



Australian Government
Australian Accounting
Standards Board

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Mr Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Wayne

Clarification of accounting for levies that are subject to a minimum activity threshold

We are writing to raise some concerns in relation to the accounting for levies that are subject to a minimum activity threshold. We note that minimum threshold issues were not addressed in the draft IFRIC that led to IFRIC 21 *Levies*, but were added in response to constituents' comments.

Although this issue has arisen in Australia primarily in relation to payroll taxes and the carbon tax, we believe the issue is relevant to how to account for levies that are subject to a minimum activity threshold more broadly. We think the issue may also be relevant to other jurisdictions internationally that have, or introduce, regimes with the same or similar characteristics. Please note that we are not raising concerns about whether such levies are within the scope of IFRIC 21.

In summary, our concerns arise from the lack of clarity in IFRIC 21 as to whether the obligating event for a levy that is subject to a minimum threshold can occur before that threshold is reached. These concerns arise from the interpretation of the phrase "the activity that triggers the payment of the levy" in paragraph 8 of the Interpretation. This issue has arisen in applying the principles of IFRIC 21 to circumstances in which a liability to pay a levy arises as a result of activity during a period (such as employee service or carbon emission), but is not payable until a minimum annual threshold is reached.

We are particularly concerned that IFRIC 21 might be interpreted by some as not allowing the recognition of a liability when relevant activity occurs, which might be many years before the strict liability to pay arises. An example of this may be the dumping of putrescible waste as landfill that will eventually emit carbon and result in an obligation of a landfill operator to pay carbon tax in, say, 50 years' time when the carbon is released into the atmosphere. In such circumstances the emission of the carbon is a certain event that will occur due to the entity's past action of dumping the waste. That is, the obligation is unavoidable.

In addition, we are concerned that the principle in IFRIC 21 appears to be inconsistent with a number of other analogous scenarios such as the recognition of liabilities that arise from contingent rent payments, unvested long service leave and pension entitlements. Further, the principle in IFRIC 21 appears to be inconsistent with the existing guidance in IAS 34 *Interim Financial Statements*, including, specifically, paragraph B1 addressing employer payroll taxes and paragraph B7 addressing contingent rents. Whilst we acknowledge that this issue was identified in the deliberations on the Interpretation, the

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issuance of the Interpretation did not amend IAS 34, consequently it is not clear which principle should be applied when considering levies such as payroll taxes.

Because of the above concerns, consistent with the Committee's process for considering issues, we have provided a more detailed explanation of the issue, possible alternative accounting treatments and reasons for the Committee to address the issue in the form of a more formal Committee potential agenda request in Appendix A to this letter.

If you require further information on the matters raised above or in Appendix A, please contact me or Nikole Gyles (ngyles@aasb.gov.au).

Yours sincerely

A handwritten signature in black ink that reads "K.M. Stevenson". The signature is written in a cursive style with a long, sweeping underline.

Kevin M. Stevenson

Chairman and CEO

Appendix A: Potential agenda item request

Issue

The issue we are requesting the Committee clarify is whether the obligating event for a levy that is subject to a minimum annual threshold can occur before that threshold is reached. This issue arises from the interpretation of the phrase “the activity that triggers the payment of the levy” in paragraph 8 of the Interpretation in circumstances in which a levy arises as a result of activity during a period (such as employee service or carbon emission), but is not payable until a minimum annual threshold is reached.

Two examples of circumstances in which this issue arises are described below. Note that we are not requesting the Committee consider whether such levies would be within the scope of IFRIC 21 *Levies*. For the purposes of this request the Committee is asked to assume that the principles in IFRIC 21 are being applied.

Payroll tax

Payroll tax is a State tax calculated on wages paid or payable by an employer to its employees and deemed employees and applies in all States and Territories of Australia. For example, in the State of Victoria, payroll tax is currently payable at a rate of 4.90 per cent. Payroll tax is payable when an employer’s wages exceed a certain annual amount. In Victoria, this amount is \$550,000.

Most employers are required to self-assess their liability on a monthly basis, and all perform an annual reconciliation at the end of each financial year (1 July to 30 June). Employers pay tax by the seventh day of the month following the month in which their wages exceed a pro-rata threshold level (currently in Victoria this amount is \$45,833 (i.e. \$550 000 ÷ 12)). If a business starts or stops employing within a financial year it does not get a full threshold entitlement. The business will be subject to a pro-rata of the threshold equal to the ratio of the number of days they employ to the number of days in the financial year.

The annual reconciliation reconciles actual amounts payable for the whole financial year against payments previously made (including the June return). Any over payments of payroll tax are refunded to the entity, and any shortfall of tax is payable by the entity at this time.

Fixed price phase of the Carbon Pricing Mechanism (CPM)

The fixed price phase of the CPM (the carbon levy) began on 1 July 2012 and is applicable until 30 June 2014. From 1 July 2012, entities with emissions exceeding 25,000 tonnes of carbon dioxide equivalent (CO₂-e) are required to pay a carbon tax. Specifically, an entity will be a “liable entity” and subject to the levy in circumstances when the emissions from the facility exceed:

- A threshold of 25,000 tonnes of Co₂-e in the financial year if the entity is liable for the whole financial year, or

- A pro-rata threshold, if the entity is liable for part of the financial year, which is calculated by multiplying 25,000 by the proportion of the year for which the entity is liable.

Where a person has operational control over a facility for part of the year, the threshold to determine whether they are a liable entity is applied on a pro-rata basis. A person might have operational control for part of a year where:

- there is a change in ownership of a facility during the year; or
- a facility permanently closes down part way through the year. (However, if a person has operational control over a facility that operates intermittently throughout the compliance year, this is not considered permanent stoppage of production.)

If a person has operational control over a facility for part of a year, the threshold is calculated using the following formula:

The facility passes the threshold test if the total amount of covered emissions from the operation of the facility had a carbon dioxide equivalence of not less than $25,000 \text{ tonnes} \times \text{Number of control days} / \text{number of days in the eligible financial year}$.

For example, if a person has operational control over a facility for one month (30 days) and the facility emits 2,055 tonnes of CO₂-e or more of covered emissions during this period, the person with operational control will be obligated to pay for this amount of emissions as this exceeds the pro-rata threshold of $30 \times 25000 / 365$ or 2054.79 tonnes.

In the case where a facility operates intermittently throughout the compliance year the annual threshold for the levy is 25,000 tonnes, as if the facility's intermittent emissions were made over the whole compliance year.

As noted above, the question we are seeking clarification from the Committee on is whether the obligating event for a levy that is subject to a minimum annual threshold can occur before that threshold is reached. Specifically, how "the activity that triggers the payment of the levy" should be interpreted in paragraph 8 of IFRIC 21 in assessing when a liability should be recognised.

Alternative accounting treatments

View 1: The activity that triggers the payment of the levy is passing the annual threshold

Those supporting view 1 are of the view that the activity that triggers the payment of the levy is passing the annual threshold. This view is formed on the basis that a levy that is only payable if a threshold is passed is not a liability until the annual threshold is passed. Passing the annual threshold is the "activity that triggers" as, until such time as that threshold is passed, the entity retains discretion to avoid the obligation (however remote). In both the payroll tax and CPM examples provided above, the existence of a "pro-rata" threshold is not relevant in determining whether a liability exists as, in order for a liability to arise, the entity would need to close down a facility / stop paying wages. This is considered to be a separate event that would need to occur prior to an entity incurring a liability. Those supporting this view particularly cite paragraph 12 of IFRIC 21 as well as the variation to Example 4 of IFRIC 21 as support for their view.

View 2: The activity that triggers the payment of the levy can occur prior to the annual threshold

View 2A: The activity that triggers the payment of the levy is passing the pro-rata threshold (i.e. prior to passing the annual threshold)

Those supporting view 2A are of the view that the activity that triggers the obligation is the provision of service by employees/emission of CO₂-e¹. Entities that assess that they have exceeded the pro-rata threshold and consider that it is probable that the annual threshold will be exceeded would begin accruing a liability once they exceed the pro-rata threshold. That is, a provision would, in particular circumstances, be recognised prior to reaching the annual threshold. Supporters of this view particularly refer to paragraph 11 and Example 1 of IFRIC 21 as support for their view.

View 2B: The activity that triggers the payment of the levy is provision of service by employees/carbon emission (i.e. prior to passing the annual threshold and irrespective of a pro rata threshold)

Those supporting view 2B are of the view that the “activity that triggers” is the provision of service by employees/carbon emission¹. The activity occurs over a period of time and consequently the liability to pay payroll tax / carbon tax would be recognised progressively. Entities that assess that it is probable they will exceed the annual threshold would begin accruing a liability as services are provided/emissions occur, irrespective of the existence of a pro rata threshold. That is, a provision would, in particular circumstances, be recognised prior to reaching the annual threshold. Supporters of this view refer to paragraph 11 of IFRIC 21 as well as the principles of IAS 34, including paragraph B1 addressing employer payroll taxes and paragraph B7 addressing contingent lease payments, as support for their view.

¹ Or even, in some cases, before emission, for example in the case of landfill operators. In some cases there may be significant separation between the activity occurring and the levy payment being required, for example dumping of putrescible waste as landfill that will eventually emit carbon in future years and result in an obligation of a landfill operator to pay carbon tax in future periods when the carbon is released into the atmosphere.

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Reasons for IFRS IC to address the issue

| Criteria | Assessment |
|--|--|
| The issue is widespread and has practical relevance. | Yes. The issue affects all entities in Australia (and potentially other jurisdictions) subject to levies with minimum thresholds. The issue is also likely to affect entities in other jurisdictions that have introduced similar regimes. |
| The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). | Yes. Based on queries raised by constituents in Australia the AASB is of the view that, in the absence of further guidance, diversity in practice could arise when IFRIC 21 becomes effective. |
| Financial reporting would be improved through the elimination of the diversity. | 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 and the <i>Framework for the Preparation and Presentation of Financial Statements</i> , but not so narrow that it is inefficient to apply the interpretation process. | Yes. The issue relates to an interpretation of a specific application of IFRIC 21. |
| If the issue relates to a current or planned IASB 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 relevant IASB project (on the active or research work plans). |