

Proposed Minerals Resource Rent Tax Issues Paper – Scope of AASB 112 and AASB Interpretation 1003

Introduction

- 1 In June 2011 the Australian Government released a draft Exposure Draft (ED) of proposed Minerals Resource Rent Tax (MRRT) legislation¹. The proposed MRRT would apply to the mining of iron ore and coal in Australia and is expected to be applicable from 1 July 2012.
- 2 At its September 2011 meeting the AASB received an education session on the proposed MRRT, including a draft project plan for considering any accounting issues that may arise.² Two potential accounting issues were raised by AASB staff as part of the education session:
 - (a) Is the proposed MRRT an income tax within the scope of AASB 112 *Income Taxes*?
 - (b) Does the proposed MRRT fall within the scope of AASB Interpretation 1003 *Petroleum Resource Rent Tax* by analogy?

No decisions were made in relation to these potential accounting issues, and staff were requested to undertake targeted outreach to determine if the introduction of the MRRT would be likely to result in any diversity in accounting practice in Australia.

Purpose of this paper

- 3 The purpose of this paper is to outline the staff analysis of potential accounting issues associated with the proposed MRRT, including consideration of the feedback received from the targeted outreach performed.³ Staff recommendations are provided in paragraphs 31 and 34 of this paper.

¹ The draft ED is available at: <http://www.treasury.gov.au/contentitem.asp?ContentID=2070&NavID=066> (accessed 4 November 2011).

² http://www.aasb.gov.au/admin/file/content102/c3/Sept_2011_AP_4.1_MRRT_education_session.pdf (accessed 4 November 2011).

³ The potential accounting issues addressed in this paper relate to the scope of AASB 112 and AASB Interpretation 1003. A separate paper, Agenda Paper 6.3 considers potential accounting issues arising from the application of AASB 112 itself.

Scope of AASB 112 *Income Taxes*

- 4 AASB 112 applies to accounting for income taxes. Income taxes are defined in AASB 112 to include ‘all domestic and foreign taxes which are based on taxable profits. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint venture on distributions to the reporting entity’ (para 2).
- 5 As MRRT is not a withholding tax, for MRRT to be an income tax and therefore fall within the scope of AASB 112, MRRT must be a tax based on taxable profit. Taxable profit (tax loss) is defined in AASB 112 paragraph 5 as:

...the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).

- 6 In March 2006 the International Financial Reporting Interpretations Committee (IFRIC) considered the scope of IAS 12 and whether to provide guidance on which taxes are within the scope of IAS 12. The IFRIC decided not to add the issue to the agenda, and issued the following agenda decision:

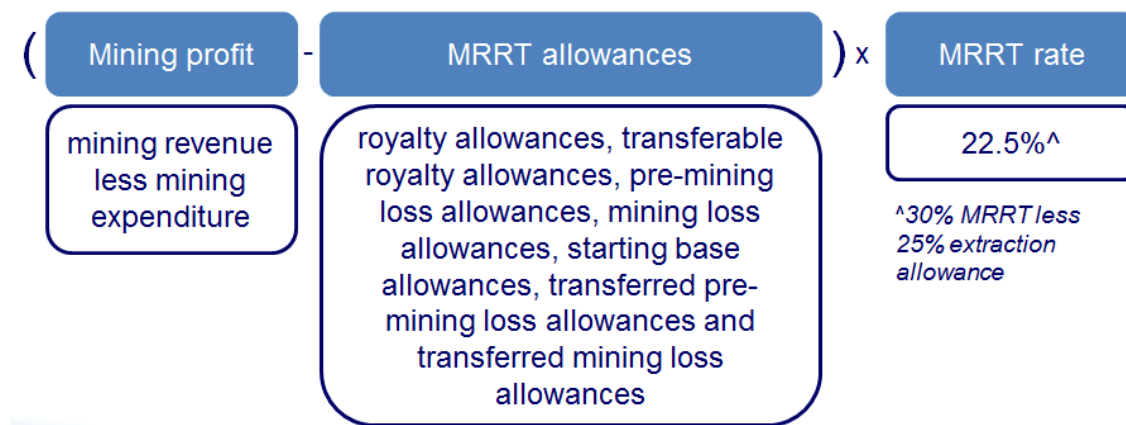
IAS 12 *Income Taxes* – Scope

The IFRIC considered whether to give guidance on which taxes are within the scope of IAS 12. The IFRIC noted that IAS 12 applies to income taxes, which are defined as taxes that are based on taxable profit. That implies that (i) not all taxes are within the scope of IAS 12 but (ii) because taxable profit is not the same as accounting profit, taxes do not need to be based on a figure that is exactly accounting profit to be within the scope. The latter point is also implied by the requirement in IAS 12 to disclose an explanation of the relationship between tax expense and accounting profit. The IFRIC further noted that the term ‘taxable profit’ implies a notion of a net rather than gross amount. Finally, the IFRIC observed that any taxes that are not in the scope of IAS 12 are in the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

However, the IFRIC also noted the variety of taxes that exist world-wide and the need for judgment in determining whether some taxes are income taxes. The IFRIC therefore believed that guidance beyond the observations noted above could not be developed in a reasonable period of time and decided not to take a project on this issue onto its agenda.

7 Of particular significance from a MRRT perspective, the IFRIC agenda decision specifically highlights that:

- (a) the term ‘taxable profit’ implies a notion of a net rather than a gross amount. MRRT profit is based on a measure of profit that is based on a net amount. This would be calculated as follows:



- (b) because taxable profit is not the same as accounting profit, taxes do not need to be based on a figure that is exactly accounting profit to be within the scope.

8 In relation to (b), not only is the timing of the calculation of the proposed MRRT is at an earlier point in the production process (the ‘taxing point’) than accounting profit (calculated when the extracted minerals are sold), there are also a number of differences between the proposed MRRT profit and accounting profit, including:

- (a) the deductibility of a number of allowances, including the starting base allowance.
- (b) the uplift applied to undeducted allowances (proposed to be the Long-term Bond Rate plus seven per cent).

9 The proposed MRRT has a number of similarities to Australian Petroleum Resource Rent Tax (PRRT); therefore it is instructive to consider the AASB’s thinking when developing AASB Interpretation 1003. When considering the issue of whether (PRRT) is a tax within the scope of AASB 112, the AASB noted the following (AASB Interpretation 1003):

- BC13 Board members noted that there are differences between the calculation of Australian PRRT taxable profit and accounting profit. These differences can be attributed to specific features of the Australian PRRT regime such as:
- (a) the limited extent to which receipts are assessable and expenditures are deductible for Australian PRRT purposes; and
 - (b) the uplift factor (referred to as ‘augmentation’) that is applied to undeducted expenditures so that the amount of Australian PRRT payable reflects a tax on what may be considered to be an ‘economic return’.
- BC14 The existence of such differences was not considered to preclude Australian PRRT from being a tax based on taxable profit. Board members noted that this could be seen to be consistent with the IFRIC’s observation that “... because taxable profit is not the same as accounting profit, taxes do not need to be based on a figure that is exactly accounting profit to be within the scope [of IAS 12]. [This] point is also implied by the requirement in IAS 12 to disclose an explanation of the relationship between tax expense and accounting profit”.
- BC15 Board members noted that it can be difficult to explain the relationship between accounting profit and corporate tax expense in some tax jurisdictions (and given unique tax positions of the taxpaying entity). Regardless, Board members agreed that corporate income tax would be expected to be accounted for as an income tax. Board members therefore expressed the view that although the relationship between Australian PRRT tax expense and accounting profit might not be easily explained, this does not provide sufficient supporting evidence to suggest that Australian PRRT is not an income tax.
- 10 Similarly, it may be argued that the existence of the differences between accounting profit and taxable profit in relation to the MRRT is not inconsistent with the March 2006 IFRIC agenda decision.

Application of AASB Interpretation 1003 *Petroleum Resource Rent Tax* by analogy

- 11 AASB Interpretation 1003 addresses only the question of whether Australian PRRT falls within the scope of AASB 112. The consensus reached in the Interpretation is that Australian PRRT is an income tax within the scope of AASB 112. The basis for conclusions to AASB Interpretation 1003 further states that the Interpretation is only clarifying the scope of Australian Accounting Standards, and specifically only in relation to Australian PRRT.
- 12 Despite the limited scope of the Interpretation, the Interpretation does not *prohibit* its application by analogy by applying the hierarchy in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Targeted outreach conducted

13 The staff sent out a request for information to a number of large accounting firms and large mining/minerals entities. Specifically, we asked:

- (a) Do you consider that the proposed MRRT would be an income tax within the scope of AASB 112?
- (b) If you consider that the proposed MRRT **would be** an income tax within the scope of AASB 112, do you believe there are any major issues with applying AASB 112 to the proposed MRRT?
- (c) If you consider that MRRT **would not be** an income tax, which accounting treatment do you believe should be applied to the proposed MRRT?
- (d) In addition to the potential accounting treatment outlined in your response to (a) and/or (c) above, do you believe there would be any other equally valid alternative accounting treatments available to entities under Australian Accounting Standards or Interpretations when accounting for the proposed MRRT? If yes, please outline the alternative accounting treatment(s).
- (e) Do you expect that diversity in accounting for the proposed MRRT would arise in Australia if no amendments were to be made to existing Australian Accounting Standards or Interpretations?

14 The breakdown of responses received⁴ is as follows:

	Request sent	Response received
Large accounting firms	4	4
Mining companies	15 ⁵	1

15 In response to question (a), noted in paragraph 13 above, the majority of respondents stated that they considered the proposed MRRT would be an income tax within the scope of AASB 112, either directly, or by analogy to the requirements of AASB Interpretation 1003.

16 In response to question (d), noted in paragraph 13 above, the majority of respondents believed that, in relation to the accounting required by AASB 112, there would not be any other equally valid alternative accounting treatments available to entities under

⁴ Responses as at 9am 14 November 2011. AASB staff will provide details of any additional late respondents verbally at the forthcoming Board meeting.

⁵ Requests sent directly to the mining companies or via a request to the G100.

Australian Accounting Standards or Interpretations when accounting for the proposed MRRT.

17 However, two respondents considered that in the absence of AASB Interpretation 1003 there may be a number of possible accounting treatments for the proposed MRRT. Other respondents indicated that AASB Interpretation 1003 simply provides further support by analogy that the proposed MRRT is within the scope of AASB 112.

18 One respondent noted that:

In the absence of Int. 1003, we are aware of a number of alternative accounting treatments that may be identified, similar to the range of alternative treatments previously applied by other entities to PRRT. These include recognising MRRT on a cash paid basis, on a simple accruals basis, or using IAS12 recognition and measurement principles, but in all cases, classified and presented as an operating cost. [Respondent] considers all of those alternative methods to be inferior to treatment as an income tax under AASB 112.

19 Another respondent commented:

...if AASB 1003 did not exist (or was withdrawn) we believe there is a real possibility that diversity might arise.

20 A further respondent indicated, in the absence of AASB Interpretation 1003, the following alternative accounting treatments were possible, although not necessarily supported:

- A provision under AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, which may or may not include some measure of future expected MRRT/PRRT outflows (effectively as a constructive obligation) in the determining of the 'best estimate' of the expenditure required to settle the obligation
- An income tax under AASB 112, including full deferred tax accounting where appropriate
- By analogy to an income tax under AASB 112, including adopting deferred tax principles, but treating the amount recognised as a production cost and not as part of income tax expense
- An inventory cost under AASB 102 *Inventories*, recognising the total expected MRRT/PRRT cost into production costs on a units of production basis over the life of the operation
- A liability (accrual) under the *Framework*, only for amounts of MRRT/PRRT that are payable, i.e. recognising the legal obligation arising from production that has occurred only.

- 21 One respondent recommended withdrawing AASB Interpretation 1003⁶ as ‘not all entities globally applying IFRS are accounting for PRRT and/or similar imposts as income taxes.’ The respondent believes that:

Such a withdrawal would deal with issues such as inconsistencies with the AASB's own objectives in relation to full convergence with IFRS and permit Australian entities to consider global practice in this area when setting their accounting policies. It would also serve to address misconceptions Australia is ‘not fully compliant’ with IFRSs, and set a leading example for other jurisdictions in Asia-Oceania and more broadly.

- 22 In response to question (b), noted in paragraph 13 above, several of the respondents commented that the proposed MRRT would give rise to practical issues under AASB 112 that would require significant judgement and estimation; however, none of these respondents indicated that these issues would be pervasive. Respondents indicated that these issues could be addressed by entities providing adequate disclosure in accordance with the requirements of AASB 101 *Presentation of Financial Statements*.
- 23 One respondent indicated that a number of difficult interpretational issues may arise in the application of AASB 112 to the proposed MRRT. These issues related to the accounting for the market value uplift (starting base allowance) and accounting for royalties. These issues are further discussed in Agenda Paper 6.3.
- 24 In response to question (e), noted in paragraph 13 above, the majority of respondents indicated that they would not expect diversity in accounting for the proposed MRRT to arise in Australia if no amendments were made to existing Australian Accounting Standards or Interpretations.
- 25 One respondent indicated they thought diversity in practice could arise because AASB Interpretation 1003 is scoped to only include the accounting for PRRT. This respondent indicated that this diversity could be removed if the scope of AASB Interpretation 1003 was extended to also include the proposed MRRT.

⁶ The respondent also recommended withdrawing all other Australian domestic Interpretations.

Options for addressing the accounting for the proposed MRRT

26 Staff have identified three options for how the AASB could address the accounting for the proposed MRRT in light of AASB 112 and AASB Interpretation 1003:

(a) Make no modification to the requirements of AASB Interpretation 1003

On the basis of outreach performed, the majority of respondents were in agreement that, either by applying the requirements of AASB 112 directly, or by applying the requirements of AASB Interpretation 1003 by analogy, Australian entities would be required to account for the proposed MRRT as an income tax. Although there is a minority view that other interpretations are possible, those supporting the view to not make any modification to the requirements of AASB Interpretation 1003 in relation to the proposed MRRT would consider that this minority view is not a significantly divergent interpretation to warrant the AASB addressing the issue either by issuing/modifying an interpretation or referring the issue to the IFRS Interpretations Committee.

(b) Modify the requirements of AASB Interpretation 1003 to incorporate the proposed MRRT

Modifying the requirements of AASB Interpretation 1003 to incorporate the proposed MRRT would help ensure that diversity in practice would not arise due to the lack of specific guidance in relation to the accounting for the proposed MRRT. Those two respondents supporting this view consider that, although a *preferred view* may be that the proposed MRRT is accounted for as an income tax, there is some uncertainty in applying the current requirements of Australian Accounting Standards and Interpretations such that financial reporting would be improved through the elimination or reduction of potentially diverse reporting methods.

(c) Withdraw AASB Interpretation 1003

Withdrawing AASB Interpretation 1003 would provide Australian constituents the same base for selecting an accounting policy to account for the MRRT⁷ as

⁷ The accounting for PRRT is outside the scope of this paper, however, this view also equally applies to the accounting for PRRT.

is available to other entities applying IFRS globally. The respondent supporting this view consider that there are differing views on how the MRRT should be accounted for, and believe that Australian entities should be in the same position as other IFRS entities globally when selecting an appropriate accounting policy.

Staff recommendations

- 27 In response to the issue of whether the proposed MRRT is an income tax within the scope of AASB 112, staff considered each of the options discussed in paragraph 27 above.
- 28 Staff think that, based on the above analysis and responses to the outreach, it is clear that MRRT is an income tax within the scope of AASB 112.
- 29 Although staff acknowledge that there appears to be uncertainty expressed by a minority as to the interaction between MRRT and AASB Interpretation 1003/ AASB 112, staff do not consider that this uncertainty is sufficient to require the AASB to amend or withdraw AASB Interpretation 1003. Specifically, based on the outreach performed, AASB staff would not expect significant diversity in practice in Australia to arise when considering which Australian Accounting Standard or Interpretation applies to the proposed MRRT under the current requirements of Australian Accounting Standards and Interpretations.
- 30 Accordingly, staff recommend that the AASB makes no modification to the requirements of AASB Interpretation 1003.
- 31 Staff do not recommend the following options for the reasons provided below:
- (a) Modify the requirements of AASB Interpretation 1003 to incorporate the proposed MRRT

Although staff acknowledge that modifying the requirements of AASB Interpretation 1003 to incorporate the proposed MRRT would help ensure that diversity in practice would not arise, staff do not consider there are sufficiently divergent interpretations either emerging or existing in practice that would justify the AASB undertaking a modification to the interpretation.

(b) Withdraw AASB Interpretation 1003

Staff do not recommend withdrawing AASB Interpretation 1003 as this option would possibly *increase* diversity in practice, not only in relation to the accounting for the proposed MRRT, but also accounting for PRRT.⁸

Question 1

Does the Board agree with the staff recommendation to not make any modification to the requirements of AASB Interpretation 1003 in relation to the proposed MRRT?

IFRS Interpretations Committee protocol

32 As noted in paragraph 30 above, staff recommend that the AASB does not make any modification to the requirements of AASB Interpretation 1003 in relation to the proposed MRRT. In accordance with the AASB Interpretations Model (June 2006, as modified in December 2007), where an issue proposal relates to an Australian Accounting Standard – the AASB may either:

- (a) take no action and give reasons; or
- (b) refer the issue to the IFRS Interpretations Committee for consideration for inclusion on its work program.

33 On the assumption that the issue addressed in this paper is within the scope of the AASB Interpretations Model, staff recommend not to refer the issue to the IFRS Interpretations Committee on the basis that the Committee has previously rejected similar issues because there are a variety of taxes that exist world-wide and noted the need for judgement in determining whether some taxes are income taxes. The Committee has previously decided not to add such issues onto its agenda as guidance could not be developed in a reasonable period of time.

Question 2

Does the Board agree with the:

- (a) staff recommendation not to refer the issue of whether the proposed MRRT is within the scope of AASB 112 to the IFRS Interpretations Committee?
- (b) Proposed Agenda Decision wording outlined in Appendix A to this paper on the assumption the issue is within the scope of the AASB Interpretations Model.

⁸ This staff recommendation is limited to the issue addressed in this paper. It does not refer to the broader issue of whether it is appropriate for Australian domestic interpretations to be reassessed for possible withdrawal.

Appendix A: Proposed Agenda Decision

Issue

The AASB considered the issue of whether the proposed Australian Minerals Resource Rent Tax (MRRT) would be an income tax within the scope of AASB 112 *Income Taxes*.

Reasons for Not Adding the Issue to the AASB's Agenda

In considering this issue the AASB noted the previous IFRIC decision in March 2006 not to provide guidance on which taxes are within the scope of IAS 12. In that decision, the IFRIC noted that (i) not all taxes are within the scope of IAS 12, but (ii) because taxable profit is not the same as accounting profit, taxes do not need to be based on a figure that is exactly accounting profit to be within the scope. The IFRIC further noted that the term 'taxable profit' implies a notion of a net rather than gross amount.

The Board observed that there are differences between the calculation of the proposed Australian MRRT taxable profit and accounting profit. However, the existence of such differences was not considered to preclude the proposed Australian MRRT from being a tax based on taxable profit.

In considering this issue the AASB also noted the similarities between the calculation of the proposed Australian MRRT taxable profit and the Australian Petroleum Resource Rent Tax (PRRT). The consensus reached in the existing interpretation dealing with Australian PRRT, AASB Interpretation 1003 *Petroleum Resource Rent Tax*, is that Australian PRRT is an income tax within the scope of AASB 112.

The Board thinks that existing guidance in Australian Accounting Standards and Interpretations is sufficient to address the issue of whether the proposed Australian MRRT should be accounted for as an income tax, either by applying the requirements of AASB 112 directly, or by applying the requirements of AASB Interpretation 1003 by analogy.

The Board does not expect that significantly divergent interpretations would arise in practice. Consequently, the AASB [decided] not to add this issue to its work program.