Australian Government
Australian Accounting Standards Board

Staff Paper

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Executive summary

1 In recent years, the global scrutiny in relation to the income tax practices adopted by multinational corporate groups has intensified with a particular focus on base erosion and profit shifting. In this regard, the OECD has made a number of recommendations not only in respect of strengthening tax laws across jurisdictions, but has also focused on the effectiveness of tax transparency in combating aggressive income tax structuring. In Australia, the Australian Government has enacted laws requiring greater tax transparency, and companies have started reporting in accordance with these new laws. The United Kingdom, United States and European Union (EU) have also been developing proposals and requirements for income tax disclosures to be made both within and outside of financial reports.

2 While much of the tax transparency initiative to date has been driven by the tax authorities, as part of remaining relevant in an ever-changing regulatory environment, we consider that it is timely for accounting standard-setters to take a leadership role in improving income tax disclosures for users of financial reports.[1]

Question to ASAF members

Q1 Do ASAF members agree, given the global focus on improving the tax transparency of multinational enterprises, it is timely for accounting standard-setters to take a leadership role in improving income tax disclosures for users of financial reports?

[1] In Australia, the AASB has been requested to develop guidance to assist entities in this process, given the 'accounting' nature of certain public information seen as important for tax transparency.

Should IAS 12 *Income Taxes* be amended?

3 AASB staff conducted preliminary research with a view to understanding whether there is a case for amending IAS 12 to address user needs for greater transparency with respect to an entity's tax practices. AASB staff:

(a) reviewed the income tax disclosures of a sample of Australian headquartered multinational corporate groups that voluntarily sought to improve their tax transparency to users by making supplementary income tax disclosures to those required under IAS 12 both within and outside of financial reports;

(b) met with a number of preparers, analysts and representatives from tax authorities;

(c) considered the work performed by the FASB with respect to revisions to tax disclosures, and developments in other jurisdictions;

(d) reviewed relevant academic literature.

4 Our research suggests that improvements to income tax disclosures are required to provide greater tax transparency as to the linkage between:

(a) income tax amounts disclosed in the financial statements;

(b) a corporate group's income tax liability; and

(c) income taxes paid to tax authorities.

5 AASB staff note that preparers were not averse to making further disclosures to communicate additional income tax information they consider to be useful to users (not necessarily the tax authority). However, care is necessary to maintain simplicity of presentation and avoid disclosure overload.

6 In summary, our research suggests that users would like to better understand why:

(a) income tax expense (or income tax payable) deviates from the corporate income tax rate (being 30% in Australia);

(b) the relationship income tax expense bears to income taxes paid and payable; and

(c) the overall relationship between the income tax amounts reported in the financial statements.

Recommended amendments to IAS 12

7 Consequently, AASB staff recommend that standard-setters should take the opportunity to consider amending IAS 12 to address the following disclosure objective:

For an entity to disclose sufficient information to enable users of financial statements to understand:

(a) *the relationship between income tax amounts reported in the financial statements; and*

(b) *why reported tax expense deviates from the corporate income tax rate.*

8 To meet this disclosure objective, AASB staff suggest consideration of one or more of the following (see paragraph 41 for further detail), in addition to the disclosures already specified by IAS 12:

(a) Reconciliation of accounting profit before tax to income tax paid and payable;

(b) Explanation of key items adjusting accounting profit before tax to current tax expense;

(c) Group and domestic income tax paid and payable ratio;

(d) Reconciliation of group net current tax liability;

(e) Significant amounts of income tax paid in foreign jurisdictions; and

(f) Disclosure of accounting profit before tax of domestic entities, domestic income tax payable, and domestic and foreign income tax paid.

Question to ASAF members

Q2 Do ASAF members consider the proposed income tax disclosures (outlined in Appendix 1) to provide users of general purpose financial statements with a better understanding of the income tax position of an entity? Do ASAF members have specific comments in respect of the four components? Do ASAF members have any other comments in this regard?

Background

9 As part of the recent global focus on base erosion and profit shifting, governments around the world have considered the income tax practices of multinational enterprises, particularly with respect to the implementation of aggressive corporate income tax planning strategies. In response to the intensifying scrutiny, in 2013 the OECD developed a comprehensive Action Plan consisting of 15 action items[2] to address weaknesses in the international tax system. The OECD's findings in this regard covered a number of practices adopted by multinationals through mismatches in tax laws between jurisdictions, transfer pricing practices and challenges posed by the digital economy, but also considered the need for increased tax transparency between tax authorities and the public more generally as a key measure in targeting such practices. Accordingly, a number of the action items proposed by the OECD were designed to address perceived weaknesses in the tax transparency of multinational enterprises. In October 2015 the OECD released its final report and recommended measures aimed at improving tax transparency including country-by

2 https://www.oecd.org/ctp/BEPSActionPlan.pdf

country-reporting, which a number of jurisdictions, including Australia[3], have since legislated.

Voluntary Tax Transparency Code

10 In response to the perceived need for greater tax transparency of multinational corporate taxpayers, in 2015 the Board of Taxation, an advisory body focused on improving the design of Australia's income tax laws, designed a Voluntary Tax Transparency Code (TTC) for consultation, with the final report released in February 2016.[4] The TTC sets out the minimum tax disclosures that the Board of Taxation consider to be meaningful to improving the transparency for users (particularly general public) of the tax affairs of multinational enterprises. The TTC does not mandate the income tax disclosures to be made in financial reports, but rather, leaves the location and form of disclosure to the discretion of multinational corporate taxpayers.

11 The disclosure requirements of the TTC include, for corporate taxpayers with Australian aggregated turnover between A$100 million and A$500 million:

(a) a reconciliation of accounting profit before tax (APBT) to income tax expense (ITE) and to income taxes paid or payable;

(b) identification of material temporary and non-temporary differences; and

(c) effective tax rates for Australian and global operations.

12 The TTC sets out further disclosures for corporate taxpayers with Australian aggregated turnover of A$500 million.

13 The Board of Taxation has asked the AASB to prepare "guidance materials" to assist corporate entities in preparing the disclosures required by the TTC, as well as develop a common definition of an 'effective tax rate' (ETR). In response to the intense global scrutiny of multinational corporate groups and their income tax affairs, in 2014 the Australian Government conducted an inquiry in relation to corporate tax avoidance to which a number of Australian multinational corporate taxpayers were required to respond. Accordingly, AASB staff understand the reason for identifying these disclosures in the TTC is to provide greater clarity to users, in particular the general public, regarding the income tax affairs of multinational corporations. The Board of Taxation has requested the AASB's involvement in order to achieve the Australian Government's overarching objective of improving the tax transparency of multinational corporate groups in a clear and comparable way.

14 Other laws aimed at improving the tax transparency of entities meeting certain turnover thresholds, including the disclosure of certain tax attributes (total income, taxable income, income tax payable as disclosed in the income tax return) by the Australian tax authorities, have also recently been enacted[5] in Australia. The

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3 Subdivision 815-E of the *Income Tax Assessment Act 1997* (ITAA 1997)
4 https://cdn.tspace.gov.au/uploads/sites/70/2016/05/BoT_TransparencyCode_Final-report.pdf
5 Section 3C of the *Taxation Administration Act 1953* (TAA 1953)

information is publicly available and published annually on the Australian Government's data website.[6]

15 Given the global focus on improving the tax transparency of multinational enterprises, it is timely for accounting standard setters to consider whether, and if so how, we should play a role in addressing the improvement of income tax disclosures for users of financial reports more generally.

Other Australian measures

16 In 2015, in response to the OECD's final recommendations on tax transparency measures, Australia enacted legislation[7] forming part of the Australian income tax law requiring entities considered 'significant global entities' meeting certain criteria to prepare country-by-country reports for submission to the Australian tax authorities within 12 months of the relevant entity's end of financial year. These measures are applicable to entities for incoming years commencing on or after 1 January 2016. Broadly, the country-by-country reports address three 'levels' of information required to be submitted including:

(a) A statement relating to the global operations and activities and the pricing policies relevant to transfer pricing.

(b) A statement relating to local operations, activities and dealings.

(c) A statement relating to the allocation between countries of income, activities conducted and taxes paid.

17 These disclosures are not publicly available.

18 The Australian Government also recently enacted further measures[8] which require Australian tax authorities to publicly disclose certain tax attributes as reported in the income tax return for certain entities satisfying turnover threshold tests. The following attributes are disclosed for privately held entities with turnover of A$200 million or more, and public entities with turnover of A$10 million or more:

(a) Total income;

(b) Taxable income;

(c) Tax payable;

(d) Minerals Resource Rent Tax Payable; and

(e) Petroleum Resource Rent Tax Payable.

6 https://www.data.gov.au/dataset/corporate-transparency
7 Subdivision 815-E of the ITAA 1997
8 Section 3C of the TAA 1953

19 The first report was published by the Australian tax authorities in December 2015, with information of over 1,800 entities disclosed[9].

Research focus and purpose

20 AASB staff conducted research regarding income tax disclosures as currently reported in the financial reports of Australian headquartered multinational and domestic corporate and stapled groups across a range of industries. The purpose of conducting this research was to understand how companies currently present disclosures pertaining to income taxes required under IAS 12, as well as other domestic income tax laws.[10] Specifically, AASB staff were seeking to understand whether the disclosure practices as currently adopted are meeting the needs of users.

21 In response to the Board of Taxation's recommendations under the TTC, 36 Australian headquartered multinational and domestic corporate and stapled groups registered as signatories to the voluntary TTC.[11] AASB staff reviewed the tax disclosures for 24 entities[12] with published financial reports adopting the TTC. The sample of entities for which the AASB reviewed tax disclosures varied in size across the extractive, healthcare, infrastructure, property construction, food and beverage, banking and finance, multimedia and logistics industries.

22 As part of our research, AASB staff held initial discussions with several preparers[13] and analysts of financial reports with a view to gaining an understanding regarding how users of general purpose financial reports use the currently specified IAS 12 income tax disclosures, and whether these preparers/ analysts considered alternative or supplementary income tax disclosures could improve a user's understanding the income tax affairs of corporate taxpayers, especially multinational corporate taxpayers.

23 AASB staff also reviewed academic literature and met with an academic with an income tax research focus. The academic literature considers the calculation of ETR (as represented by income taxes paid/APBT) on a longer term, and the use of existing IAS 12 disclosures in estimating a corporate group's income tax liability. The academic literature concludes that a longer term ETR is likely to be indicative of corporate taxpayers adopting tax planning strategies, and that existing disclosures under IAS 12 do, in limited cases, allow users to reasonably estimate a corporate group's income tax liability. Other academic research studies considered the use of income tax disclosures and their correlation with overall tax risk of corporate groups. The academic literature reviewed by AASB staff is listed at Appendix 3. Whilst most academic literature considers the use of ETR metrics and income tax disclosures as valid indicators of overall income tax risk, few articles specifically address the value of existing income tax disclosures in financial reports.

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9 https://www.data.gov.au/dataset/corporate-transparency/resource/237d7ede-3a63-4b9b-9434-2f79b9d70ce8

10 Subdivision 815-E of the ITAA 1997 and Section 3C of the TAA 1953

11 http://taxboard.gov.au/current-activities/transparency-code-register/

12 As the signatories have different adoption dates for the voluntary TTC, AASB staff reviewed the income tax disclosures for those entities that had published income tax disclosures under the voluntary TTC.

13 The preparers AASB staff held discussions with were Australian headquartered multinational corporate groups.

24 In our analysis and in making recommendations outlined in the remainder of this paper, AASB staff considered the practices under Australian law, and law being considered and adopted by other jurisdictions in the tax transparency space. Paragraphs 16 and 18 set out the financial information already publicly disclosed under Australia's other tax transparency initiatives.

25 The US, UK and EU have been active in developing proposals and enacting law changes requiring entities to make more detailed disclosures regarding their income tax affairs residing inside and out of financial reports. An analysis of these requirements is set out at Appendix 2.

Research observations and findings

Review of income tax disclosures

26 AASB staff reviewed the income tax disclosures made by 24 Australian headquartered multinational corporate groups made under the voluntary TTC. Generally, AASB staff observed that the location and presentation format of disclosures differed for each corporate group. Some corporate groups presented the income tax disclosures as supplementary disclosures contained in the income tax note contained in the financial report, and other corporate groups prepared separate tax specific disclosure reports.

27 In respect of the specific disclosures made, AASB staff note that although all entities reviewed reported a reconciliation of APBT to ITE (showing both the current and deferred tax expense components) as required under IAS 12.80, the level of detail reported with respect to the calculation of the current and deferred ITE varied widely. Generally, staff observed that larger entities prepared more detailed income tax disclosures.

28 The comparison of the ETR calculation between the entities in Table 1 below is demonstrative of variation between entities in calculating an ETR, although there is observable consistency in the 'starting point' being ETR as defined in IAS 12.86 (ETR is calculated as ITE divided by APBT).

29 The following table summarises the key quantitative income tax disclosures made by 6[14] companies, and the disclosed ETR calculations. The comparison between the approach and calculation methods adopted by each entity, is demonstrative of the overall differing approaches taken by entities aiming to better their tax transparency. AASB staff note that where the word 'domestic' is used in the context of the ETR, in the TTC this term refers to the Australian operations of the multinational group. However, staff have received feedback that entities may be interpreting 'Australian operations' in differing ways, as entities consider it is unclear whether this encompasses non-wholly owned entities beyond the Australian income tax consolidated group.

14 Although AASB staff reviewed the income tax disclosures for 24 entities, for ease of presentation, AASB staff have chosen 6 corporate groups to demonstrate the degree of difference with respect to the format and approach adopted by corporate groups in preparing their income tax disclosures.

Table 1: Summary of income tax disclosures made by Australian multinational corporate groups adopting the TTC

Entity	Key quantitative income tax disclosures	ETR
SEEK Limited[15] *Disclosures made in tax note to financial statements*	• Reconciliation of APBT to net tax liability supported by detailed explanations of key adjustments	• Global and domestic ETR calculations disclosed • ETR calculated as ITE / APBT, • modified to exclude post-tax share of associate earnings
Cochlear Limited[16,17] *Prepared Tax Contribution Report, separate to the annual report*	• Reconciliation of APBT to ITE (detail of key adjustments is summarised) • Reconciliation of prima facie consolidated income tax payable (APBT x Australian corporate tax rate) to cash taxes paid	• Global and domestic ETR calculations disclosed • ETR calculated as ITE / APBT
BHP[18,19] *Prepared Tax Contribution Report, separate to the annual report*	• Taxes paid disaggregated by tax type eg corporate income taxes, royalty related income taxes, taxes levied on production • Reconciliation of total taxation benefit to income tax and royalty related taxation paid • Reconciliation of APBT to ITE	• Global ETR and global adjusted ETR disclosed • A domestic ETR is not disclosed • $Global\ adjusted\ ETR = \frac{Total\ tax\ benefit\ or\ expense^{1}}{Loss\ or\ profit\ before\ tax^{2}}$ 1 excluding exceptional items, discontinued operations and exchange rate movements not included in tax 2 excluding exceptional items
Commonwealth Bank of Australia[20,21]	• Reconciliation of APBT to ITE (detail of key adjustments is summarised)	• Global and bank[22] only ETR calculations disclosed

15https://ir.seek.com.au/FormBuilder/_Resource/_module/NCkygw0x0kmQG8Q1PXfUNg/file/FY16_Full_Year_Results.pdf

16 http://www.cochlear.com/wps/wcm/connect/ebe550d5-d6c2-4b06-a1d2-8f873fb0c345/en_corporate_annualreport2016_2.37mb.pdf?MOD=AJPERES&CONVERT_TO=url&CACHEID=ROOTWORKSPACE-ebe550d5-d6c2-4b06-a1d2-8f873fb0c345-lpSVNkn

17 http://www.cochlear.com/wps/wcm/connect/768abe60-61a0-4ef0-80a9-f40fa28997cc/en_corporate_taxreport2016_3.28mb.pdf?MOD=AJPERES&CONVERT_TO=url&CACHEID=ROOTWORKSPACE-768abe60-61a0-4ef0-80a9-f40fa28997cc-lpSVNrs

18 http://www.bhpbilliton.com/~/media/bhp/documents/investors/annual-reports/2016/bhpbillitonannualreport2016.pdf?utm_source=Website&utm_medium=Organic&utm_term=ARDownload&utm_campaign=AR2016

19 http://www.bhpbilliton.com/~/media/bhp/documents/investors/annual-reports/2016/bhpbillitoneconomiccontributionandpaymentstogovernments2016.pdf?utm_source=Website&utm_medium=Organic&utm_term=EconomicDownload&utm_campaign=AR2016

20 https://www.commbank.com.au/content/dam/commbank/about-us/shareholders/pdfs/annual-reports/2016_Annual_Report_to_Shareholders_15_August_2016.pdf

Entity	Key quantitative income tax disclosures	ETR
Disclosures made in tax note to financial statements		• ETR calculated as ITE / APBT • Both ITE and APBT adjusted to exclude policyholder tax
Wesfarmers[23] *Part A disclosures made in the financial statements* *Part B disclosures in a separate Taxes Paid report separate to the annual report*	• Reconciliation of APBT to current year tax paid or payable (detail of key adjustments is summarised)	• Global and domestic ETR calculations disclosed • ETR calculated as ITE / APBT, calculation adjusted for the impact of goodwill impairment
Telstra[24] *Disclosures made in financial statements*	• Reconciliation of APBT to ITE	• Global ETR calculations disclosed • ETR calculated as ITE / APBT • APBT included both continued and discontinued operations

30 AASB staff observe that some corporate groups in Australia, particularly large corporate groups in the extractive industries such as Rio Tinto and BHP Limited prepare comprehensive 'Taxes Paid' reports that are publicly available. Broadly, these reports contain detailed information outlining the relevant entity's tax payments by project, tax type, country and level of government, ETR and other qualitative tax information. However, the number of corporate groups preparing such reports is limited.

<u>Findings from discussions with stakeholders</u>

31 As part of its research activities pertaining to income tax disclosures, AASB staff conducted outreach with several analyst and preparers[25] with a view to understanding how each group uses the income tax disclosures as currently made, the challenges in preparation and whether income tax disclosures could be improved, or supplemented with additional disclosures, to be made more meaningful. Our general comments pertaining to both analyst and preparer groups are outlined at paragraphs 32 and 36, with specific comments relating to the alternative presentation of income tax disclosures reflected in Table 3.

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21 https://www.commbank.com.au/content/dam/commbank/about-us/docs/australian-tax-transparency.pdf
22 Refers to banking and insurance and funds management entities
23 http://www.wesfarmers.com.au/mwg-internal/de5fs23hu73ds/progress?id=N8iZkiDc9N2uCwj3zwTno20rJtAVf7Oj1o9AT0Z2d88,&dl
24 https://www.telstra.com.au/content/dam/tcom/about-us/investors/pdf-e/2016-Annual-Report.pdf
25 AASB staff held discussions with an analyst, and 2 Australian headquartered multinational preparers. AASB staff note that the analyst's views are representative of several other analysts that the analyst consulted.

32 From an analyst perspective, income tax is considered a key input into determining an entity's earnings quality and franking capacity. Analysts considered that income tax disclosures as currently presented by entities in financial reports did not provide sufficient granularity to determine the components of income tax pertaining to isolated transactions allowing 'normalisation' for the determination of a sustainable tax rate. Accordingly, analysts also expressed interest in further disclosures pertaining to income taxes paid and disaggregation between foreign and domestic amounts of income tax paid. It is noted that analysts expressed interest in income taxes 'paid' (rather than payable) notwithstanding the payment of income tax in an financial year is generally referable to the income tax liability for current and prior financial years. Analysts also sought clarity regarding the link between APBT and the amount of income tax paid per the cash flow statement as relevant for better projecting earnings quality.

33 In respect of an ETR, analysts observed that adjustments to the numerator or denominator may be necessary in some circumstances in order to remove 'noise' (eg amounts not subject to income tax) from the inputs to a corporate group's ETR. AASB staff understand that a 'standardised' ETR (or alternative ratio) to be of less value to analysts compared to discussion/detail in accompanying notes and explanations providing sufficient clarity pertaining to the nature of the adjustments. This allows a user to form their own assessment of a sustainable tax rate.

34 This view is consistent with feedback from our discussions with staff from the Australian Taxation Office (ATO). During the course of developing its own metric for risk assessment purposes, AASB staff understand that the ATO held discussions with stakeholder groups in considering the usefulness of a 'standardised' ETR (ie an ETR without any adjustment for corporate group specific factors) for the purposes of comparability. The feedback AASB staff received suggests that, notwithstanding the adjustments that are necessary to any ETR in order to reflect a corporate group's true income tax position, the metric in isolation may lack context without explanations outlining any such adjustments and deviations.

35 The AASB notes that in the context of the global base erosion and profit shifting debate, the needs of general public as users of financial reports should also be considered. Based on discussions with the Australian Board of Taxation, AASB staff understand that a key objective of the voluntary TTC is to clearly demonstrate to general public users why the income tax liability of corporate groups deviates from the corporate tax rate (30% in Australia) as a function of APBT. General public users are likely to have a relatively unsophisticated understanding of IAS 12 and the deferred tax component of income tax expense.

36 In preparing income tax disclosures, preparers were concerned with presenting income disclosures in a simple and understandable format. Accordingly, whilst preparers did not express significant concerns in obtaining the information underlying the proposed alternatives as outlined by the AASB, concerns regarding the potential length some disclosures may result in, as well as deviating from disclosures pertaining to amounts already disclosed on the face of the financial statements, were raised. The preparers AASB staff met with considered the potential compliance burden to be marginal. AASB staff envisage that the underlying information required with respect to the disaggregation of disclosures between foreign and domestic amounts may present

considerable difficulty for corporate groups with different group structures. This further considered in Table 3.

Analysis and recommendations

37 Based on our research to date, AASB staff think that users would like to better understand why:

(a) ITE (or income tax payable) deviates from the corporate income tax rate (being 30% in Australia);

(b) the relationship ITE bears to income taxes paid and payable; and

(c) the overall relationship between the income tax amounts reported in the financial statements.

38 The common themes observed by AASB staff were:

(a) quantitative disclosures must be supplemented by adequate explanation to provide clarity and context to a corporate group's specific operations;

(b) a 'standardised' ETR (tax expense divided by accounting profit as defined in IAS 12.86, without adjustment to the numerator/denominator) is unlikely to improve a user's understanding of an entity's performance in comparison to that of another entity. Staff observed from their review of company financial reports that in many instances, APBT was modified to exclude various items. There was some support from non-preparers for this to continue.

39 AASB staff think there is opportunity for standard-setters to contribute to improving accountability/ transparency through better communication of information to address the observations in paragraph 33 and 34 above, by considering additional disclosures to those currently included in IAS 12.

40 AASB staff think IAS 12 could be amended to require, as a disclosure objective, an entity to disclose sufficient information to enable users of financial statements to understand:

(a) the relationship between income tax amounts reported in the financial statements; and

(b) why reported tax expense deviates from the corporate income tax rate.

41 This disclosure objective could be met by considering one or more of the following additional income tax disclosures to those currently included in IAS 12:

(a) require clear presentation of the entity's income tax paid and payable referable to the income of the financial year, by reconciling APBT to current tax expense with line items setting out both material temporary and non-temporary differences. Material adjustments made to APBT to determine current tax expense should be clearly explained. This disclosure should address feedback from users seeking clarity regarding the reasons underlying the deviation from of a corporate group's income tax not necessarily reflecting the corporate income tax rate as a function of APBT, but also clearly demonstrate the relationship between income tax paid and payable with income tax expense. This also addresses the degree of granularity required to ascertain sustainable tax rates and underlying earnings quality. AASB staff note that the reconciliation of APBT to current tax expense should work in conjunction with the existing requirements under IAS 12 to disclose a reconciliation from APBT to ITE, and should therefore continue to satisfy for the overall disclosure requirements of IAS 12.

(b) require corporate groups to provide information at both a domestic (eg Australia) and group level. This responds to feedback from users wanting to better understand a corporate group's franking capacity, and also provides 'general public' users with an overview of a corporate group's income tax position domestically (eg Australia) relative to its global position. (However, AASB staff acknowledge that disaggregating information between domestic and group levels could be costly (including preparer effort, audit costs) for corporate groups that do not already prepare accounting consolidation calculations for the domestic subgroup within the multinational group. This is discussed further in the Table in Appendix 1.)

(c) require a reconciliation of opening to closing current tax liability. This reconciliation responds to feedback from users seeking clarity regarding the relationship between income tax amounts reported throughout the financial statements, including income taxes paid per the statement of cash flows.

(d) encourage presentation of both a domestic (eg Australia) and global income taxes paid and payable / APBT ratio. This metric responds to feedback that users seek greater clarity with respect to whether a corporate group's income taxes reflects the corporate income tax rate, specifically in respect of general public users with a relatively unsophisticated understanding of IAS 12 and the deferred tax component of income tax expense. AASB staff note that the ETR metric still remains relevant in capturing a corporate group's total income position as it is inclusive of future income tax outcomes, and should continue to be disclosed where relevant. However, AASB staff are of the view that a corporate group's actual income tax liability referable to a financial year is better represented by the income taxes paid and payable metric.

(e) encourage corporate groups to include narrative discussion providing context to the income taxes paid and payable ratio, including discussion of any reasons for significant deviations from the corporate income tax rate, and significant deviations from the prior year ratio. This responds to feedback that the value of the metric is attributable to the underlying contextual explanation, and should also address user feedback pertaining to the granularity of disclosures being sufficient to determine the sustainable income tax rate.

(f) encourage corporate groups to disclose significant amounts of income tax paid during the financial year in foreign jurisdictions. This disclosure responds to users interested in understanding whether corporate groups may have low ETRs or income tax payable metrics due to long term tax structuring of multinational groups or whether adjustments should be made in ascertaining the sustainable tax rate. However, staff are conscious that constituents may object to making such disclosure.

42 AASB staff acknowledge that recommending additional income tax disclosures would lengthen the financial statements, which could be seen as contrary to addressing the disclosure overload concern of preparers. However, AASB staff are of the view that there is some value in the suggested disclosure objective as it respond to user needs for better information in the changed global tax environment. AASB staff consider that the additional income tax disclosures outlined above, other than with respect to the domestic tax ratio, leverage off information already disclosed in financial reports where possible. The income tax reconciliation suggested above seeks to reflect current tax expense as already reported in the financial statements, with additional detail setting out the material adjustments.

Alternative disclosures considered

43 AASB staff also considered the following income tax disclosures:

(a) an income taxes paid / ABPT ratio. Whilst AASB staff note that analysts expressed a preference for this metric to be prepared on an income taxes paid basis (that is, with reference to the current year cash flow statement), AASB staff are of the view that income taxes paid as the numerator may create a timing mismatch with the denominator, and may therefore be difficult to understand. Income tax payments made by corporate groups within a financial year are generally referable not only to the income tax liabilities of the current year, but also to the prior (and possibly earlier) financial year(s). Comparison of the income taxes paid amount relative to APBT referable to a particular financial year may produce a result difficult to explain and may require additional supporting reconciliations to be disclosed. There was some support from stakeholders for not presenting this metric.

(b) significant amounts of actual income taxes paid in foreign jurisdictions in respect of an income tax year. However, the challenges of obtaining such information may be significant. Financial reports are generally prepared well before final income tax liabilities are determined. This view is supported by feedback received by the Financial Accounting Standards Board's (FASB) on a similar disclosure proposed.

(c) a country-by-country method of reporting, as the EU are currently considering and have implemented in respect of banking institutions (see Appendix 2 for more detail in this regard). However, AASB staff have not propose such measures, as:

(d) In response to the TTC measures, entities expressed concerns regarding making public commercially sensitive information;[26]

26 https://cdn.tspace.gov.au/uploads/sites/70/2016/05/BoT_TransparencyCode_Final-report.pdf

(e) During the FASB's consultation on similar measures, entities expressed concerns regarding such information being used by tax authorities, and / or misinterpreted by the public;[27] and

(f) Such disclosures could give rise to 'double up' with country-by-country reporting to tax authorities in Australia and other jurisdictions.

(However, AASB staff considered the proposed disaggregation of APBT and income tax payable between foreign and domestic amounts represents a reasonable compromise given the concerns of potentially affected entities and user interest in such information.)

Possible manners of presenting the suggested disclosures

44 In Appendix 1, AASB staff considered alternative extents to which the disclosures outlined above could be presented in the notes to the financial statements. The illustrative example contains a number of components. We set out the objective of each component in the following table.

Table 2: Summary of suggested disclosure components

Component	Colour	Objective
• Reconciliation of APBT to income tax paid and payable • Explanation of key items adjusting APBT to current tax expense • Group and domestic income tax paid and payable ratio	**Black**	This reconciliation should clearly articulate to users the key drivers behind the difference between an entity's tax effected APBT and income tax liability for the year. The explanation of key items is to provide users with clarity and context pertaining to material non-deductible and non-assessable amounts. The income tax paid and payable ratio is used to illustrate, on a percentage basis, an entity's income taxes payable to the relevant tax office(s) referable to a financial year relative to the APBT generated.
• Reconciliation of group net current tax liability	**Red**	This reconciliation should 'tie together' the key income tax amounts reported for the group across the financial statements. It should, by reconstructing the balance sheet tax liability amount, facilitate understanding of the relationship between an entity's current tax expense reported in the profit and loss, income tax payable and income tax amounts reported in the cash flow statement.
• Significant amounts of income tax paid in foreign jurisdictions	**Green**	This disclosure aims to clearly illustrate to users, on an income tax paid basis, the jurisdictions in which significant amounts of income tax were remitted during the financial year. The amounts reported under this disclosure may not directly correlate to income tax paid and payable amount

27 http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168335332&acceptedDisclaimer=true

Component	Colour	Objective
		(as disclosed in the black component), as the income tax remitted to tax authorities during the financial year may relate to both current and prior year assessable amounts.
• Disaggregation of domestic disclosures: ○ Domestic APBT ○ Domestic income tax payable ○ Domestic and foreign income tax paid	**Blue**	The **blue** component also proposes to disclose the income tax paid and payable ratio disaggregated for domestic operations based on APBT attributable to domestic entities, accompanied by a narrative explaining the main drivers of deviations from the domestic corporate income tax rate. This informs users of the extent to which domestic income taxes deviated from the domestic corporate income tax rate. This also provide a relative metric to the global income tax paid and payable ratio disclosed in the black component, which may necessarily differ from the domestic corporate tax rate depending on how an entity structures its operations.

45 In addition, in the Table in Appendix 1, AASB staff set out proposed combinations of the different components. Pros and cons of each of the combinations are discussed in this Table.

APPENDIX 1
Illustrative example of proposed income tax disclosures

In paragraph 41, AASB staff note that the disclosure objective could be met by considering one or more of the identified additional income tax disclosures. Table 2 set out the respective objective of disclosures classified as **Black**, **Red**, **Blue** and **Green**. This Appendix illustrates the disclosure suggested by each of those components, and considers pros and cons of proposed combinations of the components.

Pros and cons of each proposed combination

<table>
<tr><th colspan="2">Alternative A – black components only</th></tr>
<tr><th>Pros</th><th>Cons</th></tr>
<tr><td>Analysts expressed interest in understanding an entity's income tax payable referable to its profit for the financial year. Whilst the information is currently indirectly derivable from present IAS 12 disclosures, the reconciliation of APBT to income tax payable should make clear a corporate group's income tax payable. Analysts thought a reconciliation of this nature may provide better granularity to enable identification of isolated transactions to better determine the sustainable tax rate.
Identification of material accounting to tax adjustments made to calculate current tax expense clarifies to users why income tax payable for a corporate group may not be APBT x corporate income tax rate. The explanation of key items should further supplement this by providing detail and clarity regarding the nature of the adjustments (if not sufficiently clear from the line item in the reconciliation).
The APBT to income taxes paid and payable reconciliation, and the associated ratio leverage existing information and therefore should not result in any significant cost to preparers.</td><td>Although the disclosures provide clarity around an entity's income tax obligations referable to a financial year on an accounting consolidated basis, they do not address an entity's foreign income tax obligations relative to its domestic obligations.
The degree of detail a corporate group discloses its accounting to tax adjustments in arriving at current tax expense will vary between corporate groups. Although there may be some commonalities, each corporate group will have a unique set of adjustments that cannot be captured in a standard reporting format. That is, the reconciliation may only go part of the way to providing further useful granularity to users.
It will not be obvious from the reconciliation and information about divergence from the domestic corporate tax rate, at a consolidated entity level, whether domestic entities are making tax payments at the domestic corporate tax rate. To the extent an accounting consolidated group conducts significant operations in foreign jurisdictions, the group ratio may deviate significantly from the Australian corporate income tax rate.
Preparers expressed concerns that the income tax disclosures will become lengthier, and consequently compromise understandability.</td></tr>
<tr><th colspan="2">Alternative B – black, red and blue components</th></tr>
<tr><th>Pros</th><th>Cons</th></tr>
<tr><td>This alternative builds on alternative A and proposes the separate disclosure of the domestic component of APBT, income taxes paid and payable, and disclosure of the domestic income tax payable ratio.
The blue component better addresses user requirements from an investor perspective, as it provides a measure of domestic entity</td><td>Disclosing amounts disaggregated between domestic and foreign proposed by the blue component may be challenging for some corporate groups that do not prepare accounting consolidation calculations for Australian entities within the multinational group. For example, to the extent a multinational accounting consolidated group</td></tr>
</table>

profitability relative to its domestic income tax liability but also relative to its global position and therefore the corporate group's franking capacity. • The **red** component 'ties together' the tax numbers reported in the financial statements in respect of the balance sheet tax liability amounts, income tax payable calculated and income taxes paid as reported in the cash flow statement. This should provide users with clarity on how tax amounts reported throughout the financial statements fit together.	prepares and reports its global consolidated group accounts only, its financial reporting process may not 'naturally' require specific consolidation calculations to be prepared for only the Australian entities. Accordingly, preparing this information specifically for the purpose of disclosure may impose significant cost and present considerable difficulty for preparers. • Although the red component should provide users with additional clarity regarding the income tax amounts disclosed throughout the financial statements, this information may be considered contextual and not essential in better informing investor decision making. This information is currently not required to be disclosed by IAS 12.
Alternative C – black, red, blue and green components	
Pros	**Cons**
• Alternative C builds on alternative B and looks to outline significant amounts of income tax paid in foreign jurisdictions during the relevant financial year. • The **green** component, to some extent, supplements the domestic and foreign disaggregated disclosures as outlined in the **blue** component by further addressing the key area of interest of users in decision making in understanding where, outside of Australia, the relevant multinational group paid income tax during the financial year. • To the extent that entities are required to prepare country-by-country reports for filing with tax authorities in foreign jurisdictions, the disclosures proposed in the green component may leverage information already prepared and may therefore minimise preparation costs.	• There may be an additional cost of preparation imposed on entities that are not required to prepare and submit country-by-country reports to foreign tax authorities. • The term 'significant' may be subjectively interpreted and could give rise to inconsistencies amongst corporate groups regarding the amounts they may choose to report. • The amounts proposed to be reported are on a paid basis, and may not correlate directly with amounts of tax paid that are referable to the relevant financial year.

Illustrative example of proposed income tax disclosures

Global Group Pty Ltd
Income tax disclosures - 30 June 2016
(Amounts are for illustrative purposes only)

		Group (A$ millions)	
Accounting profit before tax - Group		568.9	
Tax at the Australian tax rate (30%)		170.67	
Add:			
Taxable unfranked dividend	1	6.4	
Net movement in provisions and accruals	2	10.1	
Net unrealised foreign exchange loss	3	11.8	
Non-deductible interest expense	4	5.7	
Taxable gain on equity accounted investment	5	15.2	
Net difference between accounting and tax depreciation	6	1.3	
Impairment of intangibles	7	1.3	
(Over) / under provision - current		3.1	
Other non-deductible items [disaggregate where material]		4.3	
Deduct:			
Post tax associate earnings	8	-11.1	
Tax deductible goodwill	9	-6.6	
Research and development claim	10	-10.1	
Net fair value gain on investments	11	-12.9	
Overseas tax rate differential	12	-12.7	
Other deductible items [disaggregate where material]		-2.0	
Current tax expense (profit and loss statement)		**174.47**	(c)
Current tax expense (equity)			
Share issuance costs	13	-1.7	(b)
2016 Group income tax paid and payable		**172.77**	
Current tax expense		**174.47**	
Deferred tax expense		4.3	(a)
Income tax expense reported in the profit and loss statement		**178.77**	(d)

Income tax paid and payable ratio

	2016 income taxes paid and payable (A$ millions)	**Accounting profit before tax (A$ millions)**	**Ratio**
Australia	97.6	360.4	27.08%
Group	172.77	568.9	30.37%

[To the extent additional context to the income taxes paid and payable ratio is required beyond the 'explanation of key items' as below, this should also be included as part of the disclosure. For example, should the income taxes paid or payable metric deviate significantly from the prior year result, the key drivers should be explained.]

Explanation of key items

1	Unfranked dividends received from foreign subsidiary
2	Net increase in employee and other provisions and accruals
3	Non-deductible unrealised foreign currency loss on trade payables, loans
4	Non-deductible interest expense pursuant to thin capitalisation rules
5	Difference between tax and accounting gain on disposal of investment
6	Represents the net difference between depreciation of assets for accounting and income tax
7	Non-deductible impairment of intangible assets
8	Share of profit from associates and join ventures taken up net of tax expense
9	Goodwill amortisation is deductible in a foreign jurisdiction
10	Research and development incentives utilised
11	Non-assessable fair value gain recognised on financial instruments
12	International profits taxed at local tax rates different from the Australian statutory rate
13	Current tax items recognised in equity

Reconciliation to net group current tax liability	**A$ millions**
Opening net group current tax liability	55.0
Add: 2016 income tax payable	172.8
Less: income tax paid in Australia	-60.0
Less: income tax already paid in foreign jurisdictions	-50.0
Closing net group current tax liability	**117.8**

2016 Significant amounts of income tax paid in foreign jurisdictions	**Amount (A$ millions)**
[Country 1]	
[Country 2]	
[Country 3]	

These disclosures are already required to be made by IAS 12.79 and have been presented as part of this example for contextual purposes. AASB staff note that the reconciliation of APBT to income tax paid and payable, in conjunction with the existing ITE disclosure requirements, should continue to satisfy the overall disclosure requirements of IAS 12.

Includes payments in respect tof the current and prior year income tax liability.

Footnotes:

(a) IAS 12.81(g)(i)-(ii) requires disclosure of the amount of deferred tax assets and liabilities in respect of each type of difference. That is, a reconciliation to deferred tax expense will be made in the tax note
Deferred tax expense itself is required to be disclosed under IAS 12.80(c)-(d)
(b) Required to be disclosed under IAS 12.81(a)
(c) Required to be disclosed under IAS 12.80(a)
(d) A reconciliation of accounting profit before tax to income tax expense is required per IAS 12.81(c)

APPENDIX 2
Summary of public tax disclosure measures proposed and / or enacted by other jurisdictions

The table below sets out a summary of key public income tax disclosures that are currently being considered or have already been adopted by the US, UK and EU. Although not reflected in the table below, AASB staff also note that a number of jurisdictions globally have adopted specific country-by-country reporting and exchange of information measures, under which information obtained will not be publicly disclosed by tax authorities.

Country / region	Entities affected	Disclosure requirements	Current status
US	• Proposed accounting standards update[28] • All entities preparing financial statements in accordance with US FAS that are subject to income taxes. Some exceptions apply for entities are not public business entities.	Key financial report disclosures proposed: • Description of enacted changes to tax law that are probable to have an effect on a reporting entity in a future period. • Income / (loss) before ITE (or benefit) disaggregated between domestic and foreign. • ITE (or benefit) from continuing operations disaggregated between domestic and foreign. • Income taxes paid disaggregated between domestic, foreign, and income tax paid to any country that is significant to total income taxes paid. • An explanation of circumstances that caused a change in assertion about indefinite reinvestment of undistributed foreign earnings and the corresponding amount of those earnings. • Aggregate of cash, cash equivalents and marketable securities held by foreign subsidiaries.	The disclosure requirements were published in an exposure draft released by the Financial Accounting Standards Board in July 2016 and remained open for comment to 30 September 2016.
UK	• Schedule 19 of the UK Finance Act 2016[29] • Qualifying UK groups, companies and partnerships that satisfy either	Tax strategy to be made available online and accessible to the public free of charge, including: • Approach to UK tax risk management and governance. • Attitude towards tax planning so far as affecting UK tax.	The disclosure requirements were legislated in March 2016 for financial years commencing on or after the date of royal assent.

28 http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176168335332&acceptedDisclaimer=true
29 http://www.legislation.gov.uk/ukpga/2016/24/schedule/19/enacted

Country / region	Entities affected	Disclosure requirements	Current status
	or both of the following by reference to the previous financial year: ○ Turnover: more than £200 million ○ Balance sheet total: more than £2 billion	• Level of risk in relation to UK tax that the qualifying entity is prepared to accept. Approach towards dealings with HMRC. The tax strategy may also include: • Other information relating to tax (whether UK or otherwise).	
EU	• Chapter 10 of the EU Accounting Directive[30] • Public-interest and non-public large companies in the EU, with activity involving exploration, prospecting, development and extraction of minerals or oil and gas, or the logging of primary forests.	The following payments are to be disclosed as part of a company's annual financial report on a project by project basis subject to a threshold of €100,000 within a financial year: • Taxes levied on income, production or profits • Dividends • Royalties • Licence fees, rental fees, entry fees • Production entitlements • Signature, discovery and production bonuses • Payments for infrastructure improvements	Implemented by all EU member states by July 2015.
	• Article 89 of the Capital Requirements Directive[31] • Credit institutions and investment firms established in the EU.	Together with its financial statements, any bank in the EU must disclose, on a country by country basis: • Names, nature of activities and geographical location • Turnover • Number of employees on a full time equivalent basis • Profit or loss before tax • Tax on profit or loss • Public subsidies received	Implemented by all EU member states by 31 December 2013, with the rules effective from 1 January 2014.

30 http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1425994405386&uri=CELEX:02013L0034-20141211
31 http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32013L0036

Country / region	Entities affected	Disclosure requirements	Current status
	• Corporate Tax Transparency[32] • Any multinational company (European or not) that is currently active in the EU's single market with a permanent presence in the EU and that has a turnover in excess of €750 million.	The following proposed key disclosures are required to be made for all entities within the EU broken down country by country on their websites: • Taxes paid • Taxes due • Profit before tax • Turnover • Nature of activities • Accumulated earnings	Proposal adopted by the EU in April 2016.

32 http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52016PC0198

APPENDIX 3
Academic literature reviewed

AASB staff reviewed the following academic literature in conducting research regarding income tax disclosures:

- Demere, P., Lisowsky, P., Li, L.Y. and Snyder, R.W. (2016) *The Smoothing and Informativeness of GAAP Effective Tax Rates*. Available at: https://accountancy.smu.edu.sg/sites/accountancy.smu.edu.sg/files/PetroLisowsky_paper_1.pdf (Accessed: 8 November 2016).

- Dyreng, S.D., Hanlon, M. and Maydew, E.L. (2008) 'Long-Run Corporate Tax Avoidance', *The Accounting Review*, 83(1), pp. 61–82. doi: 10.2308/accr.2008.83.1.61.

- Goh, B.W., Lee, J., Lim, C.Y. and Shevlin, T.J. (2016) 'The effect of corporate tax avoidance on the cost of equity', *SSRN Electronic Journal*, 91(6), pp. 1647–1670. doi: 10.2139/ssrn.2237742.

- Heaney, R. (2009) *Dividend Imputation in Australia: The Value of Franking Credit Balances*. Available at: http://mams.rmit.edu.au/a2xcepchcqp4.pdf (Accessed: 8 November 2016).

- Lisowsky, P., Robinson, L. and Schmidt, A. (2013) 'Do Publicly Disclosed Tax Reserves Tell Us About Privately Disclosed Tax Shelter Activity?', *Journal of Accounting Research*, 51(3), pp. 583–629. doi: 10.1111/joar.12003.

- Tran, A. (2015) 'Can taxable income be estimated from financial reports of listed companies in Australia?', *SSRN Electronic Journal*, . doi: 10.2139/ssrn.2666308.