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Australian Accounting Standards Board

AASB Transition Resource Group for AASB 17 *Insurance Contracts*
Submission form for potential implementation question

In addition to the form, attachments (such as memos) may be included with the submission.

Any public discussion of issues submitted will be without the identification of the submitter's name. Although the submission forms will remain private, please do not include any confidential information in your submission.

Email a PDF of the completed (including any attachments) form to standards@aasb.gov.au.

Submission date	28/11/2022
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Stakeholder group	Preparer
Do you wish to present to the TRG?	Yes

Potential implementation question

Deferred tax assets or liabilities will be recognised on transitioning to IFRS 17 which will have a corresponding impact on retained earnings and there are potentially different views on how the subsequent changes to these tax effects are recognised.

Paragraph of IFRS 17 *Insurance Contracts*

IFRS 17 transition requirements

Analysis of the question

The analysis of the question should include a detailed description of the different ways the new Standard may be applied, resulting in possible diversity in practice.

Please see the Appendix

Is the question pervasive?

Explain whether the question is expected to be relevant to a wide group of stakeholders.

Yes – virtually all insurers are expected to recognise tax assets or liabilities on transitioning to IFRS 17 which will have a corresponding impact on retained earnings.

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Tax effect accounting for transition to IFRS 17 *Insurance Contracts*

December 2022

Purpose

To the extent to which an entity has reasonable and supportable information to apply a retrospective approach on transitioning to IFRS 17, the requirements of IFRS 17 must be applied retrospectively.

Retrospective application will lead to various insurance liabilities and assets needing to be restated for reporting periods beginning on or after 1 January 2022, being the start date of the comparison year for the first set of IFRS 17 financial statements for reporting periods beginning on or after 1 January 2023.

The restatement will have a corresponding transitional impact on retained earnings.

It is expected that deferred tax assets or liabilities will be recognised from the change to IFRS 17 which will have a corresponding impact on retained earnings. These tax effects may translate into current tax assets and liabilities in subsequent periods depending on the interaction with local tax laws. This paper addresses where in the financial statements the subsequent changes to these tax effects are recognised.

Possible approaches

Two possible approaches are identified.

Approach 1: Current and deferred tax relating to transition adjustments are subsequently recognised in equity.

Approach 2: Current and deferred tax relating to transition adjustments are subsequently recognised as income or an expense and in profit or loss for the period, or outside profit or loss, either in other comprehensive income or directly in equity, as they would have been had the entity always applied IFRS 17.

Approach 1 – comments in favour

AASB 112 *Income Taxes*, paragraph 58, notes that current and deferred tax expense is recognised in profit or loss except to the extent that the tax arises from a transaction or event that was recognised in the same or prior period outside of profit or loss, either in other comprehensive income or directly in equity.

Transition to IFRS 17, of itself is an event and IFRS 17 transition adjustments are recognised directly in retained earnings. Accordingly, consistent with AASB 112.58, current and deferred tax expense amounts that relate to those transition adjustments would be recognised in retained earnings. That is, there is consistency between the treatment of the transitional adjustments themselves and the subsequent accounting for the tax effects of those adjustments.

This approach can also be viewed as consistent with the example provided in AASB 112.62A(a) of when it is appropriate for current and deferred tax expense to be reported in equity; namely:

> *"IFRS Standards require or permit particular items to be credited or charged directly to equity. Examples of such items are:* ***an adjustment to the opening balance of retained earnings***

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__resulting from either a change in accounting policy__ that is applied retrospectively or the correction of an error …".

Approach 2 – comments in favour

The requirements in AASB 112.58 and 62A are relevant to the transition to IFRS 17 but not to tax effects that that occur in subsequent income years. The recognition of amounts in retained earnings on transition is effectively a net catch-up adjustment and any amounts recognised thereafter are treated as if IFRS 17 had always applied.

To the extent that IFRS 17 is applied retrospectively and gives rise to net differences that are recognised in equity, the objective is to re-set the basis of accounting and proceed from that 'new' accounting basis from the transition date. Approach 1 is consistent with the purpose of retrospectively applying AASB 17, and applying AASB 112 to the 'new' basis of AASB 17 accounting from the transition date.

The main point of retrospective application is to reset the accounting basis as if IFRS 17 had always applied. Accordingly, current and deferred tax movements subsequent to the initial recognition of transition should be recognised under AASB 112 as income or an expense and included in profit or loss for the period, or outside profit or loss, either in other comprehensive income or directly in equity as if the entity always applied IFRS 17 (to the extent of the entity's retrospective application).

Approach 2 Interaction with OECD BEPS Pillar Two Model Rules (Global Minimum Tax)

The Pillar Two Model Rules are designed to ensure large multinational enterprises (MNE) pay a minimum level of tax of 15% on the income arising in each jurisdiction where they operate. The rules are expected to apply from 1 January 2024 subject to government implementation. The rules require the calculation of an effective tax rate (ETR) in each jurisdiction the MNE operates to know if top-up tax is owed. The calculation of the ETR is based on the financial accounts subject to certain adjustments.

Under Approach 2, the model rules will disregard from the ETR the accounting income from the restatement of insurance liabilities and assets on adoption of IFRS 17 pursuant to article 3.2.1(h) as the restatement would occur in a prior period to the application of the rules. The rules may also disregard from the ETR the current and deferred tax expense to the extent they qualify as "excluded taxes" under article 4.1.3(a) and 4.4.1(a) creating a symmetrical outcome for the ETR calculation.

To qualify as excluded taxes under article 4.1.3(a) and 4.4.1(a), the model rules must exclude the income to which the taxes relate. There is some uncertainty as to whether the required nexus exists between the excluded income and the current and deferred tax movements subsequent to the initial recognition. If the nexus does not exist, this could give rise to tax expense recognised in the ETR calculation with no corresponding accounting income or expense.

Note – under Approach 1 the model rules disregard from the ETR both the restatement of insurance liabilities and assets on adoption of IFRS 17, and the subsequent current and deferred taxes booked outside of the P&L. This achieves symmetry in the ETR calculation.

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