

**Proposed Minerals Resource Rent Tax  
Issues paper – Potential issues in applying AASB 112 to the  
proposed MRRT and extended PRRT**

- 1 The AASB has received comments about the clarity of AASB 112 *Income Taxes* and its application to the proposed Minerals Resource Rent Tax (MRRT)<sup>1</sup> and extended Petroleum Resource Rent Tax (PRRT)<sup>2</sup>. For the purposes of this paper the issues are discussed in terms of MRRT, however, the issues are also equally applicable to the extended PRRT.
- 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.<sup>3</sup>
- 3 In November 2011, the AASB Chairman received a letter highlighting a number of issues arising in applying AASB 112 to the proposed MRRT. The letter is included as agenda paper 6.4. This paper includes:
  - (a) Background information on three issues raised in the letter.
  - (b) Staff analysis of each issue.
  - (c) Assessment of each issue against the Board's agenda criteria.<sup>4</sup>
  - (d) Staff recommendations on each issue.

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<sup>1</sup> The issue of whether the proposed MRRT is an income tax within the scope of AASB 112 is considered in Agenda Paper 6.2.

<sup>2</sup> The PRRT is proposed to be extended to apply to petroleum production, including coal seam gas and shale oil, sourced from petroleum projects located onshore and in territorial waters, as well as from the North West Shelf Project area from 1 July 2012.

<sup>3</sup> [http://www.aasb.gov.au/admin/file/content102/c3/Sept\\_2011\\_AP\\_4.1\\_MRRT\\_education\\_session.pdf](http://www.aasb.gov.au/admin/file/content102/c3/Sept_2011_AP_4.1_MRRT_education_session.pdf) (accessed 4 November 2011).

<sup>4</sup> As outlined in the Interpretations Model (June 2006, as modified in December 2007) [http://www.aasb.gov.au/admin/file/content102/c3/Interpretations\\_Model\\_12-07.pdf](http://www.aasb.gov.au/admin/file/content102/c3/Interpretations_Model_12-07.pdf) (accessed 14 November 2011).

## Background

4 In relation to issues arising in applying AASB 112 to the proposed MRRT, the letter raises the following key issues<sup>5</sup>:

- (a) Issue 1: Accounting for the 'market value' uplift.
- (b) Issue 2: Accounting for royalties.
- (c) Issue 3: Timing of substantive enactment of the enabling legislation.

### Issue 1: Accounting for the market value uplift (starting base allowance)

5 In relation to the accounting for the market value uplift (starting base allowance) under the proposed MRRT the letter indicates there are three potential accounting treatments when applying the requirements of AASB 112. In summary, the views are:

- (a) View 1: Adjustment to the tax base

Supporters of this view consider the starting base allowance to be the tax base of the upstream assets. A deferred tax asset arises (because the carrying amount of the assets is lower than the tax base) and would be recognised to the extent it meets the recognition requirements of AASB 112.

- (b) View 2: Tax holiday

Supporters of this view consider the market value approach to the starting base allowance to be akin to the Federal Government providing the entity with a tax holiday for an amount of tax equal to the initial starting base ascribed to the asset. A zero tax rate would likely be applied which would result in the entity not recognising any deferred tax amounts during the tax holiday period.

- (c) View 3: Government grant accounting

Supporters of this view consider the market value uplift to be a government grant within the scope of AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*. The starting base allowance would be considered to be akin to assistance provided to eligible entities to ameliorate (at least partially) the effects of the proposed MRRT.

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<sup>5</sup> The letter also raised two further issues relating to specific aspects of the proposed MRRT legislation. These issues will be considered at a later point in time, depending on the outcome of the Board's discussion at its December 2011 meeting.

## Issue 2: Accounting for royalties

6 Under the proposed MRRT, entities are entitled to a credit for royalties paid to State Governments (royalty allowances). In relation to the accounting for royalties, the letter indicates there are three potential alternative accounting treatments when applying the requirements of AASB 112. In summary, the views are to treat the royalties as:

(a) View 1: Operating cost.

Supporters of this view consider the royalty obligation to be separate from the proposed MRRT. Any royalties would be treated as operating costs (consistent with the current policy usually adopted by Australian entities).

(b) View 2: Prepayment of tax.

Supporters of this view consider the payment of royalties to be a 'prepayment' of the proposed MRRT.

(c) View 3: Apply either view 1 or 2 depending on the entity's circumstances.

Supporters of this view would advocate adopting view 1 when an entity is expected to pay little or no amount under the proposed MRRT and view 2 otherwise.

## Issue 3: Substantive enactment

7 In relation to substantive enactment, the letter notes the following issue:

The timing of substantive enactment of the enabling legislation, particularly if the legislation passes the House of Representatives, but not the Senate, prior to December 2011 but there is an apparent intention by a majority of the parties in the Senate for passage of the legislation. Whilst this seems straightforward in terms of the application of Interpretation 1039 in these circumstances (suggesting substantive enactment may have occurred), the finely balanced nature of the Federal Parliament and the behaviour of political parties in recent times may not necessarily indicate that 'substantive enactment' has occurred

## **Staff analysis and recommendations**

### Issue 1: Accounting for the market value uplift (starting base allowance)

8 The following are the key features of the starting base allowance<sup>6</sup>:

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<sup>6</sup> *Minerals Resource Rent Tax Exposure Draft Explanatory Material*, 10 June 2011, Chapter 7.

- (a) The starting base allowance reduces the MRRT liability for a mining project interest for an MRRT year.
- (b) The allowance recognises investments in assets that relate to the upstream activities of a mining project interest (starting base assets) that existed before the announcement of the MRRT on 2 May 2010.
- (c) A starting base allowance exists if a miner has profit remaining after using all other higher ranked allowances, and it has one or more starting base losses. That is, a miner has a starting base allowance when it can use a starting base loss.
- (d) A starting base loss reflects the annual depreciation of the starting base assets. If there is insufficient profit to use a starting base loss, it is carried forward and uplifted. That is, starting base assets produce starting base losses.
- (e) A miner can generally choose to calculate the starting base losses based on either:
  - The market value of starting base assets (including rights to the resources) at 2 May 2010 (the ‘market value approach’); or
  - The most recent accounting book value of starting base assets (not including rights to the resources) (the ‘book value approach’) available at the time.

9 The tax base of an asset is defined in AASB 112 as the amount attributed to that asset or liability for tax purposes (para. 5). The Standard goes on to state that the tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset (para. 7).

10 Staff are of the view that applying the tax holiday approach (view 2) under the market value approach to calculating the starting base allowance, for an entity that elects to adopt the market value approach, would be effectively bifurcating the tax base of the starting base assets between the carrying amount and market value uplift.

The most recent accounting book value would be considered to be the 'tax base' of the assets, and any amount above this value would be considered to be the 'tax holiday'.

11 Staff are concerned that such bifurcation ignores the fact that the entity would receive a deduction for starting base losses, regardless of the measurement basis applied. That is, the tax treatment of the starting base losses is substantially the same under the book value and market value approaches; it is just that the initial method of calculating the value (i.e. book value or market value) differs.

12 In the staff's opinion, the application of AASB 112 to the proposed MRRT would require an entity to reflect the increase in the future deductions available (resulting in future tax payments being smaller than if no uplift were to occur) as a deductible temporary difference giving rise to a deferred tax asset to the extent it meets the recognition criteria in AASB 112 (view 1).

13 In forming our opinion, we note the letter's comment that:

...[i]n some cases, the effect of the market value uplift and augmentation *can result in* the entity expecting *no payment of MRRT/PRRT at all* over the remaining life of the project... [emphasis added].

In our opinion, the reduction in MRRT otherwise payable to nil represents a benefit received by the entity that would meet the definition of a deductible temporary difference giving rise to a deferred tax asset to the extent it meets the recognition criteria in AASB 112.

14 Staff further think that the increase in total deductions available to an operation can be distinguished from a time-period tax holiday (an exemption from tax that would otherwise give rise to tax payable). Staff distinguish the increase in the total deductions available from a scenario in which an entity receives a reduction in tax payable for a period of time, particularly because the increase in total deductions available is not linked to any time based measure.

15 Consequently, staff are of the view that view 1, recognising the starting base allowance as an adjustment to tax base, is the appropriate accounting treatment. On balance, staff do not consider the arguments supporting view 2 expressed in the letter provide a sufficient basis to justify it being regarded as a valid interpretation of the requirements of AASB 112 for the reasons expressed in paragraphs 10-14 above.

However, we have not yet sought the reaction of the supporter of view 2 to our arguments against that view.

- 16 Furthermore, staff note that AASB 112 does not specifically address the issue of tax holidays. Accordingly, staff acknowledge that, based on the views expressed in the letter, potentially different interpretations of the requirements of AASB 112 could arise.
- 17 With regards to the view expressed in view 3 that the market value uplift may be treated as a government grant in accordance with AASB 120, staff note that the letter qualifies this view by stating that this view relies on the starting base allowance being excluded from the scope of AASB 112 as paragraph 2(b) of AASB 120 excludes government assistance that is provided for an entity in the form of benefits that are available in determining taxable profit or loss, or are determined or limited on the basis of income tax liability.
- 18 As outlined in Agenda Paper 6.2 staff believe that the MRRT is an income tax within the scope of AASB 112 (either directly, or by analogy to AASB Interpretation 1003 *Petroleum Resource Rent Tax*). Accordingly, staff do not support view 3.

#### *Agenda criteria assessment*

- 19 On balance, staff are of the opinion that AASB 112 is clear and therefore no further action is warranted. However, if the Board disagrees, in accordance with the AASB Interpretations model, issues relating to IFRS based Australian Accounting Standards that the AASB considers warrant further guidance would, in the first instance, be forwarded to the IFRS Interpretations Committee for consideration for inclusion in the Committee's work program.<sup>7</sup> A preliminary step available to the AASB would be to refer the issue in the first instance to the National Standard Setters (NSS). However, staff think that, given the timing of the introduction of the MRRT in Australia, and the dates for the next IFRS Interpretations Committee meeting (17-18 January 2012), any issue would need to be raised directly with the Committee to help ensure a timely response.

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<sup>7</sup> The AASB considers that a unique domestic interpretation of IFRS based Australian Accounting Standards is required in rare and exceptional circumstances.

20 The staff have assessed this issue against the Board’s criteria, on the assumption that the Board concludes the tax holiday approach is a reasonably feasible interpretation of the Standard, as follows:

The issue is widespread and has practical relevance.	Yes. The issue affects all entities in Australia subject to the proposed MRRT.
The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice).	Yes. Although staff question the validity of view 2, in the absence of further guidance, diversity in practice could arise.
Financial reporting would be improved through the elimination of or reduction in diverse reporting methods.	Yes. The accounting treatment in view 1 would provide a significantly different outcome to view 2. Therefore, eliminating or reducing the potentially diverse reporting methods would improve financial reporting.
The issue is a narrow implementation or application issue that can be resolved efficiently within the confines of existing IFRSs or Australian Accounting Standards.	Yes.
It is probable that the IFRS Interpretations Committee or AASB (as relevant) will be able to reach a consensus on a timely basis.	Yes, the staff believe that the IFRS IC could reach consensus on the issue on a timely basis. See paragraph 19 of this paper for an indication of the urgency with which the issue might need to be dealt with.
If the issue relates to a current or planned IASB or AASB project, there is a pressing need to provide guidance on a more timely basis than would be expected from that project.	There is no current project, however, depending on the outcome of the IASB’s agenda consultation, the Income Taxes project may be reactivated. There is a pressing need to provide guidance on a more timely basis that would be expected from that project (again, see paragraph 19 above).

*Staff recommendation*

21 If the Board concludes the tax holiday approach is a reasonably feasible interpretation of the Standard, based on the assessment of the agenda criteria, staff suggest the issue of how to apply AASB 112 to the market value uplift (starting base allowance) is raised with the IFRS Interpretations Committee for urgent consideration. Staff recommend including only view 1 and view 2 in the request as, depending on the decisions made by the Board in Agenda Paper 6.2, view 3 is not applicable as the proposed MRRT would be considered to be within the scope of AASB 112.

### **Question 1**

- (a) Does the Board want to raise the issue of how to apply AASB 112 to the market value uplift (starting base allowance) to the IFRS Interpretations Committee?
- (b) If the answer to question 1(a) is no, does the Board agree with the Proposed Agenda Decision wording outlined in Appendix A?

### Issue 2: Accounting for royalties

- 22 Although royalties paid to State Governments would be permitted to be ‘credited’ against MRRT otherwise payable to the Federal Government, the nature of the royalty payments is not changed under the proposed MRRT. The royalty amounts are payable based on a measure of sales revenue, rather than being payable based on a measure of taxable profit.
- 23 We think this issue arises specifically in relation to the allowance received for royalty payments in the proposed MRRT particularly because AASB 112 refers to taxes payable to ‘taxation authorities’ (plural – which could encompass both State and Federal governments). In the proposed MRRT the non-income taxes paid to one taxation authority is deductible against income taxes payable to another taxation authority. More than one view may be considered to be acceptable depending on how broadly an entity interprets the term ‘taxation authorities’ – is it only referring to the Federal Government, or to both the State and Federal Government.
- 24 On the basis that the royalties paid do not meet the definition of income taxes in AASB 112 (as they are based on sales revenue, not taxable profit), and are paid to an entity that is separate from the MRRT taxation authority, the preferred view of staff is that such amounts would be included within operating cost for an entity. However, staff consider that the alternative view (view 2) that such payments are in the nature of prepayments of the proposed MRRT is also supportable applying the current requirements of Australian Accounting Standards and Interpretations given the reference to ‘taxation authorities’ in the AASB 112 definition of taxable profit.
- 25 Staff do not support the views expressed in view 3 of the letter, as outlined in paragraph 6(c) above. Staff do not support this view on the basis that the nature of the royalty deductions does not change on a project by project basis. The amounts are

deductible in the same manner across projects. Staff do not think that the fact that the net result for a particular project differs from another project is a persuasive argument for permitting different accounting treatments across projects. In addition, adopting this view would require an entity to ‘true up’ its expectations over the life of a project and potentially reclassify amounts previously recognised as income tax to be operating expenses and vice versa.

*Agenda criteria assessment*

26 The staff has assessed this issue against the Board’s criteria as follows:

The issue is widespread and has practical relevance.	Yes. The issue affects all entities in Australia subject to the proposed MRRT.
The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice).	Yes. Although staff have a strong preference for the accounting treatment described in view 1, staff believe that in the absence of further guidance, diversity in practice could arise.
Financial reporting would be improved through the elimination of or reduction in diverse reporting methods.	Yes. The accounting treatment in view 1 would provide a significantly different outcome to view 2. Therefore, eliminating or reducing the potentially diverse reporting methods would improve financial reporting.
The issue is a narrow implementation or application issue that can be resolved efficiently within the confines of existing IFRSs or Australian Accounting Standards.	Yes.
It is probable that the IFRS Interpretations Committee or AASB (as relevant) will be able to reach a consensus on a timely basis.	Yes, the staff believe that the IFRS IC could reach consensus on the issue on a timely basis (refer to paragraph 19 above).
If the issue relates to a current or planned IASB or AASB project, there is a pressing need to provide guidance on a more timely basis than would be expected from that project.	There is no current project, however, depending on the outcome of the IASB’s agenda consultation, the Income Taxes project may be reactivated. There is a pressing need to provide guidance on a more timely basis that would be expected from that project (refer to paragraph 19 above).

*Staff recommendation*

27 Based on the assessment of the agenda criteria, staff recommend to raise the issue of how to account for royalties paid that are permitted to be offset against other taxable

income to the IFRS Interpretations Committee for consideration.<sup>8</sup> Although staff do not support the accounting treatment in view 3, staff recommend all three views be included in the letter.

## Question 2

Does the Board agree with the staff recommendation to raise the issue of how to account for royalties paid that are permitted to be offset against other taxable income to the IFRS Interpretations Committee for consideration?

### Issue 3: Substantive enactment

28 In relation to substantive enactment, AASB 112 requires tax assets and liabilities to be measured based on tax rates and tax laws that have been enacted or substantively enacted by the reporting date. However, it does not specify conditions for substantive enactment. Guidance on determining substantive enactment is provided in AASB Interpretation 1039 *Substantive Enactment of Major Tax Bills in Australia*. AASB Interpretation 1039 requires the following:

- 5 **A tax Bill, to the extent that it is relevant to the entity, shall be taken into account in the recognition and measurement of deferred tax assets and liabilities when and only when the Bill has been enacted or substantively enacted prior to or on the end of the reporting period.**
- 6 **Substantive enactment of a tax Bill shall be taken to have occurred once the Bill has been tabled in Parliament and there is majority support for the passage of the Bill through both Houses of Parliament. However, where the commencement of the Bill is linked to the enactment of commencement of another Bill, the first Bill shall not be taken to be enacted or substantively enacted until the second Bill has been enacted or substantively enacted.**

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- 17 If a tax Bill becomes substantively enacted *prior to or on* the end of the reporting period, it is taken into account (where relevant) in measuring deferred tax balances as at the end of the reporting period. However, if a Bill were to become substantively enacted on *after* the end of the reporting period, it is not taken until account in measuring deferred tax balances as at that end of the reporting period...

29 Staff note that, for substantive enactment to have occurred:

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<sup>8</sup> A further option available to the AASB would be to refer the issue in the first instance to the National Standard Setters (NSS). However, staff think that, given the timing of the introduction of the MRRT in Australia, and the dates for the next IFRS Interpretations Committee meeting (17-18 January 2012), any issue would need to be raised directly with the Committee to help ensure a timely response.

- (a) the Bill does *not* need to have *passed* both Houses of Parliament.
- (b) the Bill does *not* need to have Royal ascent.

30 Staff are of the view that support for the passage of the Bill through both Houses of Parliament is a matter of judgement that will depend on the nature of the Federal Parliament at the time the assessment of substantive enactment is required (e.g. at a financial reporting year-end). Staff note the current political environment in Australia is that no party has the majority of seats in the Senate. Staff consider that the nature of the current Federal Parliament increases the need for entities to use judgement in assessing whether substantive enactment of a tax Bill has occurred at year-end.

*Agenda criteria assessment*

31 The staff has assessed this issue against the Board’s criteria as follows:

The issue is widespread and has practical relevance.	No. Although divergent views are emerging in practice in relation to the proposed MRRT, the staff are not aware of the issue being widespread to ‘tax Bills’ more generally. The staff notes that the interpretation of the term ‘majority support’ requires judgement and differences in the political environment at a point in time will influence how difficult this judgement is to make in practice.
The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice).	Yes. Two views appear to be emerging in practice – those who think that substantive enactment requires only the ‘ <i>unconditional intention</i> ’ by a majority of the parties, and those who think, in the current Australian political environment, substantive enactment cannot occur until a Bill has <i>passed</i> both Houses of Parliament.
Financial reporting would be improved through the elimination of or reduction in diverse reporting methods.	Yes. The accounting treatment if the MRRT was considered to be substantively enacted would provide a significantly different outcome to a view that it was not substantively enacted. Therefore, eliminating or reducing the potentially diverse reporting methods would improve financial reporting.
The issue is a narrow implementation or application issue that can be resolved efficiently within the confines of existing IFRSs or Australian Accounting Standards.	No. Consideration of the term ‘majority support’ in relation to substantive enactment would require consideration of an amendment to AASB Interpretation 1039 which deals with the enactment and substantive enactment of all major tax Bills in Australia.
It is probable that the IFRS Interpretations Committee or AASB (as relevant) will be able to reach a consensus on a timely basis.	No. The AASB would need to resolve the issue prior to 31 December 2011 for the consensus to be applicable in time for December 2011 reporting.

The issue is widespread and has practical relevance.	No. Although divergent views are emerging in practice in relation to the proposed MRRT, the staff are not aware of the issue being widespread to ‘tax Bills’ more generally. The staff notes that the interpretation of the term ‘majority support’ requires judgement and differences in the political environment at a point in time will influence how difficult this judgement is to make in practice.
If the issue relates to a current or planned IASB or AASB project, there is a pressing need to provide guidance on a more timely basis than would be expected from that project.	There is no current project relating to substantive enactment of major tax Bills.

*Staff recommendation*

- 32 Based on the assessment of the agenda criteria, staff do not recommend to add the issue of whether substantive enactment of the proposed MRRT has occurred at 31 December 2011 to the AASB work program.

**Question 3**

Does the Board agree with the:

- (a) staff recommendation not to add the issue of whether substantive enactment of the proposed MRRT has occurred at 31 December 2011 to the AASB work program?
- (b) Proposed Agenda Decision wording outlined in Appendix B to this paper.

## **Appendix A – Proposed Agenda Decision: Accounting for the MRRT market value uplift**

### Issue

The AASB considered the issue of how to apply the requirements of AASB 112 *Income Taxes* to the starting base allowance market value uplift in the proposed *Minerals Resource Rent Tax Bill 2011* and *Petroleum Resource Rent Tax Assessment Amendment Bill 2011* (the ‘resource rent tax Bills’).

### Reasons for Not Adding the Issue to the AASB’s Agenda

The AASB considered the issue of how to apply the requirements of AASB 112 *Income Taxes* to the starting base allowance market value uplift in the proposed resource rent tax Bills. The starting base allowance market value uplift is an option available to entities on transition to the proposed resource rent tax regime in Australia. The option permits entities to elect an initial tax value for assets based on the market value of each eligible operation.

In considering this issue, the Board noted that the application of AASB 112 requires an entity to reflect an increase in the deductions available (resulting in future tax payments being smaller than if no uplift were to occur) as a deductible temporary difference giving rise to a deferred tax asset to the extent it meets the recognition criteria in AASB 112.

The Board thinks that existing guidance in Australian Accounting Standards and Interpretations is sufficient to address the issue of how to apply the requirements of AASB 112 to the starting base allowance market value uplift in the proposed resource rent tax Bills, and 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.

## **Appendix B: Proposed Agenda Decision: Substantive enactment of resource rent tax Bills**

### Issue

The AASB considered the issue of when it would be appropriate to conclude that substantive enactment of the proposed *Minerals Resource Rent Tax Bill 2011* and *Petroleum Resource Rent Tax Assessment Amendment Bill 2011* (the ‘resource rent tax Bills’) has occurred.

### Reasons for Not Adding the Issue to the AASB’s Agenda

The AASB considered the issue of substantive enactment of the resource rent tax Bills, particularly if the legislation passes the House of Representatives, but not the Senate, prior to December 2011.

In considering this issue, the Board noted that AASB Interpretation 1039 *Substantive Enactment of Major Tax Bills in Australia* requires that substantive enactment of a tax Bill shall be taken to have occurred once the Bill has been tabled in Parliament and there is majority support for the passage of the Bill through both Houses of Parliament.

The Board observed that the assessment of whether there is majority support for the passage of a Bill through both Houses of Parliament requires the application of judgement. The Board noted that the nature of the current Federal Parliament, in which no party has the majority of seats in the Senate, may increase the need for entities to use judgement in assessing whether substantive enactment of a tax Bill has occurred at year-end.

The Board thinks that existing guidance in Australian Accounting Standards and Interpretations is sufficient to address the issue of whether substantive enactment has occurred at year-end, and 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.