruments").

10.2.2 When an asset's tax base changes (for example, as a result of indexation for capital gains tax purposes of the cost base of an asset that is expected to be recovered through sale) and that asset is or is expected to be revalued for accounting purposes, with the revaluation recognised in an asset revaluation reserve, the tax effect of the tax base change is credited or debited to the reserve in the reporting periods in which the change occurs. However, if the tax base changes and the asset is not or is not expected to be revalued for accounting purposes, the tax effect of the tax base change is recognised in net profit or loss/result.

EXAMPLE 12

Example illustrating the effect of paragraphs 10.2 and 10.2.1(a)

An entity acquires land at a cost of $100. On disposal the proceeds will be subject to capital gains tax of 30% of the amount by which proceeds exceed the indexed cost base. On reporting date the land is revalued to $150 in accordance with AAS 10. At that same date the indexed cost base is $110. The assessable temporary difference is therefore $40 (calculated as $150 – $110), and the deferred tax liability is $12 (calculated as $40 × 30%). The following shows the calculation of the deferred tax liability:

	Carrying Amount	**Tax Base**	**Temporary Difference**
	$	$	$
Cost	100	100	
Revaluation	50	10	
Net Amount	150	110	40
@ Tax Rate			30%
Deferred tax liability			12

In accordance with AAS 10 the journal entry necessary to recognise the asset revaluation is:

		$	$
Dr	Land	50	
Cr	Asset Revaluation Reserve		50

In accordance with paragraph 10.2, the journal entry necessary to recognise the deferred tax liability at the reporting date is:

Dr	Asset Revaluation Reserve	12	
Cr	Deferred Tax Liability		12

If the land is immediately sold for $150 cash, the journal entries would be:

Dr	Cash	150	
Cr	Land		150
Dr	Deferred Tax Liability	12	
Cr	Asset Revaluation Reserve		12
Dr	Asset Revaluation Reserve	12	
Cr	Current Tax Liability		12

The second and third journal entries are shown separately in accordance with paragraph 10.2 (see also paragraph 10.4.2).

(Note: The nature of land [which is normally not a depreciable asset] means that it can only be recovered through sale, not through use.)

EXAMPLE 13

Example illustrating the effect of paragraphs 10.2 and 10.2.1(a)

An entity acquires a building, which forms an integral part of plant, for $100. For the purpose of simplicity, the building is treated as a separate class of assets. On disposal, the proceeds would be subject to capital gains tax of 30% (which is also the rate of tax applicable to income other than capital gains) of the amount by which proceeds may exceed the indexed cost base. The building is eligible for write-off at a rate of 4% p.a. for tax purposes. After four years, the building has a written-down tax value of $84. For accounting purposes the building is depreciated at a rate of 3% p.a. (and has an expected residual value of zero). After four years, the building has a carrying amount for accounting purposes of $88.

Each year, deferred tax liability has been increased by $0.3 (calculated as [$4 – $3] × 30%), based on the expectation that the asset would be recovered through use (therefore the deferred tax liability has a balance of $1.2 after four years, which has been recognised as an expense over the four years in accordance with paragraph 10.1 of this Standard). The following illustrates the calculation of the deferred tax liability of $1.2:

	Carrying Amount	**Tax Base**	**Temporary Difference**
	$	$	$
Cost	100	100	
Accumulated Depreciation	12	16	
Net Amount	88	84	4
@ Tax Rate			30%
Deferred Tax Liability			1.2

The cumulative effect of the journal entries recognising the four years' depreciation would be:

		$	$
Dr	Retained Profits (Surplus)	13.2	
Cr	Accumulated Depreciation		12.0
Cr	Deferred Tax Liability		1.2

After four years the building is revalued to $150 in accordance with AAS 10 when the indexed cost base is $110. The tax law requires that to the extent previous write-offs are recouped through proceeds from sale they must be included in assessable income.

The following alternative scenarios, and the resultant journal entires, are based on these common assumptions.

(a) ***If the entity's management or governing body continues to expect to recover the carrying amount of the building through use***

	$
Carrying amount of the building	150
Tax base of the building	84
Assessable temporary difference	66
@ Tax rate	30%
Deferred tax liability	19.8

The journal entries to recognise the revaluation and the consequential change in deferred tax liability would be:

		$	$
Dr	Accumulated Depreciation	12	
Cr	Building		12
Dr	Building	62	
Cr	Asset Revaluation Reserve		62
Dr	Asset Revaluation Reserve	18.6	
Cr	Deferred Tax Liability		18.6

(The $18.6 credit to deferred tax liability is determined as $62 × 30%, which reconciles with $19.8 (calculated above) less the opening balance of deferred tax liability of $1.2.)

(b) ***If the entity's management or governing body expects to recover the carrying amount of the building immediately through sale***

Carrying amount of the building		150
Tax base of the building:		
Indexed cost base	110	
less recouped write-off	16	94
Assessable temporary difference		56
@ Tax rate		30%
Deferred tax liability		16.8

The journal entries to record the revaluation and the consequential change in deferred tax liability would be:

		$	$
Dr	Accumulated Depreciation	12	
Cr	Building		12
Dr	Building	62	
Cr	Asset Revaluation Reserve		62
Dr	Asset Revaluation Reserve	15.6	
Cr	Deferred Tax Liability		15.6

(The $15.6 credit to deferred tax liability is determined as follows:

Credit to asset revaluation reserve on revaluation of building		62
Tax effect of change from expecting recovery of carrying amount through use to recovery of carrying amount through sale:		
Tax base of building (used to assess tax paid where recovery occurs through use)	100	
Deduct: Indexed cost base of building (used to assess tax paid where recovery occurs through sale)	110	(10)
Increase in assessable temporary difference		52
@ Tax rate		30%
Increase in deferred tax liability		15.6

This amount reconciles with $16.8 (calculated above) less the opening balance of deferred tax liability of $1.2.)

(c) If the entity's management or governing body changes its expectation from recovering the carrying amount of the building through use (as in (a) above) to recovering the carrying amount of the building immediately through sale (as in (b) above)

The journal entry to reflect the change in expectation would be (per paragraph 10.1.2):

Dr	Deferred Tax Liability	3	
Cr	Asset Revaluation Reserve		3

(d) ***If the tax rate changes from 30% to 25%, and the entity's management or governing body continues to expect to recover the carrying amount of the building through use (that is, per (a) above)***

The journal entry to adjust the deferred tax liability from $19.8 to $16.5 (calculated as $66 × 25%) would be:

		$	$
Dr	Deferred Tax Liability	3.3	
Cr	Asset Revaluation Reserve		3.1*
Cr	Income Tax Expense (deferred)		0.2#

* (18.6/19.8) × 3.3 = $3.1. $18.6 relates to items previously credited to asset revaluation reserve (see (a) above)

\# (1.2/19.8) × 3.3 = $0.2. $1.2 relates to items previously recognised in net profit or loss/result.

(e) ***If the building is subsequently revalued down by $20 (reversing a portion of the previous revaluation increment), the entity's management or governing body continues to expect to recover the carrying amount through use, and the tax rates remain at 30% (that is, per (a) above)***

The journal entries to recognise the revaluation decrement and to adjust the deferred tax liability from $19.8 to $13.8 (calculated as $130 – $84 = $46; $46 × 30% = $13.8) would be:

Dr	Asset Revaluation Reserve	20	
Cr	Building		20
Dr	Deferred Tax Liability	6	
Cr	Asset Revaluation Reserve		6

(Note: The asset revaluation reserve is credited with the tax effect because the downwards revaluation is recognised as a debit to the asset revaluation reserve.)

(f) ***If the building's revalued carrying amount is $150 (as in (b) above) and the entity sells the building for that amount in cash immediately after it is revalued, and elects to transfer the related amount in the asset revaluation reserve to retained profits (surplus) or accumulated losses (deficiency)***

The journal entries to reflect the sale and transfer would be (assuming a 30% tax rate and that the deferred tax liability is based on the entity's management or governing body's expectation that it will recover the carrying amount of the building through sale):

		$	$
Dr	Cash	150	
Cr	Building		150

Dr	Deferred Tax Liability	16.8	
Cr	Asset Revaluation Reserve		15.6
Cr	Income Tax Expense (deferred)		1.2

Dr	Income Tax Expense (current)	1.2	
Dr	Asset Revaluation Reserve	15.6	
Cr	Current Tax Liability		16.8

Dr	Asset Revaluation Reserve	46.4	
Cr	Retained Profits (Surplus)		46.4

The debit and credit entries to asset revaluation reserve of $15.6 are made in accordance with the requirements of paragraph 10.2 (see also paragraph 10.4.2).

(g) ***If, instead of selling the building immediately after revaluation, the entity continues to expect to recover the revalued carrying amount of the building through use and expects to use the building over the next 10 years (that is, the remaining useful life is assessed to be 10 years in contrast with the originally assessed remaining useful life of 29.3 years)***

The journal entries to reflect the subsequent depreciation for the first year after the revaluation would be:

Dr	Depreciation Expense	15	
Cr	Accumulated Depreciation		15

Dr	Deferred Tax Liability *	3.3	
Cr	Income Tax Expense (deferred)		3.3

* The credit to income tax expense (deferred) of $3.3 is made in accordance with paragraph 10.4. The change in deferred tax liability relating to the building one year after revaluation is calculated as:

Opening balance of deferred tax liability		19.8
Carrying amount	135	
Tax base	80	
Temporary difference	55	
@ Tax rate	30%	
Deferred tax liability		16.5
Decrease in deferred tax liability		3.3

(Note: To the extent that the proceeds from recovering 1/10 of the carrying amount of the building through use during the year give rise to taxable income, income tax expense (current) and the current tax liability will be affected. For example, if $15 assessable income is earned, the taxable income associated with recovery of 1/10 of the carrying amount of the building is $11 (that is, $15 assessable income less $4 allowable deduction). $11 × 30% is $3.3, giving rise to the following journal entry:

		$	$
Dr	Income Tax Expense (current)	3.3	
Cr	Current Tax Liability		3.3

The distinction between income tax expense (current) and income tax expense (deferred) is relevant in making the disclosures required by paragraph 13.1 (see paragraph 13.1.1(a) and (c)).)

(h) ***If at the end of the first year after revaluing the building the entity expects to recover the carrying amount of the building immediately through sale, and for tax purposes the indexed cost base of the building has changed to $113***

The journal entry to reflect the change in expectations would be:

Dr	Deferred Tax Liability	3.9	
Cr	Asset Revaluation Reserve		3.9

The credit to asset revaluation reserve is made in accordance with paragraphs 10.2 and 10.2.2 and is calculated as follows:

Deferred tax liability immediately prior to changing the expectation about the manner of recovery from use to sale (see (g) above)			16.5
Carrying amount of building		135	
Tax base of the building:			
Indexed cost base	113		
less recouped write-off	20*	93	
Assessable temporary difference		42	
@ Tax rate		30%	
Deferred tax liability immediately after changing the expectation about manner of recovery from use to sale			12.6
Decrease in deferred tax liability			3.9

* accumulated tax deductions claimed for 5 years ($100 × 4%) × 5 = $20.

The journal entries to record the sale of the building at its carrying amount, and the tax effect in accordance with paragraphs 10.1 and 10.2, would be:

		$	$
Dr	Deferred Tax Liability	14.7	
Cr	Asset Revaluation Reserve		14.7
Dr	Asset Revaluation Reserve	14.7	
Cr	Current Tax Liability		14.7
Dr	Income Tax Expense (deferred)	2.1	
Cr	Deferred Tax Liability		2.1
Dr	Current Tax Liability	2.1	
Cr	Income Tax Expense (current)		2.1

If the entity elects to transfer the related amount in the asset revaluation reserve to retained profits (surplus) or accumulated losses (deficiency), the amount transferred is $47.3, determined as:

Credit to asset revaluation reserve on revaluation of building (see (a) above)		62.0
Debit to asset revaluation reserve for tax effect of the revaluation (see (a) above)	(18.6)	
Credit to asset revaluation reserve for tax effect reflecting the change in the expected manner of recovery (see the first journal entry in (h) above)	3.9	(14.7)
Balance of asset revaluation reserve transferred to retained profits (surplus) or accumulated losses (deficiency)		47.3

10.2.3 Detailed records of amounts of direct credits and debits to equity that give rise to a tax effect are maintained to enable the requirements of paragraph 10.2 to be complied with. In exceptional circumstances it may be difficult to determine the amount of current and deferred tax that relates to items directly credited or debited to equity. This may be the case, for example, when:

(a) there are graduated rates of income tax and it is difficult to determine the rate at which a specific component of taxable amount (tax loss) has been taxed; or

(b) a change in the statutory tax rate or other tax rules affects a deferred tax liability or asset relating in part to an amount

that was previously directly credited or debited to equity; or

(c) the *entity's* management or governing body determines that a deferred tax asset should be recognised, or should no longer be recognised in full, and the deferred tax asset relates in part to an amount that was previously directly credited or debited to equity.

In such cases, the current and deferred tax related to amounts that are directly credited or debited to equity are based on a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction concerned, or another method that achieves a more appropriate allocation in the circumstances. Example 14 illustrates how an appropriate allocation is determined in particular circumstances.

EXAMPLE 14

Illustrating the effect of paragraph 10.2.3

An entity does not recognise a deferred tax asset of $400 (of which $100 relates to items directly debited to equity) because it is not probable that future taxable amounts will be available against which the deductible temporary difference can be utilised. In a subsequent reporting period, the entity assesses that it will probably recover benefits of $160 of the $400. Unless the entity is able to attribute the benefits that will be recovered to particular categories of temporary differences, some form of apportionment is needed: for example ($100/$400) × $160 = $40 attributable directly to equity and ($300/$400) × $160 = $120 attributable to net profit or loss/result.

10.3 Where an amount is transferred from an asset revaluation reserve to retained profits (surplus) or accumulated losses (deficiency), the amount transferred must be net of any current tax and deferred tax that was originally recognised in respect of that amount.

10.3.1 If the entity transfers from an asset revaluation reserve an amount equal to the difference between the depreciation or amortisation on a revalued asset and the depreciation or amortisation based on the cost of that asset, or an amount is transferred on disposal of a revalued non-current asset, to retained profits (surplus) or accumulated losses (deficiency) the amount transferred is net of any deferred tax that was originally recognised in respect of that amount.

10.4 Current tax and deferred tax must be recognised as expense or revenue in the net profit or loss/result for the reporting period if the amounts to which the tax relates were:

(a) credited or debited to an asset revaluation reserve in a previous reporting period, to the extent, and only to the extent, that the current tax and deferred tax would otherwise cause the asset revaluation reserve for that class to have a negative carrying amount; or

(b) directly credited or debited to equity in a previous reporting period and the current tax and deferred tax arise from the recovery of the carrying amount of an asset through use; or

(c) directly credited or debited to equity in a previous reporting period and the current tax and deferred tax arise from the unwinding of the discount on the component of a compound financial instrument classified as a *liability* (see Example 4 in Appendix 2).

10.4.1 There may be cases where the net amount previously recognised in an asset revaluation reserve for a particular class of non-current assets is distributed as dividends or bonus shares, or is offset by a revaluation decrement for an asset in the same class. If an event then arises that would cause the deferred tax originally recognised in the reserve to be changed (such as one of the events described in paragraph 10.1.2), the change is recognised in net profit or loss/result to the extent to which the carrying amount of the asset revaluation reserve would otherwise be negative.

10.4.2 Where an asset has previously been revalued upwards, the revaluation would have been credited to an asset revaluation reserve in accordance with Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets". At the time of revaluation, the deferred tax effect would have been recognised as a debit to the reserve in accordance with paragraph 10.2 of this Standard. If the carrying amount of the asset is recovered through sale during a reporting period, the current and deferred tax that arise on sale are directly debited and credited to the asset revaluation reserve (see Example 12, and items (f) and (h) in Example 13, following paragraph 10.2.2). If the carrying amount of the asset is recovered partially or fully through use (as reflected in depreciation expense recognised in relation to the asset), the current and deferred tax that arise relating to the depreciation (including that which could be attributed to the revaluation component) are credited or debited to net profit or loss/result (see item (g) in Example 13

following paragraph 10.2.2, and the treatment of current tax and deferred tax in respect of depreciation of the revalued building in Example 2 in Appendix 2). The differential treatment of current and deferred tax between sale and use of an asset avoids the practical difficulties that arise in attributing the appropriate proportions of current and deferred tax to the asset revaluation reserve where an asset is being depreciated.

10.4.3 A revaluation decrement that is debited to an asset revaluation reserve may give rise to a recognised deferred tax asset relating to a deductible temporary difference. Where the revalued asset is sold for its carrying amount and this gives rise to a capital loss, that capital loss may give rise to a deferred tax asset relating to a carry forward tax loss (this will occur where there are insufficient capital gains against which the capital loss can be offset) that effectively replaces the deferred tax asset relating to the deductible temporary difference. Where the deferred tax asset relating to the tax loss does not meet the criteria for recognition, the decrease in the deferred tax asset relating to the deductible temporary difference is recognised as an expense in the net profit or loss/result, in the reporting period in which the asset is sold, to the extent required by paragraph 10.4(a). If the tax loss is transferred to another entity in the group, paragraphs 7.3.11 to 7.3.17 provide guidance on the loss entity's and the income entity's accounting for the transfer.

Deferred Tax arising from the Acquisition of an Entity or Operation

10.5 Where the entity:

(a) has acquired another entity or operation and the acquisition is accounted for in a way that could give rise to *goodwill* or *discount on acquisition* in the acquiring entity's financial report; and

(b) recognises in the acquiring entity's financial report a deferred tax liability or asset at the date of the acquisition as a result of the acquisition that was not recognised by the acquirer or acquiree prior to the acquisition;

the deferred tax liability or asset must be recognised in the statement of financial position. For the purposes of Australian Accounting Standards AAS 18 "Accounting for Goodwill" and AAS 21 "Acquisitions of Assets" the deferred tax liability or asset must be taken into account in measuring goodwill or

discount on acquisition. Where a discount on acquisition arises, the fair values of non-monetary assets that are reduced proportionately by the discount in accordance with AAS 18 and AAS 21 must not include deferred tax assets.

10.5.1 As explained in paragraphs 4.3.2(b) and 6.1.3, temporary differences may arise in an acquisition of an entity or operation as a result of fair value adjustments to the assets and liabilities of the entity or operation acquired. Furthermore, as explained in the concluding section of paragraph 6.1.8, temporary differences may arise in an acquisition of an entity or operation as a result of the exception in paragraph 6.1(b) not applying by virtue of paragraph 6.1(b)(i). The entity recognises any resulting deferred tax liabilities or deferred tax assets (to the extent that they meet the recognition criteria in paragraph 4.3) as identifiable liabilities and assets at the date of the acquisition, measured in accordance with paragraphs 4.5 and 4.7. Consequently, those deferred tax liabilities and assets affect goodwill or discount on acquisition. However, in accordance with paragraph 6.1(a), the entity does not recognise deferred tax liabilities arising from goodwill itself (if amortisation of the goodwill is not deductible for tax purposes).

10.5.2 As a result of an acquisition of an entity or operation, the acquiring entity may assess that it is probable that a deferred tax asset that was not recognised by the acquiring entity prior to the acquisition, will be recovered. For example, the acquiring entity may be able to utilise the benefit of the acquiring entity's unused *tax losses* against the future *taxable amounts* of the acquiree. In such cases, a deferred tax asset is recognised in the statement of financial position, measured in accordance with paragraphs 4.5 and 4.7, and is taken into account in measuring the goodwill or discount on acquisition arising on the acquisition. Paragraphs 7.3.11 to 7.3.17 and Appendix 3 provide guidance for the treatment of a transfer of a tax loss in the loss entity's and the income entity's financial report.

10.6 When a deferred tax asset of an acquired entity or operation which is not recognised at the date of acquisition by the acquiring entity is subsequently recognised in the statement of financial position and the acquisition is accounted for in a way that could give rise to goodwill or discount on acquisition:

(a) the deferred tax must be recognised as revenue in net profit or loss/result; and

(b) goodwill and any related accumulated amortisation must be adjusted to amounts that would have been recorded if the deferred tax asset had been recognised

at the date of acquisition, and the net adjustment must be recognised as an expense in net profit or loss/result.

10.6.1 An acquirer of an entity or operation might not recognise a deferred tax asset of the acquiree as an identifiable asset in the statement of financial position (which may be a consolidated statement of financial position) at the date of an acquisition because it does not satisfy the recognition criteria. If the deferred tax asset is subsequently recognised in the statement of financial position, the resulting deferred tax revenue is recognised in net profit or loss/ result. In addition, the acquirer:

(a) adjusts the gross carrying amount of the goodwill and the related accumulated amortisation to the amounts that would have been recorded if the deferred tax asset had been recognised in the statement of financial position as an identifiable asset measured in accordance with paragraphs 4.5 and 4.7 at the date of the acquisition; and

(b) recognises the reduction in the net carrying amount of the goodwill as an expense.

Example 15 illustrates the application of this paragraph in relation to the acquisition of a *subsidiary*.

EXAMPLE 15

Example illustrating the application of paragraph 10.6.1

An entity acquired a subsidiary which had deductible temporary differences of $300. The tax rate at the time of the acquisition was 30%. The resulting deferred tax asset of $90 was not recognised as an identifiable asset in measuring the goodwill of $500 resulting from the acquisition, because it was assessed as not meeting the "probable" recognition criterion at the date of acquisition. The goodwill is amortised over 20 years. Two years after the acquisition, the entity assessed that future taxable amounts would probably be sufficient for the entity to recover the benefit of all the deductible temporary differences.

The economic entity recognises a deferred tax asset of $90 (calculated as $300 ´ 30%) and, in net profit or loss/result, deferred tax revenue of $90. It also reduces the cost of the goodwill by $90 and the accumulated amortisation by $9 (representing 2 years' amortisation). The net adjustment of $81 to the amortised cost of the goodwill is recognised as an expense in net profit or loss/result. Consequently, the cost of the goodwill, and the related accumulated amortisation, are reduced to the amounts ($410 and $41) that would have been recorded if a deferred tax asset of $90 had been recognised as an identifiable asset at the date of the acquisition.

If the tax rate has increased to 40%, the economic entity recognises a deferred tax asset of $120 (calculated as $300 ´ 40%) and, in net profit or loss/result, deferred tax revenue of $120. If the tax rate has decreased to 20%, the economic entity recognises a deferred tax asset of $60 (calculated as $300 ´ 20%) and deferred tax revenue of $60. In both cases, the economic entity also reduces the cost of the goodwill by $90 and the accumulated amortisation by $9 and recognises the net adjustment of $81 as an expense in net profit or loss/result based on the 30% tax rate at the time of acquisition.

10.6.2 Where the recorded amounts of the identifiable net assets acquired that would have been determined if the deferred tax asset had been recognised at the date of acquisition would, when compared with the cost of acquisition, give rise to a discount on acquisition or an increased discount on acquisition, no resultant adjustment is made to the carrying amount of non-monetary assets or other items. This policy acknowledges the practical difficulties that may be encountered if the adjustments were required to be made.

11 A Change in the Entity's Tax Status

11.1 Any adjustments to account balances that result from the *entity* changing its status from a non-taxed entity to a taxed entity as at the date of the change in status must be calculated, to the extent that it is practicable, and *recognised*, in accordance with the accounting policies required by this Standard.

11.1.1 The entity's tax status may change from non-taxable to taxable or from taxable to non-taxable. An example is a government organisation becoming subject to corporate tax equivalents for the first time, or a non-taxed private sector entity becoming a taxed entity by virtue of a change in the scope of the income tax law. The effect of a change in the tax status of the entity is treated in the same way as a change in the tax status of certain transactions undertaken by the entity where the tax status of the entity itself does not change.

11.1.2 It may not be practicable to determine adjustments to *goodwill* on acquisitions made some time prior to the entity changing its status from non-taxable to taxable. In other circumstances, the effects of recognising or eliminating tax *liabilities* or *assets* as a result of a change in the tax status of the entity are recognised in accordance with Section 10 of this Standard.

12 Presentation

Tax Liabilities and Tax Assets

12.1 ***Current tax liabilities* and *assets* and *deferred tax liabilities* and *assets* must be presented separately from other *liabilities* and *assets* in the statement of financial position. Deferred tax liabilities and assets must be distinguished from current tax liabilities and assets.**

12.2 **When the *entity* makes a distinction between *current* and *non-current liabilities* and *assets* in the statement of financial position, it must classify deferred tax liabilities (assets) as non-current liabilities (assets).**

Set-Off

12.3 **The entity must set off current tax liabilities and current tax assets and *recognise* the net amount in the statement of financial position to the extent, and only to the extent, that:**

(a) **the entity has a legally recognised right to set off the liabilities and the assets; and**

(b) **the entity's management or governing body intends either to settle on a net basis, or to settle the liabilities and realise the assets simultaneously.**

12.3.1 Although current tax liabilities and assets are separately recognised and measured, they are set off in the statement of financial position subject to criteria specified in Australian Accounting Standard AAS 23 "Set-off and Extinguishment of Debt". The entity will normally have a legally recognised right to set off a current tax liability against a current tax asset when they relate to income taxes levied by the same taxation authority and the taxation authority permits the entity to make or receive a single net payment.

12.3.2 In the consolidated financial report, a current tax liability of one entity within the *economic entity* is set off against a current tax asset of another entity within the economic entity to the extent, and only to the extent, that the entities concerned have a legally enforceable right to make or receive a single net payment and the entities' management or governing bodies intend to make or receive such a net payment or to settle the liability and recover the asset simultaneously.

12.4 Subject to paragraph 12.5, the entity must set off deferred tax liabilities and deferred tax assets and recognise the net amount in the statement of financial position to the extent, and only to the extent, that:

(a) the entity has a legally recognised right to set off current tax liabilities and current tax assets; and

(b) the deferred tax liabilities and the deferred tax assets relate to income taxes levied by the same taxation authority on either:

(i) the same taxable entity; or

(ii) different taxable entities the management or governing bodies of which intend either to settle current tax liabilities and assets on a net basis, or to settle the liabilities and realise the assets simultaneously, in each future reporting period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

12.4.1 In rare circumstances, entities within an economic entity may have a legally recognised right to set off a current tax liability of one entity against the current tax asset of another entity, and its management or governing body has an intention to settle those liabilities and assets net, for some periods but not for others. In such rare circumstances, detailed scheduling involving projections of future tax returns may be required to establish reliably whether the deferred tax liability of one taxable entity will result in increased tax payments in the same period in which a deferred tax asset of another taxable entity will result in decreased payments by that second taxable entity.

12.5 Where the income tax law allows a capital loss only to be used to reduce a current or future capital gain, deferred tax assets arising from unrealised capital losses or carry-forward capital losses must not be set off against deferred tax liabilities except to the extent that deferred tax liabilities arise from unrealised capital gains.

12.5.1 Under the capital gains tax provisions of Australian income tax law, a capital loss can only be used to reduce a current or future capital gain and thereby reduce income taxes otherwise payable. Accordingly, a recognised deferred tax asset arising from a capital loss is set off against recognised deferred tax liabilities to the extent,

and only to the extent, that the deferred tax liabilities reflect the future tax consequences of unrealised capital gains.

Income Tax Expense (Income Tax Revenue)

12.6 ***Income tax expense (income tax revenue)* must be presented on the face of the statement of financial performance.**

13 Disclosure

13.1 The major components of *income tax expense (income tax revenue)* must be disclosed separately.

13.1.1 Components of income tax expense (income tax revenue) may include:

(a) *current tax* expense (revenue)

(b) any adjustments *recognised* in the reporting period for current tax of prior reporting periods

(c) the amount of *deferred tax* expense (revenue) relating to the origination and reversal of *temporary differences*

(d) the amount of deferred tax expense (revenue) relating to changes in tax rates or tax laws

(e) the amount of the *revenue* arising from a previously unrecognised *tax loss* or temporary difference of a prior reporting period that is used to reduce current tax expense

(f) the amount of the revenue arising from a previously unrecognised tax loss or temporary difference of a prior reporting period that is used to reduce deferred tax expense

(g) deferred tax expense arising from the write-down, or reversal of a previous write-down, of a *deferred tax asset* in accordance with paragraph 7.1

(h) the amount of income tax expense (income tax revenue) relating to those changes in accounting policies which are included in the calculation of *pre-tax net profit or loss/ result* for the period in accordance with Australian Accounting Standard AAS 6 "Accounting Policies".

13.2 The following information must be disclosed separately:

(a) the aggregate current tax and deferred tax that is not recognised in *net profit or loss/result* in accordance with paragraph 10.2

(b) where relevant, a numerical reconciliation between income tax expense (income tax revenue) and the product of pre-tax net profit or loss/result multiplied by

the Australian tax rate(s), disclosing also the basis on which the tax rate(s) is (are) determined

(c) a description of changes, if any, in the tax rate(s) compared to the previous reporting period

(d) the amount (and expiry date, if any) of deductible temporary differences and unused tax losses for which no deferred tax asset is recognised in the statement of financial position, for each significant tax jurisdiction

(e) the aggregate amount of temporary differences that arise from investments in *subsidiaries*, branches, *associates*, and *joint venture entities* and interests in *joint venture operations*, for which *deferred tax liabilities* have not been recognised in accordance with paragraph 6.1(c)

(f) in respect of each type of temporary difference, and in respect of each type of unused tax loss (including the effect of unused tax offsets):

(i) the amount of the deferred tax liabilities and assets recognised in the statement of financial position for each reporting period presented; and

(ii) the amount of the deferred tax expense or revenue recognised in net profit or loss/result, if this is not apparent from the changes in the amounts recognised in the statement of financial position

(g) where a valuation in relation to an *asset* or a class of assets has not been recognised in the statement of financial position, but has been disclosed in the financial report, the amount of income tax that has not been recognised but would be paid as a result of selling the asset(s) if the asset(s) were to be sold at the *reporting date* at the disclosed amount.

13.3 In respect of transferred tax losses:

(a) the transferor (loss *entity*) must disclose in its financial report the amount of tax losses that have been transferred, and the consideration received or

receivable for the losses where they are material in the calculation of income tax expense

(b) the transferee (income entity) must disclose the amount of tax losses that have been transferred, and the consideration paid or payable for the losses where they are material in the calculation of income tax expense.

13.3.1 The disclosures required by paragraph 13.2(b) help users of the financial report to understand whether the relationship between income tax expense (income tax revenue) and pre-tax net profit or loss/result is unusual and the significant factors that could affect that relationship in the future. The relationship between income tax expense (income tax revenue) and pre-tax net profit or loss/result may be affected by such factors as revenue that is exempt from taxation, *expenses* that are not deductible in calculating the *taxable amount (tax loss)*, the effect of tax losses, the effect of foreign tax rates, and the effect of franked dividends. Dividend revenue recognised by an entity that receives franked dividends is not grossed up for the imputation credit. Information about imputation credits is disclosed as part of the reconciliation required by paragraph 13.2(b).

13.3.2 In explaining the relationship between income tax expense (income tax revenue) and pre-tax net profit or loss/result, the entity uses the Australian tax rate because that provides the most meaningful information to the users of its financial report. Example 16 illustrates the presentation of the numerical reconciliation.

EXAMPLE 16

Example illustrating paragraph 13.2(b)

In X2, an entity has pre-tax net profit or loss/result in Australia of $1,500 (X1: $2,000) and in country B of $1,500 (X1: $500). The tax rate is 30% in Australia and 20% in country B. In Australia, expenses of $100 (X1: $200) are not deductible for tax purposes.

The following is an example of a reconciliation to the Australian tax rate

	X1 $	X2 $
Pre-tax net profit or loss/result	2,500	3,000
Tax at the Australian rate of 30%	750	900
Tax effect of expenses that are not deductible for tax purposes	60	30
Effect of lower tax rates in country B	(50)	(150)
Tax expense	760	780

13.3.3 It may be impracticable to compute the amount of unrecognised deferred tax liabilities arising from investments in subsidiaries, branches, associates and joint venture entities and interests in joint venture operations. Therefore, paragraph 13.2(e) requires the entity to disclose the aggregate amount of the underlying temporary differences but does not require disclosure of the deferred tax liabilities. Nevertheless, where practicable, the entity is encouraged to disclose the amounts of the unrecognised deferred tax liabilities because financial report users may find such information useful.

13.4 The entity must disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:

(a) the utilisation of the deferred tax asset is dependent on future *taxable amounts* in excess of the taxable amounts arising from the reversal of existing assessable temporary differences; and

(b) the entity has suffered a tax loss in either the current or preceding reporting period in the tax jurisdiction to which the deferred tax asset relates.

Other Disclosures

13.4.1 The entity discloses any contingent assets and contingent liabilities in accordance with relevant Australian Accounting Standards. Contingent assets and contingent liabilities may arise, for example, from unresolved disputes with the taxation authorities.

13.4.2 Where changes in tax rates or tax laws are enacted or announced after the reporting date, the entity discloses any significant effect of those changes on its current and deferred tax liabilities and assets in accordance with Australian Accounting Standard AAS 8 “Events Occurring After Reporting Date”.

14 Transitional Provisions

14.1 The accounting policies required by this Standard must be applied as at the beginning of the reporting period to which this Standard is first applied, to the extent that it is practicable. Where this gives rise to initial adjustments, the net amount of those adjustments must, subject to paragraph 14.2, be adjusted against retained profits (surplus) or accumulated losses (deficiency) as at the beginning of the reporting period to which this Standard is first applied.

14.2 Where the initial adoption of this Standard gives rise to *deferred taxes* that are attributable to a specific *equity* account by virtue of paragraph 10.2, the amount of those deferred taxes must be adjusted against that equity account as at the beginning of the reporting period to which this Standard is first applied.

14.2.1 It may not be practicable to determine the initial adjustments to *goodwill* on acquisitions made some time prior to the initial application of this Standard.

15 Definitions

15.1 In this Standard:

assets **means future economic benefits controlled by the *entity* as a result of past transactions or other past events**

associate **means an investee, not being**

(a) a *subsidiary* of the investor; or

(b) a partnership of the investor; or

(c) an investment acquired and held exclusively with a view to its disposal in the near future,

over which the investor has *significant influence*

carrying amount **means, in relation to an *asset* or a *liability*, the amount at which the asset or liability is recorded in the accounting records as at a particular date**

***current asset* means an asset that:**

(a) is expected to be realised in, or is held for sale or consumption in, the normal course of the entity's operating cycle; or

(b) is held primarily for trading purposes or for the short-term and is expected to be realised within twelve months of the *reporting date*; or

(c) is a cash or a cash-equivalent asset which is not restricted in its use beyond twelve months or the length of the operating cycle whichever is greater

***current liability* means a liability that:**

(a) arises and is expected to be settled in the normal course of the entity's operating cycle; or

(b) is at call or due or expected to be settled within twelve months of the reporting date

***current tax* means the amount of income taxes payable (recoverable) in respect of the *taxable amount (tax loss)* for a reporting period**

***current tax asset* means the amount of *current tax* recoverable as at the reporting date**

***current tax liability* means the amount of current tax payable as at the reporting date**

***deferred tax* means:**

(a) a *deferred tax liability* or *asset* that arises in a reporting period; and

(b) changes in a deferred tax liability or asset that occur in a reporting period, other than those arising from the translation of deferred tax liabilities and assets of foreign operations

***deferred tax assets* means the amounts of income taxes recoverable in future reporting periods in respect of:**

(a) deductible *temporary differences*; and

(b) the carry forward of unused *tax losses*

deferred tax liabilities **means the amounts of income taxes to be settled in future reporting periods in respect of assessable temporary differences**

depreciable amount **means the historical cost of a** ***depreciable asset*****, or other revalued amount substituted for historical cost, in the financial report, less in either case the net amount expected to be recovered on disposal of the asset at the end of its useful life**

depreciable asset **means a** ***non-current asset*** **having a limited useful life**

direct credit to equity **means an increase in an item of** ***equity*****, where the increase is not** ***recognised*** **in** ***net profit or loss/result***

direct debit to equity **means a decrease in an item of equity, where the decrease is not recognised in net profit or loss/result**

discount on acquisition **means the saving or allowance in the purchase consideration that flows to the purchaser on acquiring identifiable net assets or shares at less than fair value**

economic entity **means a group of entities comprising the** ***parent entity*** **and each of its subsidiaries**

entity **means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives**

equity **means the residual interest in the assets of the entity after deduction of its liabilities**

expenses **means consumptions or losses of future economic benefits in the form of reductions in assets or increases in liabilities of the entity, other than those relating to distributions to owners, that result in a decrease in equity during the reporting period**

extraordinary items **means items of** ***revenue*** **and** ***expense*** **that are attributable to transactions or other events of a type that are outside the ordinary activities of the entity and are not of a recurring nature**

general purpose financial report **means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs**

goodwill **means the future benefits from unidentifiable assets**

income tax expense (income tax revenue) **means the aggregate amount recognised in net profit or loss/result in the statement of financial performance for the reporting period in respect of current tax and** ***deferred tax***

integrated foreign operation **means a foreign operation that is financially and operationally interdependent, either directly or indirectly, with the entity and whose day-to-day operations normally expose the entity or** ***economic entity*** **to foreign exchange gains or losses**

joint venture **means a contractual arrangement whereby two or more parties undertake an economic activity which is subject to joint control**

joint venture entity **means a** ***joint venture*** **that is in the form of an entity and does not include:**

(a) an entity that is acquired and held exclusively with a view to its disposal in the near future

(b) an entity that operates under severe long-term restrictions which impair significantly its ability to make distributions to the venturer

joint venture operation **means a joint venture that is not a** ***joint venture entity*** **and does not include an entity that:**

(a) is acquired and held exclusively with a view to its disposal in the near future

(b) operates under severe long-term restrictions that impair significantly its ability to make distributions to the venturer

liabilities **means the future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events**

***net profit or loss/result* means:**

(a) in the case of an entity that is not an economic entity, profit or loss/result after *income tax expense (income tax revenue)* from ordinary activities and *extraordinary items*

(b) in the case of an entity that is an economic entity, profit or loss/result after income tax expense (income tax revenue) from ordinary activities and extraordinary items, before adjustment for that portion that can be attributed to outside equity interest

non-current assets* means all assets other than *current assets

non-current liabilities* means all liabilities other than *current liabilities

***ownership interest* means the equity interest held by an entity directly, and/or indirectly through another entity**

***parent entity* means an entity which controls another entity**

***pre-tax net profit or loss/result* means the net profit or loss/result for a given reporting period before debiting the related income tax expense or before crediting the related income tax revenue**

***recognised* means reported on, or incorporated in amounts reported on, the face of the statement of financial performance or of the statement of financial position (whether or not further disclosure of the item is made in notes)**

***reporting date* means the end of the reporting period to which the financial report relates**

***reporting entity* means an entity (including an economic entity) in respect of which it is reasonable to expect the existence of users dependent on *general purpose financial reports* for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources**

***revenues* means inflows or other enhancements, or savings in outflows, of future economic benefits in the form of increases in assets or reductions in liabilities of the entity,**

other than those relating to contributions by owners, that result in an increase in equity during the reporting period

significant influence **means the capacity of an entity to affect substantially (but not control) either, or both, of the financial and operating policies of another entity**

subsidiary **means an entity which is controlled by a parent entity**

tax base **means the amount that is attributed to an asset or a liability for tax purposes**

taxable amount (tax loss) **means the amount on which income tax is payable (recoverable) for a reporting period calculated according to the provisions of the applicable income tax legislation or according to the rules established by the relevant taxation authorities**

temporary difference **means the difference between the** *carrying amount* **of an asset or a liability in the statement of financial position and its** *tax base***. A temporary difference may be either:**

(a) an assessable temporary difference, which is a temporary difference that will result in an increase (decrease) in income tax payable (recoverable) of future reporting periods when the carrying amount of the asset or liability is recovered or settled; or

(b) a deductible temporary difference, which is a temporary difference that will result in a decrease (increase) in income tax payable (recoverable) of future reporting periods when the carrying amount of the asset or liability is recovered or settled

time of completion **means:**

(a) in the case of entities required to produce a financial report in accordance with the Corporations Law – the date of the Directors' Declaration

(b) in the case of other entities – the date of final approval of the financial report by the management or governing body of the entity, whichever is applicable

***venturer* means a party to a joint venture that has joint control over that joint venture.**

Tax Base

15.1.1 The tax base of an asset or a liability is calculated in accordance with Section 5 of this Standard.

Taxable Amount (Tax Loss)

15.1.2 Under Australian income tax law, income tax payable equals:

(a) taxable income (that is, assessable income less allowable deductions) multiplied by the tax rate; less

(b) tax offsets (credits and rebates).

Under the approach adopted by this Standard, *taxable amount* (as defined in paragraph 15.1) equals taxable income less tax offsets grossed up by the entity's tax rate (to the extent the offsets will be utilised). Accordingly, grossed-up tax offsets are treated as deductible amounts. As indicated in paragraph 5.1.2, the notions of assessable and deductible amounts do not necessarily coincide with the tax law's definitions of assessable income and allowable deductions. However, the assessable amounts referred to in this Standard less the deductible amounts referred to in this Standard result in what this Standard refers to as taxable amount which, when multiplied by the tax rate, equals what is commonly referred to as income tax payable under Australian income tax law.

15.1.3 Future assessable amounts and future deductible amounts arising from the recovery (settlement) of the carrying amount of an asset (liability) will affect the taxable amount in future reporting periods. As noted in paragraph 5.1.4, future deductible amounts may include grossed-up tax offsets that arise from the recovery (settlement) of the carrying amount of the asset (liability).

15.1.4 Under the approach adopted by this Standard, tax loss (as defined in paragraph 15.1) normally equals tax loss that would be calculated in accordance with the income tax law (that is, the excess of allowable deductions over assessable income). However, where an entity incurs a tax loss under income tax law and available tax offsets are able to be utilised (that is, carried forward or refunded), the grossed-up tax offsets increase deductible amounts, thus increasing tax loss as calculated under this Standard.

Temporary Differences

15.1.5 An unused carry-forward tax loss calculated in accordance with this Standard will result in a decrease in income tax payable of future reporting periods. A tax loss is accounted for in accordance with paragraph 4.4 and therefore does not give rise to a deductible temporary difference.

15.1.6 Appendix 1 provides examples of:

(a) circumstances that give rise to assessable temporary differences

(b) circumstances that give rise to deductible temporary differences

(c) circumstances where the carrying amount of an asset or a liability is equal to its tax base and therefore where temporary differences do not arise.

Direct Credits (Debits) to Equity

15.1.7 *Direct credits (debits) to equity* (as defined in paragraph 15.1) include increases (decreases) in items of equity, where the increase (decrease) may be recognised in the component of the statement of financial performance separate from net profit or loss/result. Australian Accounting Standard AAS 1 "Statement of Financial Performance" requires the following items to be recognised in the component of the statement of financial performance separate from net profit or loss/result:

(a) the net revaluation increment or decrement recognised in an asset revaluation reserve during the reporting period in accordance with Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets"

(b) the net exchange difference recognised in the foreign currency translation reserve during the reporting period in accordance with Australian Accounting Standard AAS 20 "Foreign Currency Translation"

(c) each revenue, expense or valuation adjustment (including each initial adjustment) recognised during the reporting period in equity but not in net profit or loss/result, in accordance with an Australian Accounting Standard

(d) each initial adjustment recognised during the reporting period in equity but not in net profit or loss/result, in accordance with a transitional provision of an Urgent Issues Group Consensus View.

15.1.8 Direct credits (debits) to equity also include increases (decreases) in items of equity, where the increase (decrease) is recognised in the statement of financial position and not in the statement of financial performance. Circumstances where this may occur include:

(a) the initial classification of the equity component of a compound financial instrument (see paragraph 10.2.1 of this Standard) as required by Australian Accounting Standard AAS 33 "Presentation and Disclosure of Financial Instruments"

(b) the issuing or repurchase of equity instruments

(c) distributions to holders of securities classified as equity.

15.1.9 As noted in paragraph 4.1.2, this Standard generally requires the entity to recognise the tax consequences of transactions and other events consistently with the way that it recognises the transactions and other events themselves. Therefore, for transactions and other events recognised in net profit or loss/result, any related tax effects are also recognised in net profit or loss/result. Subject to the exceptions identified in paragraph 10.4, for transactions and other events recognised as a direct credit to an equity item, any related tax effects are recognised as a direct debit to that equity item, while for transactions and other events recognised as a direct debit to an equity item, any related tax effects are recognised as a direct credit to that equity item.

Deferred Tax

15.1.10 Australian Accounting Standard AAS 20 "Foreign Currency Translation" specifies requirements for the translation of liabilities and assets of foreign operations. In accordance with AAS 20, deferred tax liabilities and assets of integrated foreign operations are translated at current exchange rates.

APPENDIX 1

EXAMPLES OF TEMPORARY DIFFERENCES

This Appendix forms part of the commentary and is provided for illustrative purposes only.

A. EXAMPLES OF CIRCUMSTANCES THAT GIVE RISE TO ASSESSABLE TEMPORARY DIFFERENCES

All assessable temporary differences give rise to deferred tax liabilities. However, not all deferred tax liabilities will be recognised (see Section 6 of the Standard).

1. Interest revenue is received in arrears and is included in pre-tax net profit or loss/result on a time apportionment basis but is included in taxable amounts on a cash basis.

2. Revenue from the sale of goods is included in pre-tax net profit or loss/result when goods are delivered but is included in taxable amounts when cash is collected. (*Note: As explained in B3 below, there is also a deductible temporary difference associated with any related inventory*).

3. Accumulated depreciation of an asset in the financial report is less than the cumulative depreciation allowed up to the reporting date for tax purposes (that is, depreciation of an asset is accelerated for tax purposes).

4. Development costs have been capitalised and will be amortised to the statement of financial performance but were deducted in calculating taxable amounts in the reporting period in which they were incurred.

5. Prepaid expenses have been deducted on a cash basis in calculating the taxable amounts of the current or previous reporting periods.

6. Depreciation of an asset is not deductible for tax purposes and no deduction will be available for tax purposes when the asset is sold or scrapped. (*Note: Paragraph 6.1(b) of the Standard prohibits recognition of the resulting deferred tax liability unless the asset was acquired in an acquisition of an entity or operation, see also paragraphs 6.1.7 to 6.1.10 of the Standard*).

7. The component of a convertible note classified as a liability is measured at a discount to the amount repayable on maturity, after assigning a portion of the cash proceeds to the component classified as equity (see Australian Accounting Standard AAS 33 "Presentation and Disclosure of Financial Instruments"). The discount is not deductible in calculating the taxable amount (tax loss). (*Notes: (1) the assessable temporary difference is the amount of unamortised discount, see Example 4 in Appendix 2; and (2) an entity recognises the resulting deferred tax liability and debits the deferred tax directly to the carrying amount of the component classified as equity, see paragraphs 6.1.20 to 6.1.22 and 10.2 of the Standard. In accordance with paragraph 10.4, subsequent changes in the deferred tax liability are recognised as deferred tax expense (revenue) in net profit or loss/result*).

8. Current investments or financial instruments are carried at fair value which exceeds cost but no equivalent adjustment is made for tax purposes.

9. An entity revalues property, plant and equipment (under Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets") but no equivalent adjustment is made for tax purposes. (*Note: Paragraph 10.2 of the Standard requires the related deferred tax to be directly debited to equity*).

10. The carrying amount of an asset is increased to fair value in an acquisition of an entity or operation and no equivalent adjustment is made for tax purposes. (*Note: On initial recognition, the resulting deferred tax liability increases goodwill or decreases discount on acquisition, see paragraph 10.5 of the Standard*).

11. Amortisation of goodwill is not deductible in calculating the taxable amount and the cost of the goodwill would not be deductible on disposal of the business. (*Note: Paragraph 6.1(a) of the Standard prohibits recognition of the resulting deferred tax liability*).

12. Unrealised losses resulting from transactions within an economic entity are eliminated on consolidation but no equivalent adjustment is made for tax purposes. For example, entity A sells $100 of inventory (cost $120) to its wholly owned subsidiary (entity B), and the inventory is on hand at reporting date. The carrying amount of inventory in the consolidated statement of financial position is $120 (after elimination of the unrealised loss – assuming the inventory is not written down in accordance with the lower of cost and net realisable value rule). The tax base is $100 (being the carrying amount in entity B's own statement of financial position). The future assessable amount of $120 will be offset to the extent of the

future deductible amount of $100, giving rise to an assessable temporary difference of $20. Assuming a 30% tax rate in entity B's tax jurisdiction, a deferred tax liability of $6 arises.

13. Retained profits of subsidiaries, branches, associates and joint ventures are included in consolidated retained profits or in the retained profits of the investor or venturer, but income taxes will be payable if the profits are distributed to the parent entity, investor or venturer. (*Note: Paragraph 6.1(c) of the Standard prohibits recognition of the resulting deferred tax liability if the parent entity, investor or venturer is able to control the timing of the distributions from the subsidiaries, branches, associates or joint ventures and it is probable that the assessable temporary difference will not reverse in the foreseeable future*).

14. Investments in foreign subsidiaries, branches, associates or joint venture entities or interests in foreign joint venture operations are affected by changes in foreign exchange rates. (*Notes: (1) there may be either an assessable temporary difference or a deductible temporary difference; and (2) paragraph 6.1(c) of the Standard prohibits recognition of the resulting deferred tax liability if the parent entity, investor or venturer is able to control the timing of the distributions from the subsidiaries, branches, associates or joint ventures and it is probable that the temporary difference will not reverse in the foreseeable future*).

15. An entity accounts in its own currency for the cost of the non-monetary assets of a foreign operation that is integral to the reporting entity's operations but the taxable amount or tax loss of the foreign operation is calculated in the foreign currency. (*Notes: (1) there may be either an assessable temporary difference or a deductible temporary difference; (2) where there is an assessable temporary difference, the resulting deferred tax liability is recognised, because it relates to the foreign operation's own assets and liabilities, rather than to the reporting entity's investment in that foreign operation (paragraph 6.1.19 of the Standard); and (3) the deferred tax is recognised in net profit or loss/result (see paragraph 10.1 of the Standard*).

B. EXAMPLES OF CIRCUMSTANCES THAT GIVE RISE TO DEDUCTIBLE TEMPORARY DIFFERENCES

All deductible temporary differences give rise to deferred tax assets. However, some deferred tax assets may not satisfy the recognition criteria in paragraph 4.3 of the Standard (see also Section 7 of the Standard).

1. Long service leave entitlements are deducted in calculating pre-tax net profit or loss/result as service is provided by the employee, but are not deducted in calculating the taxable amount until the entity pays the employee. (*Note: Similar deductible temporary differences arise where other expenses, such as product warranty costs or interest, are deductible on a cash basis in calculating the taxable amount*).

2. Accumulated depreciation of an asset in the financial report is greater than the cumulative depreciation allowed up to the reporting date for tax purposes.

3. The cost of inventories sold before the reporting date is deducted in calculating pre-tax net profit or loss/result when goods or services are delivered but is deducted in calculating the taxable amount when cash is collected. (*Note: As explained in A2 above, there is also an assessable temporary difference associated with the related trade receivable*).

4. The net realisable value of an item of inventory, or the recoverable amount of an item of property, plant or equipment, is less than the previous carrying amount and the entity therefore reduces the carrying amount of the asset, but that reduction is ignored for tax purposes until the asset is sold.

5. Research costs (or organisation or other start-up costs) are recognised as an expense in calculating pre-tax net profit or loss/result but are not permitted as a deduction in calculating the taxable amount until a later period.

6. Current investments or financial instruments are carried at fair value which is less than cost, but no equivalent adjustment is made for tax purposes.

7. A liability is recognised at its fair value in an acquisition of an entity or operation; but its carrying amount is not deducted in calculating the taxable amount until a later period. (*Note: On initial*

recognition, the resulting deferred tax asset decreases goodwill or increases discount on acquisition, see paragraph 10.5 of the Standard).

8. Unrealised profits resulting from transactions within the economic entity are eliminated from the carrying amount of assets, such as inventory or property, plant or equipment, but no equivalent adjustment is made for tax purposes. For example, entity A sells \$100 of inventory (cost \$80) to its wholly owned subsidiary (entity B) and the inventory is on hand at reporting date. The carrying amount of inventory in the consolidated statement of financial position is \$80 (after elimination of the unrealised profit). The tax base is \$100 (being the carrying amount in entity B's own statement of financial position). The future assessable amount of \$80 will be more than offset by the future deductible amount of \$100, giving rise to a deductible temporary difference of \$20. Assuming a 30% tax rate in entity B's tax jurisdiction, a deferred tax asset of \$6 arises.

9. Investments in foreign subsidiaries, branches, associates or joint venture entities or interests in foreign joint venture operations are affected by changes in foreign exchange rates. (*Notes: (1) there may be an assessable temporary difference or a deductible temporary difference; and (2) paragraphs 4.3 and 7.2 of the Standard require recognition of the resulting deferred tax asset to the extent, and only to the extent, that it is probable that: (a) future taxable amounts will be available within the entity against which the deductible temporary difference can be utilised; and (b) the temporary difference will reverse in the foreseeable future*).

10. An entity accounts in its own currency for the cost of the non-monetary assets of a foreign operation that is integral to the reporting entity's operations but the taxable amount or tax loss of the foreign operation is calculated in the foreign currency. (*Notes: (1) there may be either an assessable temporary difference or a deductible temporary difference; (2) where there is a deductible temporary difference, the resulting deferred tax asset is recognised to the extent that it is probable that sufficient taxable amounts will be available, because the deferred tax asset relates to the foreign operation's own assets and liabilities, rather than to the reporting entity's investment in that foreign operation (paragraph 6.1.19 of the Standard); and (3) the deferred tax is recognised in net profit or loss/result, see paragraph 10.1 of the Standard*).

C. EXAMPLES OF CIRCUMSTANCES WHERE THE CARRYING AMOUNT OF AN ASSET OR A LIABILITY IS EQUAL TO ITS TAX BASE

1. Accrued expenses have already been deducted in calculating an entity's current tax liability for the current or earlier reporting periods.

2. Accrued expenses (for example, statutory fines payable) will never be deductible for tax purposes.

3. Accrued income will never be assessable.

4. A loan payable is measured at the amount originally received and this amount is the same as the amount repayable on final maturity of the loan.

5. The component of a converting financial instrument that is classified as a financial liability will never be deductible for tax purposes.

APPENDIX 2

ILLUSTRATIVE COMPUTATIONS AND PRESENTATION

This Appendix forms part of the commentary and is provided for illustrative purposes only. It does not illustrate every possible disclosure that may be appropriate to the circumstances of an entity. Other methods of presentation may comply with the accounting standards set out in this Standard.

The examples in this Appendix assume that the entities concerned have no transactions other than those described.

Example 1 – Depreciable Assets

This example illustrates the calculation of deferred tax expense (revenue) and the related deferred tax liability (asset) for an entity whose sole asset is a piece of equipment that is depreciated for tax purposes at a rate that differs from the rate used for financial reporting purposes.

An entity buys equipment for $10,000 and depreciates it on a straight line basis over its expected useful life of five years. The expected residual value is nil. For tax purposes, the equipment is depreciated at 25% per annum on a straight line basis. Tax losses may be carried forward against the taxable amount of future years but cannot be carried back and used against the taxable amount of previous years. The tax rate is 30%.

The entity's management expects to recover the carrying amount of the equipment by using it to manufacture goods for resale. The entity's current tax is nil for each of years 1 to 5 because a tax loss is incurred in years 1 to 4 and carried forward to year 5 to reduce the taxable amount in year 5 to nil.

The entity recognises a deferred tax asset in respect of the carry-forward of the unused tax loss at the end of each of years 1 to 4 because its management concludes that it is probable that it will recover the benefit of the tax loss against the taxable amounts of future years (see paragraph 4.4 of the Standard). The tax loss, and the tax expense (revenue) and related deferred tax liability (asset) is calculated as follows:

	1 $	2 $	3 $	4 $	5 $
Assessable amounts	2,000	2,000	2,000	2,000	2,000
Depreciation for tax purposes	2,500	2,500	2,500	2,500	–
Taxable amount (tax loss) before the effect of carried forward tax losses	(500)	(500)	(500)	(500)	2,000
Opening deferred tax asset in respect of carried forward tax losses	–	(150)	(300)	(450)	(600)
Tax expense (revenue) in respect of carried forward tax losses	(150)	(150)	(150)	(150)	600
Closing deferred tax asset in respect of carried forward tax losses	(150)	(300)	(450)	(600)	–

The temporary differences associated with the equipment and the resulting deferred tax liability and asset and tax expense and revenue are as follows:

	1	2	3	4	5
	$	$	$	$	$
Carrying amount	8,000	6,000	4,000	2,000	–
Tax base	7,500	5,000	2,500	–	–
Assessable temporary difference	500	1,000	1,500	2,000	–
Opening deferred tax liability in respect of temporary differences	–	150	300	450	600
Tax expense (revenue) in respect of temporary differences	150	150	150	150	(600)
Closing deferred tax liability in respect of temporary differences	150	300	450	600	–

The entity recognises the deferred tax liability in respect of the assessable temporary difference as at the end of each of years 1 to 4. The reversal of the assessable temporary difference will create taxable amounts (and recoup the benefit of the tax loss) in subsequent years. In year 5 the temporary difference reverses.

The deferred tax asset in respect of the carried forward tax loss effectively offsets the deferred tax liability in respect of the temporary difference. An extract from the entity's statement of financial performance is as follows:

	1	2	3	4	5
	$	$	$	$	$
Revenue	2,000	2,000	2,000	2,000	2,000
Depreciation	2,000	2,000	2,000	2,000	2,000
Profit before tax	–	–	–	–	–
Tax expense (revenue) in respect of carried forward tax losses	(150)	(150)	(150)	(150)	600
Tax expense (revenue) in respect of assessable temporary differences	150	150	150	150	(600)
Total tax expense (revenue)	–	–	–	–	–
Net profit for the period	–	–	–	–	–

Example 2 – Deferred Tax Assets and Liabilities

This example provides a comprehensive illustration of the calculation of current tax expense (revenue) and the related current tax liability (asset); and deferred tax expense (revenue), the deferred tax directly debited (credited) to equity and the related deferred tax liability (asset) for an entity that enters into a number of transactions that affect income tax. In addition, the example illustrates selected disclosures required by Section 13 of the Standard.

This example deals with an entity over the two-year period, X5 and X6. In X5 the enacted income tax rate is 40%. In X6 the enacted income tax rate is 30%.

Donations are recognised as an expense when they are paid and are not deductible for tax purposes.

In X5, the entity was notified by the relevant authorities that they intend to pursue an action against the entity with respect to environmental emissions. Although as at December X6 the action had not yet come to court the entity recognised a liability of $700 in X5 being its best estimate of the fine arising from the action. Fines are not deductible for tax purposes.

In X2, the entity incurred $1,250 of costs in relation to the development of a new product. These costs were deducted for tax purposes in X2. For accounting purposes, the entity capitalised this expenditure and amortised it on a straight line basis over five years. At 31 December X4, the unamortised balance of these product development costs was $500.

The entity provides long service leave benefits for its employees. The entity recognises as an expense the cost of long service leave as employees provide service. No payments were made to employees for such benefits in X5 or X6. Long service leave costs are deductible for tax purposes when payments are made to employees. The entity has determined that it is probable that taxable amounts will be available against which any resulting deferred tax asset can be utilised.

Buildings are depreciated for accounting purposes at 5% a year on a straight line basis (and have an expected residual value of nil) and at 10% a year on a straight line basis for tax purposes. Motor vehicles are depreciated for accounting purposes at 20% a year on a straight line basis (and have an expected residual value of nil) and at 25% a year on a straight line basis for tax purposes. Acquired assets are first ready for use at the beginning of a year. Accordingly, a full year's depreciation is recognised for accounting purposes and for tax purposes in the year that an asset first becomes ready for use.

At 1 January X6, the building was revalued to $65,000 and the entity estimated that the remaining useful life of the building was 20 years from the date of the revaluation. The revaluation did not affect the taxable amount in X6.

The tax base of the building did not change to reflect the revaluation because the entity intends recovering the building's carrying amount entirely through use. Because the revalued building is depreciated during X6 (that is, recovered through use), the current tax and deferred tax that relate to the revalued component are recognised as expense or revenue in net profit or loss/result in accordance with paragraph 10.4 of the Standard. In X6, the entity transferred $1,113 from the revaluation reserve to retained profits. This represents the difference of $1,590 between the depreciation on the building that is recognised in the statement of financial performance ($3,250) and the amount of depreciation that would be recognised if it were based on the cost of the building ($1,660, which is the book value at 1 January X6 of $33,200 divided by the remaining useful life of 20 years), less the related deferred tax of $477 (see paragraph 10.3.1 of the Standard).

Current Tax Expense

	X5	X6
	$	$
Pre-tax net profit or loss/result	8,775	8,740
Add		
Depreciation for accounting purposes	4,800	8,250
Donations	500	350
Fine for environmental emissions	700	–
Amortisation of product development costs	250	250
Long service leave benefits	2,000	1,000
	17,025	18,590
Deduct		
Depreciation for tax purposes	(8,100)	(11,850)
Taxable amount	8,925	6,740
Current tax expense at 40%	3,570	
Current tax expense at 30%		2,022

Carrying Amounts of Property, Plant and Equipment

	Building	*Motor Vehicles*	*Total*
Cost	$	$	$
Balance at 31 December X4	50,000	10,000	60,000
Additions X5	6,000	–	6,000
Balance at 31 December X5	56,000	10,000	66,000
Amount of accumulated depreciation credited to the asset account on revaluation at 1 January X6	(22,800)	–	(22,800)
Revaluation at 1 January X6	31,800	–	31,800
Balance at 1 January X6	65,000	10,000	75,000
Additions X6	–	15,000	15,000
Balance at 31 December X6	65,000	25,000	90,000
Accumulated Depreciation	5%	20%	
Balance at 31 December X4	20,000	4,000	24,000
Depreciation X5	2,800	2,000	4,800
Balance at 31 December X5	22,800	6,000	28,800
Revaluation at 1 January X6	(22,800)	–	(22,800)
Balance at 1 January X6	–	6,000	6,000
Depreciation X6	3,250	5,000	8,250
Balance at 31 December X6	3,250	11,000	14,250
Carrying Amount			
31 December X4	30,000	6,000	36,000
31 December X5	33,200	4,000	37,200
31 December X6	61,750	14,000	75,750

Tax Base of Property, Plant and Equipment

	Building	*Motor Vehicles*	*Total*
Cost	$	$	$
Balance at 31 December X4	50,000	10,000	60,000
Additions X5	6,000	–	6,000
Balance at 31 December X5	56,000	10,000	66,000
Additions X6	–	15,000	15,000
Balance at 31 December X6	56,000	25,000	81,000
Accumulated Depreciation	10%	25%	
Balance at 31 December X4	40,000	5,000	45,000
Depreciation X5	5,600	2,500	8,100
Balance at 31 December X5	45,600	7,500	53,100
Depreciation X6	5,600	6,250	11,850
Balance at 31 December X6	51,200	13,750	64,950
Tax Base *			
31 December X4	10,000	5,000	15,000
31 December X5	10,400	2,500	12,900
31 December X6	4,800	11,250	16,050

* Applying the formula prescribed in paragraph 5.1 of the Standard would result in the same amount for the tax base. For example, the tax base of the building at 31 December X5 may be calculated as:

Carrying amount	$33,200
Less Future assessable amounts	(33,200)
Add Future deductible amounts	10,400
Tax base	10,400

Statement of Financial Position and Tax-Based Balance Sheet, and the calculation of Deferred Tax Assets and Liabilities as at 31 December X4

	Carrying Amount $	*Tax Base* $	*Temporary Differences* $
Accounts receivable	500	500	–
Inventory	2,000	2,000	–
Product development costs	500	–	500
Investments	33,000	33,000	–
Property, plant & equipment	36,000	15,000	21,000
TOTAL ASSETS	72,000	50,500	21,500
Current tax liability	3,000	3,000	–
Accounts payable	500	500	–
Fines payable	–	–	–
Liability for long service leave	–	–	–
Long term debt	20,000	20,000	–
Deferred tax liability	8,600	8,600	
TOTAL LIABILITIES	32,100	32,100	–
Share capital	5,000	5,000*	
Asset revaluation reserve	–	–*	
Retained profits	34,900	13,400*	
TOTAL LIABILITIES/EQUITY	72,000	50,500*	
TEMPORARY DIFFERENCES			21,500
Deferred tax liability	21,500 at 40%		8,600
Deferred tax asset			–
Net deferred tax liability			8,600

* For the sake of completeness (to show a balanced tax-based balance sheet), equity items are shown as having tax bases. This is not necessary when applying the requirements of the Standard as equity items do not give rise to deferred tax liabilities or assets.

Statement of Financial Position and Tax-Based Balance Sheet, and the calculation of Deferred Tax Assets, Liabilities and Expense as at 31 December X5

	Carrying Amount	*Tax Base*	*Temporary Differences*
	$	$	$
Accounts receivable	500	500	–
Inventory	2,000	2,000	–
Product development costs	250	–	250
Investments	33,000	33,000	–
Property, plant & equipment	37,200	12,900	24,300
TOTAL ASSETS	72,950	48,400	24,550
Current tax liability	3,570	3,570	–
Accounts payable	500	500	–
Fines payable	700	700	–
Liability for long service leave	2,000	–	(2,000)
Long term debt	12,475	12,475	–
Deferred tax liability	9,020	9,020	
TOTAL LIABILITIES	28,265	26,265	(2,000)
Share capital	5,000	5,000	
Asset revaluation reserve	–	–	
Retained profits	39,685	17,135	
TOTAL LIABILITIES/EQUITY	72,950	48,400	
TEMPORARY DIFFERENCES			22,550
Deferred tax liability	24,550 at 40%		9,820
Deferred tax asset	(2,000) at 40%		(800)
Net deferred tax liability			9,020
Less: Opening deferred tax liability			(8,600)
Deferred tax expense (revenue) related to the origination and reversal of temporary differences			420

Statement of Financial Position and Tax-Based Balance Sheet, and the calculation of Deferred Tax Assets, Liabilities and Expense as at 31 December X6

	Carrying Amount	*Tax Base*	*Temporary Differences*
	$	$	$
Accounts receivable	500	500	–
Inventory	2,000	2,000	–
Product development costs	–	–	–
Investments	33,000	33,000	–
Property, plant & equipment	75,750	16,050	59,700
TOTAL ASSETS	111,250	51,550	59,700
Current tax liability	2,022	2,022	–
Accounts payable	500	500	–
Fines payable	700	700	–
Liability for long service leave	3,000	–	(3,000)
Long term debt	12,805	12,805	–
Deferred tax liability	17,010	17,010	
TOTAL LIABILITIES	36,037	33,037	(3,000)
Share capital	5,000	5,000	
Asset revaluation reserve	21,147	–	
Retained profits	49,066	13,513	
TOTAL LIABILITIES/EQUITY	111,250	51,550	
TEMPORARY DIFFERENCES			56,700
Deferred tax liability	59,700 at 30%		17,910
Deferred tax asset	(3,000) at 30%		(900)
Net deferred tax liability			17,010
Less: Opening deferred tax liability			(9,020)
Adjustment to opening deferred tax liability resulting from reduction in tax rate	22,550 at 10%		2,255
Deferred tax attributable to asset revaluation	31,800 at 30%		(9,540)
Deferred tax expense (revenue) related to the origination and reversal of temporary differences			705

Illustrative Disclosure

The amounts to be disclosed in accordance with the Standard are as follows:

Major components of tax expense (revenue) (paragraph 13.1)

	X5	X6
	$	$
Current tax expense	3,570	2,022
Deferred tax expense relating to the origination and reversal of temporary differences	420	705
Deferred tax expense (revenue) resulting from reduction in tax rate	–	(2,255)
Tax expense	3,990	472

Aggregate current and deferred tax that is not recognised in net profit or loss/result in accordance with paragraph 10.2 (paragraph 13.2(a))

	X5	X6
Deferred tax relating to revaluation of building	–	9,540

In X6 $1,113 was transferred from the revaluation reserve to retained profits. This represents the difference of $1,590 between the depreciation on the building recognised in the statement of financial performance based on the revalued amount and the depreciation based on the cost of the building, less the related deferred tax of $477.

A numerical reconciliation between tax expense (revenue) and the product of pre-tax net profit or loss/result multiplied by the Australian tax rate(s), disclosing also the basis on which the tax rate(s) is (are) determined (paragraph 13.2(b))

	X5	X6
	$	$
Pre-tax net profit or loss/result	8,775	8,740
Tax at the Australian tax rate of 30% (X5: 40%)	3,510	2,622
Tax effect of expenses that are not deductible in calculating the taxable amount:		
Donations	200	105
Fine for environmental emissions	280	–
Reduction in opening balance of deferred taxes resulting from reduction in tax rate	–	(2,255)
Tax expense	3,990	472

The tax rate is the national income tax rate.

A description of changes in the tax rate(s) compared to the previous reporting period (paragraph 13.2(c))

In X6, the parliament enacted a change in the national income tax rate from 40% to 30%.

The amount of the deferred tax liabilities and assets recognised in the statement of financial position for each reporting period presented, in respect of each type of temporary difference (paragraph 13.2(f)(i))

	X5	X6
	$	$
Deferred tax liability in respect of property, plant and equipment	9,720	17,910
Deferred tax asset in respect of liabilities for long service leave	(800)	(900)
Deferred tax liability in respect of product development costs	100	–
Deferred tax liability (after offset of deferred tax asset)	9,020	17,010

The amount of the deferred tax expense or revenue recognised in net profit or loss/result, in respect of each type of temporary difference, if this is not apparent from the changes in the amounts recognised in the statement of financial position (paragraph 13.2(f)(ii))

	X5	X6
	$	$
Deferred tax expense (revenue) in respect of property, plant and equipment	1,320*	(1,350)#
Deferred tax revenue in respect of liabilities for long service leave	(800)	(100)
Deferred tax revenue in respect of product development costs	(100)	(100)
Deferred tax expense (revenue)	420	(1,550)

*	Deferred tax asset relating to property, plant and equipment at end of reporting period: $24,300 × 40%	$9,720
	Less Deferred tax asset relating to property, plant and equipment at beginning of reporting period: $21,000 × 40%	8,400
		1,320
#	Deferred tax asset relating to property, plant and equipment at end of reporting period: $59,700 × 30%	$17,910
	Less Deferred tax asset relating to property, plant and equipment at beginning of reporting period: $24,300 × 40%	9,720
		8,190
	Less Deferred tax asset relating to revaluation	9,540
		(1,350)

Example 3 – Acquisition of an Entity and its effect on Consolidated Financial Reports

This Example illustrates the application of paragraphs 6.1.13 and 6.1.15 as they relate to consolidated financial reports. As noted in paragraph 6.1.11, there may also be a tax effect on the parent entity's financial report, which may differ from the effect on the consolidated financial report.

On 1 January X5 Entity A (an Australian entity) acquired 100% of the shares of Entity B (a foreign entity) at a cost (initial tax base) of $600, and thereby created A Group. In its consolidated financial report, A Group amortises goodwill over 5 years. Goodwill amortisation is not deductible for tax purposes. The tax rate in Australia is 30% and the tax rate in B's tax jurisdiction is 40%. The exchange rate is assumed to be constant.

The fair value of the identifiable assets and liabilities (excluding deferred tax liabilities and assets) acquired by Entity A and recognised in A Group's consolidated financial report is set out in the following table, together with their tax base in Entity B's tax jurisdiction and the resulting temporary differences.

	Cost of Acquisition	**Tax Base**	**Temporary Differences**
	$	$	$
Property, plant and equipment	270	155	115
Accounts receivable	210	210	–
Inventory	174	124	50
Long service leave obligations	(30)	–	(30)
Accounts payable	(120)	(120)	–
Fair value of the identifiable assets and liabilities acquired, excluding deferred tax	504	369	135

The deferred tax asset arising from the long service leave obligations is offset against the deferred tax liabilities arising from the property, plant and equipment and inventory (see paragraph 12.4 of the Standard).

No deduction is available in Entity B's tax jurisdiction for the cost of the goodwill. Therefore, the tax base of the goodwill (in Entity B's jurisdiction) is nil. However, in accordance with paragraph 6.1(a) of the Standard, A Group's consolidated financial report does not recognise a deferred tax liability for the assessable temporary difference associated, in Entity B's tax jurisdiction, with the goodwill.

The carrying amount, in A Group's consolidated statement of financial position, of Entity A's investment in Entity B at the date of acquisition is made up as follows:

	$
Fair value of identifiable assets and liabilities acquired, excluding deferred tax	504
Deferred tax liability ($135 × 40%)	(54)
Fair value of identifiable assets and liabilities acquired	450
Goodwill (net of amortisation of nil)	150
Carrying amount	600

At the date of acquisition, the tax base, in Australia, of Entity A's investment in Entity B is $600. Therefore, no temporary difference arises from the investment on acquisition.

During X5, Entity B's equity (incorporating the fair value adjustments made on acquisition) changed as follows:

	$
Entity B's equity at 1 January X5	450
Retained profit for X5 (net profit of $150 less dividend payable of $80)	70
Entity B's equity at 31 December X5	520

Entity A's consolidated financial report recognises a liability for any withholding tax or further Australian income taxes that Entity A will be required to settle on the accrued dividend receivable of $80.

At 31 December X5, Entity A's underlying investment in Entity B is reflected in the carrying amounts recognised in A Group's consolidated financial report as follows:

	$
Net assets of Entity B	520
Goodwill (net of amortisation of $30)	120
Carrying amount	640

The temporary difference arising from Entity A's underlying investment is therefore the difference between the carrying amount of $640 and its tax base. The tax base depends on the manner in which Entity A's management expects to recover the carrying amount of the investment (see paragraph 4.7 of the Standard). Assuming the tax base has not changed since acquisition (that is, it remains at $600), the temporary difference is $40 and is comprised of:

	$
Cumulative retained profit since acquisition	70
Cumulative amortisation of goodwill	(30)
	40

In these circumstances, there is a deferred tax liability of $12 (calculated as $\$40 \times 30\%$). If Entity A has determined that it will not sell the investment in the foreseeable future and that Entity B will not distribute its retained profits in the foreseeable future, no deferred tax liability is recognised in relation to Entity A's investment in Entity B in A Group's consolidated financial report (see paragraphs 6.1(c) and 6.1.15 of the Standard).[1] A Group's consolidated financial report discloses the amount of the temporary difference for which no deferred tax is recognised in A Group's consolidated financial report (see paragraph 13.2(e) of the Standard).

If the management of Entity A expects to sell the investment in Entity B in the foreseeable future, or that Entity B will distribute its retained profits in the foreseeable future, a deferred tax liability is recognised in A Group's consolidated financial report to the extent that the temporary difference is expected to reverse and will give rise to a tax consequence. The tax consequence may be in the form of withholding tax or further Australian income tax in the absence of a double tax agreement if Entity A recovers its investment in Entity B through distributions. Alternatively, the tax consequence may be in the form of capital gains tax if Entity A recovers its investment in Entity B through sale.[2]

If exchange rates had changed, Entity A directly debits (credits) to equity the deferred tax in A Group's consolidated financial report to the extent that the deferred tax results from foreign exchange translation differences which have been directly credited (debited) to equity (paragraph 10.2 of the Standard). A Group's consolidated financial report discloses separately:

(a) the aggregate deferred tax that has been directly debited or credited to equity (paragraph 13.2(a) of the Standard); and

(b) the aggregate amount of any remaining temporary difference that is not expected to reverse in the foreseeable future and for which, therefore, no deferred tax is recognised (see paragraph 13.2(e) of the Standard).

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1 Note that this exception would apply for an investment in an associate only if there is an agreement requiring that the profits of the associate will not be distributed in the foreseeable future (see paragraph 6.1.18 of the Standard).

2 If Entity B were an Australian subsidiary and the management of Entity A expected to recover Entity A's investment in Entity B through distributions, no deferred tax liability arises because of the inter-company dividend rebate under Australian income tax law.

Example 4 – Compound Financial Instruments

This Example illustrates the application of paragraphs 6.1.20 to 6.1.22 of the Standard.

An entity issues a non-interest-bearing convertible debt security of $1,000 on 31 December X4 repayable at par on 1 January X8. In accordance with Australian Accounting Standard AAS 33 "Presentation and Disclosure of Financial Instruments", the entity classifies the instrument's components as liabilities or as equity. The entity assigns an initial carrying amount of $751 to the component of the convertible debt classified as a liability and $249 to the component classified as equity. Subsequently, the entity recognises imputed discount on the component of the convertible debt classified as a liability. The tax rate is 40%.

The temporary differences associated with the component classified as a liability and the resulting deferred tax liability and deferred tax expense and revenue are as follows:

	X4	X5	X6	X7
	$	$	$	$
Carrying amount of liability component	751	826	909	1,000
Tax base	1,000	1,000	1,000	1,000
Assessable temporary difference	249	174	91	–
Opening deferred tax liability at 40%	–	100	70	37
Deferred tax directly debited to equity	100	–	–	–
Deferred tax expense (revenue)	–	(30)	(33)	(37)
Closing deferred tax liability at 40%	100	70	37	–

As explained in paragraph 6.1.22 of the Standard, at 31 December X4, the entity recognises the resulting deferred tax liability by adjusting the initial carrying amount of the component of the convertible debt classified as equity. Therefore, the amounts recognised at that date are as follows:

	$
Liability component	751
Deferred tax liability	100
Equity component ($249 less $100)	149
	1,000

Subsequent changes in the deferred tax liability are recognised in net profit or loss/result as deferred tax revenue (see paragraph 6.1.22 of the Standard). Therefore, the effect on the entity's net profit or loss/result is as follows:

	X4	X5	X6	X7
	$	$	$	$
Interest expense (imputed discount)	–	75	83	91
Deferred tax expense (revenue)	–	(30)	(33)	(37)
	–	45	50	54

The following illustrates abridged statements of financial position over the term of the convertible debt, assuming the instrument is settled at maturity with ordinary shares of the issuer:

	X4	X5	X6	X7	X8
	$	$	$	$	$
Cash	1,000	1,000	1,000	1,000	1,000
Financial liability	751	826	909	1,000	–
Deferred tax liability	100	70	37	–	–
Net Assets	149	104	54	–	1,000
Retained profits (losses)	–	(45)	(95)	(149)	(149)
Equity (proceeds from call option sold)	149	149	149	149	149
Ordinary shares issued	–	–	–	–	1,000
	149	104	54	–	1,000

APPENDIX 3

ACCOUNTING FOR THE TRANSFER OF TAX LOSSES WITHIN THE ECONOMIC ENTITY

This Appendix forms part of the commentary and is provided to illustrate paragraphs 7.3.11 to 7.3.16 of the Standard.

A. Accounting for the Transfer of Tax Losses within the Economic Entity by the Income (Transferee) Entity

A.1 Where no consideration is exchanged for losses transferred (see paragraph 7.3.14 of the Standard)

Example A

Losses of $100,000 have been transferred by the loss entity for no consideration. The income tax benefit of the losses is $30,000 ($100,000 x 30%).

The journal entry for the income entity

		$	$
Dr	Current Tax Liability	30,000	
Cr	Income Tax Expense (current)		30,000

A.2 Where consideration is exchanged for tax losses transferred (see paragraph 7.3.15 of the Standard)

Example B

Losses of $100,000 have been transferred by the loss entity for consideration of $25,000. The income tax benefit of the losses is $30,000 ($100,000 x 30%).

The journal entries for the income entity

Dr	Current Tax Liability	30,000	
Cr	Income Tax Expense (current)		30,000

(Recognising the income tax benefit of $30,000 ($100,000 x 30%) transferred from the loss entity)

		$	$
Dr	Income Tax Expense (current)	25,000	
Cr	Cash/Payable to Loss Entity		25,000

(Recognising the consideration paid/payable to the loss entity for losses transferred)

Extracts from the income entity's statement of financial performance

	$'000
Profit (loss) from ordinary activities before income tax	1,000
Less Income tax expense (revenue)*	(295)
Net profit (loss)	705

** Income tax reconciliation*

	$'000	$'000
Profit before income tax		1,000
Tax effect at 30%		300
Less Tax benefit received on losses transferred	(30)	
Plus Consideration paid for losses transferred	25	(5)
		295

B. Accounting for the Transfer of Tax Losses within the Economic Entity by the Loss (Transferor) Entity

B.1 Where no consideration is exchanged for losses transferred

Where the loss entity has not recognised the tax losses as a deferred tax asset or other asset no accounting treatment is necessary other than a note to the financial statements of the loss entity indicating that losses have been transferred to a related entity.

In some instances, in relation to temporary differences, the loss entity will not have recognised a deferred tax asset; and/or the loss entity will not have separately recognised a deferred tax liability because it is offset by a deferred tax asset attributable to tax losses against which the temporary differences will reverse. When losses are transferred in these situations it may be necessary for the loss entity to reinstate in the financial report the deferred tax assets and deferred tax liabilities pertaining to temporary differences.

B.2 Where consideration is exchanged for tax losses transferred (see paragraphs 7.3.12 and 7.3.13 of the Standard)

Example C

Out of a total of $200,000 of losses incurred in the current year, losses of $100,000 have been transferred by the loss entity for a consideration of $25,000. Neither the deferred tax asset nor any other asset relating to the losses has been recognised by the loss entity.

The journal entry for the loss entity

		$	$
Dr	Cash/Receivable from Income Entity	25,000	
Cr	Income Tax Expense (current)		25,000

Extract from loss entity's statement of financial performance

	$'000
Profit (loss) from ordinary activities before income tax	(200)
Less Income tax expense (revenue)*	(25)
Net profit (loss)	(175)

**Income tax reconciliation*

Profit (loss) from ordinary activities before income tax	(200)
Less Amount of loss for which a tax asset has not been recognised	(200)
	–
Tax effect at 30%	–
Plus Consideration received for losses transferred	(25)
Income tax revenue	(25)

Example D

Out of a total of $200,000 of losses incurred in the current year, losses of $100,000 have been transferred by the loss entity for a consideration of $30,000. A deferred tax asset relating to the losses has been recognised at a rate of 30%.

The journal entries for the loss entity

		$	$
Dr	Deferred Tax Asset	60,000	
Cr	Income Tax Expense (deferred)		60,000

(Recognising the deferred tax asset on $200,000 of losses)

Dr	Income Tax Expense (deferred)	30,000	
Cr	Deferred Tax Asset		30,000

Dr	Cash/Receivable from Income Entity	30,000	
Cr	Income Tax Expense (current)		30,000

(Recognising transfer of $100,000 of losses for consideration of $30,000)

Extract from loss entity's statement of financial performance

	$'000
Profit (loss) from ordinary activities before income tax	(200)
Less Income tax expense (revenue)	(60)
Net profit (loss)	(140)

Example E

The amount of deferred tax asset or other asset may differ from the amount of consideration. The difference is included in the calculation of income tax expense recognised by the loss entity.

Out of a total of $200,000 of losses incurred in the current year, losses of $100,000 have been transferred by the loss entity for consideration of $25,000. A deferred tax asset relating to the losses has been recognised at a rate of 30%.

The journal entries for the loss entity

		$	$
Dr	Deferred Tax Asset	60,000	
Cr	Income Tax Expense (deferred)		60,000

(Recognising the deferred tax asset on $200,000 of losses)

Dr	Income Tax Expense (deferred)	30,000	
Cr	Deferred Tax Asset		30,000

Dr	Cash/Receivable from Income Entity	25,000	
Cr	Income Tax Expense (current)		25,000

(Recognising transfer of $100,000 of losses for consideration of $25,000)

Extract from loss entity's statement of financial performance

		$'000
Profit (loss) from ordinary activities before income tax		(200)
Less Income tax expense (revenue)*		(55)
Net profit (loss)		(145)

** Income tax reconciliation*

Profit (loss) before income tax		(200)
Tax effect at 30%		(60)
Less Tax benefits relating to losses transferred ($100,000 x 30%)	(30)	
Plus Consideration received for losses transferred	25	(5)
Income tax revenue		(55)

APPENDIX 4

A COMPARISON OF THE SUPERSEDED AAS 3 AND THE REVISED AAS 3

This Appendix forms part of the commentary and is provided to assist in the understanding of the differences between the requirements of this Standard and the requirements of the superseded Standard.

Australian Accounting Standard AAS 3 "Income Taxes" supersedes Australian Accounting Standard AAS 3 "Accounting for Income Tax (Tax-effect Accounting)" issued in November 1989. In so doing it replaces a comprehensive income statement liability method of tax-effect accounting with a comprehensive balance sheet liability method.

Although the conceptual basis of the superseded AAS 3 is significantly different from the conceptual basis of the revised AAS 3, the tax assets and liabilities that are required to be recognised under the superseded AAS 3 also arise under the revised AAS 3. However, there are likely to be more deferred tax assets and liabilities that arise under the revised AAS 3 than arose under the superseded AAS 3. The more common circumstances that cause this are asset revaluations and fair value adjustments to the assets and liabilities of acquired entities. The following outlines some of the more significant differences between the revised AAS 3 and the superseded AAS 3 and provides an explanation for some of the requirements in the revised AAS 3.

Major Changes to the Superseded AAS 3

Focus on Temporary Differences not Timing Differences

The comprehensive balance sheet liability method prescribed in the revised AAS 3 focuses on temporary differences whereas the comprehensive income statement liability method prescribed in the superseded AAS 3 focuses on timing differences.

Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and the tax base of that asset or liability and give rise to deferred tax liabilities and assets that may be recognised as liabilities and assets, respectively. Timing differences are differences between the taxable amount and pre-tax accounting profit that originate in one reporting period and reverse in one or more subsequent reporting periods and give rise to provisions for deferred income tax and future income tax benefits that may be recognised as liabilities and assets, respectively.

Circumstances where the resulting deferred tax balances are the same

The circumstances that give rise to cumulative timing differences also give rise to equivalent temporary differences. For example, the timing differences relating to employee entitlement expenses over a number of reporting periods that have not reversed at reporting date will equal the employee entitlement liability and therefore the related temporary difference. Therefore, deferred tax assets and liabilities that arise under the superseded AAS 3 are equivalent to the deferred tax assets and liabilities that arise under the revised AAS 3. However, the reverse does not always apply.

Circumstances where the resulting deferred tax balances differ: temporary differences that are not timing differences

Temporary differences arise in the following circumstances, which do not give rise to equivalent cumulative timing differences under the superseded AAS 3:

(a) asset revaluations recognised in an asset revaluation reserve in accordance with Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets" which do not result in equivalent adjustments to the tax bases of the assets (see paragraph 6.1.4 of the revised AAS 3)

(b) acquisitions of entities or operations, where an acquiree's identifiable assets and liabilities are measured at fair values as at the date of acquisition and those fair values, recognised in the acquirer's financial report, differ from their tax bases (see paragraph 6.1.3 of the revised AAS 3)

(c) investments in subsidiaries, branches, associates and joint venture entities and interests in joint venture operations, where the carrying amount of net assets recognised (including goodwill, where relevant) in the parent entity or consolidated financial report in relation to the investments or interests differs from the separately identifiable tax base of the investments or interests (see paragraphs 6.1.11 to 6.1.18 of the revised AAS 3)

(d) adjustments to the opening balance of retained profits (surplus) or accumulated losses (deficiency) resulting from changes in accounting policies under Australian Accounting Standard AAS 6 "Accounting Policies" (see paragraph 10.2.1(b) of the revised AAS 3)

(e) exchange differences arising on the translation of integrated foreign operations for the purpose of preparing consolidated financial reports (see paragraph 6.1.19 of the revised AAS 3)

(f) components of convertible financial instruments classified as equity (see paragraphs 6.1.20 to 6.1.22 of the revised AAS 3).

Deferred tax liabilities and assets that reflect the future tax consequences of the above circumstances arise under the revised AAS 3, but do not arise under the superseded AAS 3, with the exception of (c) in particular circumstances. In relation to (c), the superseded AAS 3 required some amounts to be recognised as provisions for deferred income tax where financial reports included profits and reserves of branch operations or subsidiaries which, on distribution, would be subject to overseas withholding tax or to further Australian income tax (see the section below headed "Deferred tax liabilities and assets that are not recognised").

Circumstances where the recognised deferred tax balances differ: different tax rates in different jurisdictions

Unrealised profit on the sale of inventory or other assets within the economic entity (where the buying and selling entities are in different tax jurisdictions and are subject to different tax rates) gives rise to deferred tax assets in the consolidated financial report under the revised AAS 3 and the requirements in the superseded AAS 3. However, the amount of the deferred tax asset may be different. Under the revised AAS 3 the deferred tax asset would be calculated using the tax rate applicable to the buying entity because recovery of the carrying amount of the asset by the buying entity will give rise to tax consequences in that entity's tax jurisdiction. Under the superseded AAS 3 the future income tax benefit would be calculated using the tax rate applicable to the selling entity.

Deferred tax liabilities and assets that are not recognised

The revised AAS 3 prohibits the recognition of the deferred tax liability or asset that arises in specific circumstances. Those circumstances are where:

(a) goodwill arises for which amortisation is not deductible for tax purposes (see paragraph 6.1(a) of the revised AAS 3); or

(b) in particular circumstances, the deferred tax liability or asset arises on the initial recognition of an asset or a liability because the initial carrying amount of the asset or liability differs from its tax base (see paragraphs 6.1(b) and 7.3 of the revised AAS 3); or

(c) in particular circumstances, the carrying amount of an investment in a subsidiary, branch, associate or joint venture entity or interest in a joint venture operation differs from its tax base (see paragraph 6.1(c) and 7.2 of the revised AAS 3).

These prohibitions are the same as those in International Accounting Standard IAS 12 “Income Taxes”.

The circumstances described in (a) and (b) do not give rise to provisions for deferred income tax under the superseded AAS 3. As noted in the section headed “Circumstances where the resulting deferred tax balances differ: temporary differences that are not timing differences”, the circumstances described in (c) may give rise to provisions for deferred income tax in particular circumstances under the superseded AAS 3.

Australian income tax law levies taxes on the taxable income of separate legal entities (referred to as taxable entities). The taxes may be reduced by tax offsets (credits and rebates). Generally, the parent entity and subsidiaries of an economic entity are each taxable entities in their own right whereas the economic entity is not a taxable entity (although the tax law allows the transfer of tax losses within economic entities in certain circumstances). In preparing the consolidated financial report it may be necessary to consider the tax implications for the economic entity of the parent entity recovering its investment in its subsidiaries (see paragraphs 6.1.13 and 6.1.14 of the revised AAS 3). As noted above, the revised AAS 3 explicitly prohibits recognition of the deferred tax liability that arises where the parent entity, investor or venturer is able to control the timing of distributions from subsidiaries, branches, associates or joint ventures and it is probable that the temporary difference will not reverse in the foreseeable future.

The superseded AAS 3 explicitly required overseas withholding tax or further Australian income tax relating to investments in overseas subsidiaries (or branches) to be recognised as a provision for deferred income tax unless there was evidence that the parent entity or branch operator intended leaving the profits and reserves indefinitely overseas. The superseded AAS 3 did not explicitly require overseas withholding tax or further Australian income tax relating to other overseas investments or interests to be recognised as provision for deferred income tax.

The revised AAS 3 also explicitly prohibits a deferred tax asset arising from investments in subsidiaries, branches, associates and joint venture entities and interests in joint venture operations from being recognised in the parent entity or consolidated financial report where it is probable that the investment or interest will not give rise to a tax consequence in the foreseeable future (see paragraph 7.2 of the revised AAS 3).

The definitions of liabilities and assets

The deferred tax liabilities and assets that arise under the revised AAS 3 satisfy the definitions of liabilities and assets in Statement of Accounting Concepts SAC 4 “Definition and Recognition of the Elements of Financial Statements”. For example, at the time an asset is revalued upwards the entity

is acknowledging that the asset will generate future economic benefits which will normally attract income tax. The deferred tax liability that arises at that time represents the future tax consequences that will arise from recovering the revalued asset. It satisfies the definition of liabilities because it represents future sacrifices of economic benefits (in the form of obligations to the taxation authorities) that the entity is presently obliged to make as a result of a past transaction or other event (that is, the event that gave rise to the increased carrying amount of the asset). In contrast, the superseded AAS 3 does not focus on whether deferrals resulting from timing differences meet the definitions of liabilities and assets. Its focus is on the recognition of an expense or a revenue in the net profit or loss/result. As such, application of the superseded AAS 3 would not result in the recognition of a deferred tax liability in respect of a revalued asset even though a liability exists.

Recognition Criteria

The revised AAS 3 requires that the deferred tax assets that arise from temporary differences and unused carry forward tax losses should be recognised when it is probable that taxable amounts will be available against which the deferred tax asset can be utilised.

The superseded AAS 3 required:

(a) future income tax benefits arising from timing differences to be recognised only when realisation is expected beyond any reasonable doubt; and

(b) in the case of companies which incur losses, future income tax benefits arising from tax losses or timing differences to be recognised only when there is virtual certainty that future taxable amounts would be sufficient to allow the benefit to be realised.

Measurement

The manner of recovery or settlement

The tax consequences of recovering or settling the carrying amount of certain assets or liabilities may depend on the manner of recovery or settlement. The revised AAS 3 requires that the measurement of deferred tax liabilities and deferred tax assets be based on the tax consequences that would follow from the manner in which the entity's management or governing body expects to recover or settle the carrying amount of the entity's assets and liabilities (see paragraph 4.7 of the revised AAS 3). For example, an asset can normally be recovered through sale, through use, or through use and subsequent sale. The cumulative amount that is deducted for tax purposes as depreciation if the asset is recovered through use may be less than the amount that would be effectively deducted on the sale of an asset that is subject to capital gains tax

due to indexing of the asset's cost base. Where an asset is to be recovered in a way that has no tax consequence, no deferred tax liability would arise in relation to that asset.

An alternative approach to requiring the amount of deferred tax liabilities and assets to be based on the expected manner of recovery of assets or settlement of liabilities would be to require a deferred tax liability or asset to be calculated by reference to the most tax effective manner of recovering assets or settling liabilities. That approach is not consistent with the approach in IAS 12 and consequently is not required in the revised AAS 3.

The superseded AAS 3 required future income tax benefits and provisions for deferred income tax to be measured having regard to the amount of savings or assessments of tax expected to result from the reversal of timing differences.

Discounting

The revised AAS 3 requires that deferred tax liabilities and assets be measured at their "nominal amounts", calculated by multiplying temporary differences by the tax rates, unless another accounting standard requires or permits a different measurement method such as discounted cash flows. Australian Accounting Standard AAS 21 "Acquisitions of Assets"; Australian Accounting Standard AAS 18 "Accounting for Goodwill"; and Urgent Issues Group Abstract 9 "Accounting for Acquisitions – Recognition of Acquired Tax Losses" require deferred tax balances to be measured at their fair values for the purpose of calculating the fair value of goodwill resulting from an acquisition of an entity or operation. For the purposes of applying AAS 18 and AAS 21, the revised AAS 3 deems the nominal amount of deferred tax liabilities and assets to be their fair value. It is expected that the Urgent Issues Group will review Abstract 9 in the light of the revised AAS 3 in due course.

The superseded AAS 3 does not state explicitly whether future income tax benefits and provisions for deferred income tax should be discounted.

Paragraph 4.6.1 of the revised AAS 3 notes that the discounting effect that may be implicit in a deferred tax liability or asset is not reversed. In addition, deferred tax liabilities and assets that are not implicitly discounted are not subject to discounting. Although at a conceptual level those deferred tax balances should be subject to discounting, prohibiting discounting avoids the need for detailed scheduling of the timing of the reversal of each temporary difference, which would be necessary if discounting were to be required. Such scheduling is often highly complex and impracticable. To permit, but not to require, discounting would result in deferred tax liabilities and assets that would not be comparable between entities. The reference to discounting being required or permitted by another Australian Accounting Standard

acknowledges that in certain circumstances it may be appropriate for deferred tax liabilities and assets to be discounted. For example, although no current Australian Accounting Standard requires or permits a different measurement basis to be adopted, Accounting Standard AASB 1038 "Life Insurance Business" issued by the AASB in November 1998 requires that life insurers discount deferred tax balances.

IAS 12 was developed prior to a detailed review of the accounting by life insurers by the International Accounting Standards Committee and does not acknowledge that an exception for life insurers (or other entities) may be appropriate. The IASC has formed an Insurance Steering Committee, which includes Australia.

Change in Tax Status

An entity's tax status may change from non-taxable to taxable or from taxable to non-taxable. An example is a change from a government organisation that is not subject to income tax equivalents to one that is subject to income tax equivalents. Another example is a non-taxed private sector entity becoming a taxed entity by virtue of a change in the scope of the income tax law. Consistent with the balance sheet method, the revised AAS 3 requires a deferred tax liability or asset to be recognised for temporary differences at the date a non-taxable entity becomes a taxable entity. A deferred tax liability or asset is required to be eliminated at the date an entity ceases to be a taxable entity. The effect of recognising or eliminating a deferred tax balance must be recognised as an expense or a revenue in net profit or loss/result, or as a direct debit or credit to equity where appropriate. The accounting for a change in the tax status of an entity is not explicitly addressed in IAS 12.

The superseded AAS 3 does not explicitly address how to account for a change in the tax status of an entity.

An Illustration of Differences between the Superseded AAS 3 and the Revised AAS 3

The following example compares the effect on net profit or loss/result and the statement of financial position of applying the superseded AAS 3 and the revised AAS 3. It is provided to assist those who are familiar with the superseded AAS 3 to understand the differences between the superseded AAS 3 and the revised AAS 3.

Data

	Amounts recognised for accounting purposes $'000	Amounts that are relevant for taxation purposes $'000
Sales	190	190
Income from domestic associate (equity method)	10	–
Other revenue	10	10
TOTAL REVENUE	210	200
Statutory fine	20	–
Depreciation of buildings	5.5	1
Depreciation of other assets	8	12
Long service leave benefits	20	10
Other expenses	60	60
TOTAL EXPENSES	113.5	83
NET PROFIT/TAXABLE AMOUNT	96.5	117
Current assets	330	330
Investment in domestic associate	35	35[3]
Buildings	99	48
Other depreciable assets	24	16
Land	60	33
TOTAL ASSETS	548	462
Statutory fine payable	20	20[4]
Long service leave payable	12	–
Other liabilities	90	90
TOTAL LIABILITIES	122	110
NET ASSETS	426	352
Asset revaluation reserve	87	3[5]
Other equity	339	349
TOTAL EQUITY	426	352

3 The tax base of "investment in domestic associate" is determined in accordance with paragraph 5.1 of the revised AAS 3.

4 The tax base of "statutory fine payable" is determined in accordance with paragraph 5.2 of the revised AAS 3.

5 The $3 represents the difference between the indexed cost base ($33) and the cost base ($30) of the land. Because the carrying amount of the land will be recovered through sale, the benefits of indexation will be derived.

Assumptions

- the amounts in the above table are for the year ending, or as at, 30 June 2005
- all amounts are expressed in $'000s
- the tax rate is 40%
- other liabilities includes a net deferred tax liability at the beginning of the year of $0.2 (deferred tax liabilities of $1.6 [relating to depreciable assets other than buildings] less deferred tax assets of $1.4 [$0.6 relating to the buildings and $0.8 relating to long service leave payable])
- the investment in the domestic associate is:
  - accounted for using the equity method of accounting
  - expected to be recovered through the receipt of dividends which are subject to the intercompany dividend rebate
- the buildings:
  - were purchased at the beginning of the previous year for $50 with an expected useful life of 20 years and a residual value of nil
  - are being written off over 50 years from the date of acquisition for taxation purposes
  - were revalued to $104.5 at the beginning of the current reporting period
- other depreciable assets were acquired two years earlier at a cost of $40 and are depreciated over 5 years for accounting purposes (residual value is nil) and at 30% prime cost for taxation purposes
- land was acquired two years earlier for $30, and revalued as at reporting date to $60. The indexed cost base for tax purposes is $33 as at reporting date.

Treatment under the Superseded AAS 3

Permanent differences

	$
Income from domestic associate	(10)
Statutory fine	20
Depreciation relating to revalued component of buildings	3
	13

Timing differences giving rise to future income tax benefits

Long service leave	10
@ Tax rate	40%
Future income tax benefit	4

Depreciation of buildings	1.5#
@ Tax rate	40%
Future income tax benefit	0.6

Timing differences giving rise to provision for deferred income taxes

Depreciation of other assets	4
@ Tax rate	40%
Provision for deferred income tax	1.6

#	Accounting $	Tax $	Difference $	
Depreciation of Buildings				
Component relating to revaluation ($57/19 years)	3		3	Permanent
Component relating to original cost	2.5	1.0	1.5	Timing
	5.5	1.0	4.5	

The following journal entry would record the tax-effect arising in the current period:

		$	$
Dr	Income Tax Expense	43.8	
Dr	Future Income Tax Benefit	4.6	
Cr	Provision for Deferred Income Tax		1.6
Cr	Income Tax Payable		46.8

Because the net provision for deferred income tax at the beginning of the period is $0.2 and provision for deferred income tax is offset against future income tax benefit, the statement of financial position would include a future income tax benefit of $2.8.

Treatment under the Revised AAS 3

Temporary differences giving rise to deferred tax assets and liabilities

	Carrying amount	**Tax base**	**Temp diff**	**Tax rate**	**Deferred tax asset (liability) at end of year**	**Deferred tax asset (liability) at beginning of year**	**Deferred tax asset (liability) at end of previous year**
	$	$	$		$	$	$
Buildings	99	48	51	40%	(20.4)	(22.2)	0.6
Other depreciable assets	24	16	8	40%	(3.2)	(1.6)	(1.6)
Land	60	33	27	40%	(10.8)	-	-
Long service leave payable	12	-	12	40%	4.8	0.8	0.8

The following journal entries would record the tax effect arising in the current period, assuming the land was revalued during the period:

		$	$
	At beginning of year:		
Dr	Asset Revaluation Reserve	33.6	
Cr	Deferred Tax Liability		33.6#
	At end of year:		
Dr	Income Tax Expense	42.6	
Dr	Deferred Tax Asset/Liability	5.8*	
Cr	Deferred Tax Liability		1.6
Cr	Current Tax Liability		46.8

determined as $\$84 \times 40\%$, where, of the $84, $57 (that is, $104.5 less $47.5) relates to buildings and $27 (that is, $60 less $33) relates to land.

* comprises $1.8 debit to deferred tax liability relating to the building and $4 debit to deferred tax asset relating to long service leave payable. This entry assumes that separate accounts are kept for the deferred tax asset arising from depreciation of the buildings and for the deferred tax liability arising from the revaluation of the buildings. However it is assumed the accounts are netted off for disclosure purposes.

Accordingly, assuming the deferred tax liability is offset against deferred tax asset, the statement of financial position would include a deferred tax liability of $29.6.

Comparison of financial statements

	Revised AAS 3 $	Superseded AAS 3 $
Selected line items from the statement of financial position		
Current tax liability	46.8	46.8
Deferred tax liability (asset) (net of deferred tax assets (liabilities))	29.6	(2.8)
Asset revaluation reserve	53.4	87
Selected line items from the statement of financial performance		
Income tax expense	42.6	43.8
Net profit after tax	53.9	52.7

This example shows a difference in the effect on the calculation of net profit after tax that results from the depreciation of the revalued buildings. Other transactions will also cause net profit after tax to differ, for example:

(a) exchange differences arising on the translation of integrated foreign operations

(b) unrealised profit on the sale of inventory or other assets within the economic entity (where the buying and selling entities are in different tax jurisdictions and subject to different tax rates)

(c) compound financial instruments, where there are subsequent changes in the deferred tax liability resulting from the reversal of the related temporary difference that arose on initial recognition.

The difference between the recognition criteria for deferred tax assets under the superseded AAS 3 (beyond any reasonable doubt or virtual certainty) and the revised AAS 3 (probable) may result in further differences in the profit or loss after tax.

CONFORMITY WITH INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS

Conformity with International Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with International Accounting Standard IAS 12 "Income Taxes".

Conformity with New Zealand Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will not ensure conformity with Statement of Accounting Practice SSAP-12 "Accounting for Income Tax". SSAP-12 is broadly based on an income statement liability approach which, in limited circumstances, permits the partial recognition of deferred tax balances.

The Financial Reporting Standards Board (FRSB) of the Institute of Chartered Accountants of New Zealand is in the process of preparing an Exposure Draft based on Accounting Standard AASB 1020 and Australian Accounting Standard AAS 3 "Income Taxes" which will be a proposed revision of SSAP-12.

DEVELOPMENT OF THE STANDARD

This section does not form part of the Standard. It is a summary of the reasons for the current revision to the Standard.

1. The reissue of the Standard is part of a program being undertaken by the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation and the Australian Accounting Standards Board (the Boards) to achieve greater harmony between Australian accounting standards and those of the International Accounting Standards Committee (IASC).

2. The issue of the Standard follows consideration of the responses received on Exposure Draft ED 87 "Income Taxes", which was prepared by the Boards and released in December 1997. ED 87 contained proposals aimed at harmonising with International Accounting Standard IAS 12 "Income Taxes".

3. The superseded AAS 3 was given only interim approval when it was issued jointly by the Australian Standards Review Board (ASRB) and the Public Sector Accounting Standards Board in 1989. Both Boards made a commitment to review and revise the Standard in due course. Since then, the Boards have made significant progress in developing the Conceptual Framework for Financial Reporting in Australia, documented in Statements of Accounting Concepts (SACs). The Boards used the SACs as a guide in reviewing AAS 3.

4. Standard setters in other jurisdictions have also reviewed their income tax standards since that time. For example, the Financial Accounting Standards Board (FASB) in the United States has reviewed its pronouncements relating to the financial reporting of income tax in the light of its explicit conceptual framework. The FASB issued Statement of Financial Accounting Standards SFAS 109 "Accounting for Income Taxes" in February 1992, which prescribes a comprehensive balance sheet liability method of tax-effect accounting. The IASC has a conceptual framework that is similar to that of the FASB and issued Exposure Draft E49 "Income Taxes" in October 1994, which proposed an approach that was based on the approach prescribed in SFAS 109. The IASC subsequently issued a revised IAS 12 in October 1996. The revised IAS 12 and SFAS 109 are similar but differ in some respects. For example, they identify different circumstances in which deferred tax balances are not permitted to be recognised.

5. Discussion Paper No. 22 "Accounting for Income Tax", published by the Australian Accounting Research Foundation in March 1995,

considered issues relating to the accounting for income tax in the context of the Australian conceptual framework developed by the Boards. The Australian conceptual framework is also similar to that of the FASB and of the IASC. The Discussion Paper considered the balance sheet method prescribed in SFAS 109 and proposed in E49.

6. The Boards have developed the Standard using as a basis IAS 12, modifying the structure consistent with the Boards' plain English policy. For example, all exceptions to the recognition of deferred tax liabilities have been brought together under one section in the Standard. Commentary in IAS 12 that was considered to be in the nature of requirements has been included in standard paragraphs (black letter) of the Standard to more clearly distinguish between the requirements of the Standard and the explanation of those requirements. For example, the calculation of tax base is described in commentary in IAS 12 but included as standard paragraphs in AAS 3. The Boards also took the opportunity to provide additional guidance, including additional examples, to assist readers in gaining a better understanding of what would be required in an Australian context. For example, further illustrations of assets that are subject to capital gains tax are included in the Standard.

7. In addition, the Standard addresses the accounting treatment of the transfer of tax losses within an economic entity, and of a change in an entity's tax status. These issues are not explicitly addressed in IAS 12.

Noteworthy Differences from ED 87

8. The Standard retains the basic content of ED 87, although it adopts a treatment of a change in the tax status of an entity that is different from ED 87, clarifies certain other requirements, is structured differently and includes requirements added in response to comments on ED 87.

Change in Tax Status

9. ED 87 proposed that the effect of recognising or eliminating deferred tax balances should be recognised as an adjustment to the opening balance of retained profits (surplus) or accumulated losses (deficiency). The proposals were made at a time when a number of public sector entities were changing their status from non-taxed entities to taxed entities. The Boards expect that it will only be in rare circumstances that entities will change their tax status in the future. In contrast to the proposals in ED 87, the Standard requires

the effect of a change in the tax status of an entity to be recognised as a revenue or an expense in net profit or loss/result, unless the effect relates to an equity account, in which case the adjustment is recognised as a direct debit or credit to equity. The requirements of the Standard are consistent with the definitions of revenues and expenses, and with Australian Accounting Standard AAS 1 "Statement of Financial Performance".

Clarification of Requirements

10. The Standard clarifies certain of the requirements proposed in ED 87. For example, compared with ED 87, the Standard:

    (a) clarifies the effect of tax offsets (credits and rebates) on the calculation of deferred tax liabilities and assets

    (b) specifies that a deferred tax asset that arises on initial recognition of an asset or liability, in certain circumstances, must not be recognised. This is included in IAS 12 but was omitted from ED 87 on the basis that the operation of the Australian income tax law and Australian Accounting Standards would be unlikely to give rise to a deferred tax asset. However, to ensure that the Standard is robust enough to operate in Australia and other jurisdictions, the exception is included

    (c) makes it explicit that the deferred tax liabilities and assets relating to a depreciable asset must be calculated having regard to the manner in which the entity expects to recover the asset's carrying amount, having regard to the asset's depreciable amount and residual value

    (d) clarifies that current tax liabilities and assets are to be measured at their "nominal amounts"

    (e) deems the fair value of deferred tax liabilities and assets to be their "nominal amounts" (unless another Australian Accounting Standard requires or permits otherwise)

    (f) requires the relevant equity account (not just retained profits (surplus) or accumulated losses (deficiency)) to be adjusted on initial adoption of the Standard

    (g) clarifies that, where a revalued asset is sold, the deferred tax effect is recognised against the asset revaluation reserve to the extent it relates to the reserve; and that where an

asset is used, the deferred tax effect is recognised in net profit or loss/result

(h) clarifies that, where deferred tax assets of an acquired entity that existed at the date of acquisition are recognised subsequent to acquisition and would give rise to or increase discount on acquisition, non-monetary assets are not adjusted subsequent to acquisition

(i) clarifies that deferred tax assets arising from carry-forward or unrealised capital losses are not set off against deferred tax liabilities unless those liabilities arise from unrealised capital gains

(j) avoids repetition of requirements included in other Australian Accounting Standards (for example, the requirement to disclose income tax expense (income tax revenue) relating to extraordinary items which is contained in Australian Accounting Standard AAS 1 "Statement of Financial Performance")

(k) provides guidance on the difference between the superseded Standard and the revised Standard (see Appendix 4).

Structure of Standard

11. The structure of the Standard differs from the structure of ED 87. The Standard is structured to give prominence to the principles of the balance sheet method of tax-effect accounting relating to the identification, recognition and measurement of deferred tax liabilities and assets. To the extent the Standard provides exceptions to the principles, these are contained in separate, later, sections.

Additional Requirements

12. Requirements have been added in response to comments on ED 87. Compared with ED 87, the Standard prescribes:

(a) when and how an entity must account for the consequences of changes in tax rates resulting from distributions by the entity

(b) the disclosure of unrecognised income tax that would be payable on the sale of assets, the values of which are disclosed but not recognised.

13. Furthermore, the choice proposed in ED 87 for a reconciliation of tax to profit has been removed. The Standard prescribes the use of the Australian tax rate in the preparation of the reconciliation.

Principal Features of ED 87 Retained in the Standard

14. Consistent with ED 87, the Standard requires that income tax be accounted for using the comprehensive balance sheet liability method of tax-effect accounting, consistent with that required by IAS 12. This is different from the comprehensive income statement liability method as required by the superseded AAS 3 that was issued in November 1989. The Boards believe that adopting a balance sheet liability method will ensure that the financial report better reflects the future tax consequences arising from transactions and other events that are recognised in the statement of financial position. For example, it means that the tax consequences of recovering (settling) all of an entity's assets (liabilities) are reflected in the financial report. Retaining the exemptions for recognising deferred tax liabilities and assets proposed in ED 87 ensures that the Standard harmonises with IAS 12.