

Urgent Issues Group

Interpretation 125

July 2004

**Income Taxes –
Changes in the Tax Status
of an Entity or its
Shareholders**



Australian Government

**Australian Accounting
Standards Board**

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The Customer Service Officer
Australian Accounting Standards Board
Level 3
530 Collins Street
Melbourne Victoria 3000
AUSTRALIA

Postal address:
PO Box 204 Collins St West
Melbourne Victoria 8007
AUSTRALIA

Phone: (03) 9617 7637
Fax: (03) 9617 7608
E-mail: publications@aaasb.com.au
Website: www.aasb.com.au

Other enquiries:

Phone: (03) 9617 7600
Fax: (03) 9617 7608
E-mail: standard@aaasb.com.au

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PREFACE

Reasons for Issuing UIG Interpretation 125

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's policy of adopting the Standards of the International Accounting Standards Board (IASB) for application to reporting periods beginning on or after 1 January 2005. The AASB has decided it will continue to issue sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. Except for Standards that are specific to the not-for-profit or public sectors or that are of a purely domestic nature, the AASB is using the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, to broaden the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues.

The same approach applies to UIG pronouncements. This Interpretation is part of the set of Australian equivalents to each International Accounting Standard (IAS), International Financial Reporting Standard (IFRS) and Interpretation of the IASB (collectively defined by the IASB as IFRSs). This set includes UIG Interpretations that correspond to the IASB Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

Main Features of this Interpretation

This Interpretation is applicable to annual reporting periods beginning on or after 1 January 2005. To promote comparability among the financial reports of Australian entities, early adoption of this Interpretation is not permitted.

Application of this Interpretation will begin in the first annual reporting period beginning on or after 1 January 2005 in the context of adopting all Australian equivalents to IFRSs. The requirements of Accounting Standard AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, the Australian equivalent of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, must be observed. AASB 1 requires prior period information, presented as comparative information, to be restated as if the requirements of this Interpretation had always applied. This differs from previous Australian requirements where changes in accounting policies did not require the restatement of the income statement and balance sheet of the preceding period.

The Interpretation clarifies the accounting for any current and deferred tax consequences of a change in the tax status of an entity or its shareholders,

when applying AASB 112 *Income Taxes*. The current and deferred tax consequences are recognised in profit or loss for the period, unless those consequences relate to transactions and events that result in a direct credit or charge to equity, in which case the tax consequences are recognised directly in equity.

Comparison with Superseded Requirements

There is no substantive difference with the requirements in Australia in Accounting Standards AASB 1020 and AAS 3 *Income Taxes* (1999). Now superseded by AASB 112, those Standards required any adjustments from an entity changing its tax status to be recognised in accordance with the general requirements of the Standards (which is consistent with this Interpretation). Current tax and deferred tax amounts were required to be recognised in profit or loss for the period unless they related to an amount that was recognised directly in equity.

COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS

UIG Interpretation 125 is equivalent to Standing Interpretations Committee Interpretation SIC-25 *Income Taxes – Changes in the Tax Status of an Entity or its Shareholders*, issued by the IASB. Paragraphs that have been added to this Interpretation (and do not appear in the text of the equivalent SIC Interpretation) are identified with the prefix “Aus”, followed by the number of the relevant SIC paragraph and decimal numbering.

Entities that comply with Interpretation 125 will simultaneously be in compliance with SIC-25.

International Public Sector Accounting Standards (IPSASs) are issued by the Public Sector Committee of the International Federation of Accountants. There is no specific IPSAS dealing with accounting for income taxes at present.

URGENT ISSUES GROUP

INTERPRETATION 125

INCOME TAXES – CHANGES IN THE TAX STATUS OF AN ENTITY OR ITS SHAREHOLDERS

ISSUE

1. A change in the tax status of an entity or of its shareholders may have consequences for an entity by increasing or decreasing its tax liabilities or assets. This may, for example, occur upon the public listing of an entity's equity instruments or upon the restructuring of an entity's equity. It may also occur upon a controlling shareholder's move to a foreign country. As a result of such an event, an entity may be taxed differently; it may for example gain or lose tax incentives or become subject to a different rate of tax in the future.
2. A change in the tax status of an entity or its shareholders may have an immediate effect on the entity's current tax liabilities or assets. The change may also increase or decrease the deferred tax liabilities and assets recognised by the entity, depending on the effect the change in tax status has on the tax consequences that will arise from recovering or settling the carrying amount of the entity's assets and liabilities.
3. The issue is how an entity should account for the tax consequences of a change in its tax status or that of its shareholders.

CONSENSUS

4. **A change in the tax status of an entity or its shareholders does not give rise to increases or decreases in amounts recognised directly in equity. The current and deferred tax consequences of a change in tax status shall be included in profit or loss for the period, unless those consequences relate to transactions and events that result, in the same or a different period, in a direct credit or charge to the recognised amount of equity. Those tax consequences that relate to changes in the recognised amount of equity, in the same or a different period (not included in profit or loss), shall be charged or credited directly to equity.**

Application

- Aus4.1** This Interpretation applies when Accounting Standard AASB 112 *Income Taxes* applies.
- Aus4.2** This Interpretation applies to annual reporting periods beginning on or after 1 January 2005.
- Aus4.3** This Interpretation shall not be applied to annual reporting periods beginning before 1 January 2005.
- Aus4.4** The requirements specified in this Interpretation apply to the financial report where information resulting from their application is material in accordance with AASB 1031 *Materiality*.

DISCUSSION

5. AASB 112.58 requires current and deferred tax to be included in the profit or loss for the period, except to the extent the tax arises from a transaction or event that is recognised directly in equity, in the same or a different period (or arises from a business combination). AASB 112.61 requires that current and deferred tax be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or a different period, directly to equity.
6. AASB 112.62 identifies examples of circumstances in which a transaction or event is recognised directly in equity as is permitted or required by another Australian Accounting Standard. All of these circumstances result in changes in the recognised amount of equity through recognition of a credit or charge directly to equity.
7. AASB 112.65 explains that where the tax base of a revalued asset changes, any tax consequence is recognised directly in equity only to the extent a related accounting revaluation was or is expected to be recognised directly in equity (revaluation reserve).
8. Because tax consequences recognised directly in equity must relate to a transaction or event recognised directly in equity in the same or a different period, the cumulative amount of tax charged or credited directly to equity can be expected to be the same amount that would have been charged or credited directly to equity if the new tax status had applied previously. AASB 112.63(b) acknowledges that determining the tax consequences of a change in the tax rate or other tax rules that affects a deferred tax asset or liability and relates to an item previously charged or credited to equity may prove to be difficult.

Because of this, AASB 112.63 suggests that an allocation may be necessary.

Date of SIC's Consensus: [Deleted by the UIG]

Effective Date of SIC-25: [Deleted by the UIG]

REFERENCES

Australia

The Urgent Issues Group discussed Issues Paper UIG/SIC 04/1 "Adoption of Various SIC Interpretations in Australia" in relation to this Interpretation at its meeting on 4 May 2004.

Accounting Standard AASB 112 *Income Taxes*

International Accounting Standards Board

International Accounting Standard IAS 12 *Income Taxes*

Standing Interpretations Committee Interpretation SIC-25 *Income Taxes – Changes in the Tax Status of an Entity or its Shareholders*