

**Australian Accounting
Standards Board**

Interpretation 1003
November 2007

Australian Petroleum Resource Rent Tax



Australian Government

**Australian Accounting
Standards Board**

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AASB Interpretation 1003 *Australian Petroleum Resource Rent Tax* is set out in paragraphs 1 – 14. Interpretations are listed in Australian Accounting Standard AASB 1048 *Interpretation and Application of Standards*. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

PREFACE

Main Features of AASB Interpretation 1003

Application Date

This Interpretation is applicable to annual reporting periods ending on or after 30 June 2008. Early adoption of this Interpretation is permitted for annual reporting periods beginning on or after 1 January 2005 that end before 30 June 2008.

Issue

This Interpretation specifies that Australian Petroleum Resource Rent Tax falls within the scope of Accounting Standard AASB 112 *Income Taxes*.

COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS

AASB Interpretation 1003 has no corresponding International Financial Reporting Interpretations Committee (IFRIC) Interpretation. Entities that comply with AASB Interpretation 1003 will simultaneously be in compliance with International Financial Reporting Standards, in particular IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and IAS 12 *Income Taxes*.

International Public Sector Accounting Standards (IPSASs) are issued by the International Public Sector Accounting Standards Board of the International Federation of Accountants. There is no specific IPSAS dealing with Australian Petroleum Resource Rent Tax.

AUSTRALIAN ACCOUNTING STANDARDS BOARD
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AUSTRALIAN PETROLEUM RESOURCE RENT
TAX

REFERENCES

Accounting Standard AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*

Accounting Standard AASB 112 *Income Taxes*

BACKGROUND

- 1 Australian Petroleum Resource Rent Tax (Australian PRRT) is imposed by the *Petroleum Resource Rent Tax Act 1987* at a rate of 40% on the 'taxable profit' of a petroleum project. The calculation of taxable profit is prescribed by the *Petroleum Resource Rent Tax Assessment Act 1987*. Australian PRRT applies to the recovery of all petroleum products from Australian waters other than the North West Shelf and the joint petroleum development area in the Timor Sea.
- 2 AASB 112 *Income Taxes* deals with accounting for income taxes. AASB 112 provides only limited guidance on what is considered to be an income tax, and divergent interpretations as to whether or not Australian PRRT is an income tax have emerged among Australian reporting entities. Unless AASB 112 specifically applies to Australian PRRT, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* requires that management shall use its judgement in developing and applying an accounting policy that results in information that is relevant to the economic decision-making needs of users and is reliable.
- 3 In 2005, an Australian constituent requested that the International Financial Reporting Interpretations Committee (IFRIC) clarify the scope of application of IAS 12 *Income Taxes* (AASB 112 is the corresponding Australian Accounting Standard), and identified Australian PRRT (among some other tax and royalty arrangements) as

one example of a tax that typically has not been considered to be an income tax.

- 4 In March 2006, the IFRIC decided not to take a project onto its agenda that would clarify which taxes are within the scope of IAS 12. In its published reasons for not addressing the request for interpretation, the IFRIC explained that its decision was based on “the variety of taxes that exist world-wide and the need for judgement in determining whether some taxes are income taxes” and that, aside from making some general observations about the scope of IAS 12, “guidance ... could not be developed in a reasonable period of time”.
- 5 The general observations made by the IFRIC on the scope of IAS 12 have not curtailed the diversity in practice that has emerged in accounting for Australian PRRT. Some of the different views include accounting for Australian PRRT as:
 - (a) a provision, and therefore recognised, measured and presented in accordance with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*;
 - (b) a cost of inventory under AASB 102 *Inventories*, which is allocated to inventory cost on a units-of-production basis by estimating the total tax expected to be paid over the life of the project;
 - (c) a liability that is recognised when an amount becomes payable, measured at the amount payable and presented as an operating expense;
 - (d) a liability that is recognised and measured in accordance with deferred tax principles (that is, AASB 112), but presented as an operating expense; and
 - (e) an income tax, and therefore recognised, measured and presented in accordance with AASB 112.
- 6 Concern has been expressed that, in the absence of authoritative guidance, these diverse accounting practices in accounting for Australian PRRT under Australian Accounting Standards will continue. This is considered to undermine the relevance and reliability of general purpose financial statements within Australia.

SCOPE

- 7 This Interpretation applies to Australian PRRT.

ISSUE

- 8 This Interpretation addresses only the question of whether Australian PRRT falls within the scope of AASB 112 *Income Taxes*.

CONSENSUS

- 9 Australian PRRT is an income tax within the scope of AASB 112.

APPLICATION

- 10 This Interpretation applies to:
- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the *Corporations Act 2001* and that is a reporting entity;
 - (b) general purpose financial statements of each other reporting entity; and
 - (c) financial statements that are, or are held out to be, general purpose financial statements.
- 11 This Interpretation applies to annual reporting periods ending on or after 30 June 2008.
- 12 This Interpretation may be applied to annual reporting periods beginning on or after 1 January 2005 that end before 30 June 2008. If an entity applies this Interpretation to such an annual reporting period, it shall disclose that fact.
- 13 The requirements specified in this Interpretation apply to the financial statements where information resulting from their application is material in accordance with AASB 1031 *Materiality*.

TRANSITION

- 14 Changes in accounting policy shall be accounted for in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*.

BASIS FOR CONCLUSIONS ON AASB INTERPRETATION 1003

This AASB Basis for Conclusions accompanies, but is not part of, AASB Interpretation 1003.

BC1 This Basis for Conclusions summarises the Board's considerations in reaching its consensus. Individual Board members gave greater weight to some factors than to others.

Determination of Australian PRRT taxable profit

BC2 Board members noted that Australian PRRT is assessed on a petroleum project basis, and is levied at a rate of 40% on the 'taxable profit' of a project. Taxable profit for Australian PRRT purposes is calculated as the excess of assessable receipts over the sum of:

- (a) eligible expenditures incurred (which include exploration and all project development, operating and decommissioning expenditures);
- (b) undeducted (that is, carried forward) expenditures that are compounded annually at an uplift rate comprising the Australian Government long-term bond rate plus 15% for exploration expenditure or plus 5% for project development and operating expenditure; and
- (c) undeducted exploration expenditures (compounded at the uplift rate) that are transferred from other projects the taxpayer is engaged in or, if the taxpayer is a company in a wholly-owned group, from other projects within the group.

BC3 Other features of the Australian PRRT regime include:

- (a) exploration expenditures in some designated frontier areas are eligible for a 150% uplift;
- (b) some expenditures are not deductible – these include financing costs, private override royalty payments, income tax, goods and services tax, cash bidding arrangements and some indirect administrative costs; and
- (c) Australian PRRT is paid in quarterly instalments, with a final payment (or refund) due following an assessment made by the Commissioner of Taxation on the basis of the Australian PRRT return, which is to be submitted in August each year. Australian

PRRT payments are deductible when determining taxable income under the *Income Tax Assessment Act 1997*.

Accounting for income taxes

- BC4 The objective of AASB 112 is to prescribe the accounting treatment for income taxes.
- BC5 Paragraph 2 of AASB 112 states that “For the purposes of this Standard, income taxes 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”.
- BC6 Paragraph 5 of AASB 112 defines a taxable profit as “taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable)”.
- BC7 Paragraph 10 of AASB 112 refers to the fundamental principle of AASB 112, that “... an entity shall, with certain limited exceptions, recognise a deferred tax liability (asset) whenever recovery or settlement of the carrying amount of an asset or liability would make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences”.

Application to Australian PRRT

- BC8 In relation to whether Australian PRRT is an income tax, the Board considered whether Australian PRRT is:
- (a) a tax based on taxable profit; and
 - (b) based on rules established by a taxation authority.
- BC9 Board members noted that the “upon which income taxes are payable (recoverable)” qualification in paragraph 5 of AASB 112 is circular and does not constrain the assessment of whether Australian PRRT is an income tax.

Taxable profit

- BC10 Board members noted that AASB 112 does not clearly define the boundaries of what is considered to be ‘taxable profit’ and therefore an ‘income tax’. Board members acknowledged that further, but non-authoritative, guidance has been provided by the International

Financial Reporting Interpretations Committee (IFRIC) on the scope of an income tax. This guidance was provided in the March 2006 edition of *IFRIC Update*, which advised that the IFRIC would not add a project to its agenda to provide guidance on the taxes that are within the scope of IAS 12 *Income Taxes* (AASB 112 is the corresponding Australian Accounting Standard).

BC11 Among other things, the reasoning that accompanied the IFRIC agenda decision included that:

- (a) “the term ‘taxable profit’ implies a notion of a net rather than gross amount”; and
- (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. 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”.

BC12 Board members noted that the calculation of Australian PRRT taxable profit (as described at paragraphs BC2 – BC3 above) is a measure of profit that is based on a net amount, whereby the Australian PRRT assessable receipts are reduced by deductible amounts before a taxing rate is levied on the net amount. Board members noted that, under the Australian PRRT regime, deductible amounts can be material in amount in calculating PRRT taxable profit and that material temporary differences can arise between the carrying amounts of assets and liabilities in the balance sheet and their corresponding Australian PRRT tax bases. These factors provide strong supporting evidence that Australian PRRT is a tax based on taxable profit.

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.

Taxation authority

BC16 Board members agreed that Australian PRRT is based on rules established by a taxation authority. They noted that the Parliament of Australia has imposed Australian PRRT through the enactment of the *Petroleum Resource Rent Tax Act 1987* and the *Petroleum Resource Rent Tax Assessment Act 1987*. Australian PRRT is administered by the Australian Taxation Office.

Scope of Interpretation

BC17 The scope of this Interpretation is restricted to the question of whether Australian PRRT is an income tax, given the existence of divergent treatment of Australian PRRT by Australian reporting entities. The Board has not considered whether other tax or royalty regimes that exist in Australia or internationally are income taxes. Instead, Board members noted that AASB 108 must be consulted when determining whether other taxes or royalties are income taxes.

Application of AASB 112

BC18 This Interpretation does not address the application of AASB 112 to the specific features of Australian PRRT. Board members noted that developing application guidance is inconsistent with the objectives of principle-based Standards and Interpretations. Board members contrasted this Interpretation with the provision of application guidance, on the basis that the Interpretation is only clarifying the scope of Australian Accounting Standards, and specifically only in relation to Australian PRRT. However, to avoid doubt regarding the

application of AASB 112, Board members emphasised that all the requirements of AASB 112 must be applied to Australian PRRT, including those requirements relating to the definition, recognition, measurement, presentation and disclosure of current and deferred tax relating to Australian PRRT.