



Australian Government

The Board of Taxation

EXPLORING THE POTENTIAL TO ALIGN ACCOUNTING AND TAX SYSTEMS IN AUSTRALIA

the **board** of taxation
www.taxboard.gov.au

Preliminary report by the Board of Taxation

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the **board** of taxation

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EXECUTIVE SUMMARY

The Board of Taxation (the Board) has considered whether there are opportunities for greater alignment between the tax and accounting systems in Australia. The Board concluded that broad-spectrum alignment between the accounting and tax system within Australia's current taxation framework would be neither feasible nor desirable, given the disparate purposes of the tax and accounting systems.

The tax laws provide a legal basis for raising revenue to fund Government expenditure as well as, in some cases, serving as a policy implementation tool, by intentionally creating economic incentives and disincentives to certain types of behaviour.

Accounting standards exist to guide the reporting of financial information to organisation stakeholders and support a range of decision making (e.g. in relation to investment, lending, trading transactions).

However, the Board acknowledged that there may be particular areas of the tax law where greater alignment with accounting practices can create net benefits by reducing compliance costs and improving certainty, without prejudicing tax policy objectives.

The Board considers that it is appropriate to consider such areas on a case-by-case basis to identify situations where greater alignment could be warranted and could be achieved in a simple and targeted fashion. The Board's work in this area is ongoing.

The ex officio members of the Board — the Secretary of the Treasury, John Fraser, the Commissioner of Taxation, Chris Jordan AO, and the First Parliamentary Counsel, Peter Quiggin PSM — have reserved their final views on the observations and recommendations for advice to Government.

SCOPE

In 2016 the Board commenced a self-initiated review to develop potential solutions for greater alignment of tax and accounting treatments to reduce the compliance and administrative burden of complying with two different systems for taxpayers that produce financial statements. This involved identifying specific opportunities for greater alignment between tax and accounting treatments by considering interactions between the two systems.

To investigate these matters, the Board formed a Working Group, which was chaired by Board Member Craig Yaxley and supported by Board Member Ann-Maree Wolff. The Board also received high level input from AASB staff, the ATO and the Treasury.

In order to determine priorities, the Working Group consulted with the ATO's Tax and Accounting Safe Harbour Working.

This report outlines the research undertaken to support the overarching conclusion reached by the Working Group. This report also outlines the Board's view in more depth, looks at the trends and experiences of international jurisdictions as well as lists advantages and disadvantages of alignment identified during the course of this project.

GLOSSARY

The following abbreviations and acronyms are used throughout this report.

Abbreviation	Definition
AASB	Australian Accounting Standards Board
ATO	Australian Taxation Office
GAAP	Generally Accepted Accounting Principles
IFRS	International Financial Reporting Standards
TOFA	Taxation of Financial Arrangements

CHAPTER 1: MERITS OF ALIGNMENT BETWEEN ACCOUNTING AND TAX SYSTEMS

KEY POINTS

- The Board of Taxation considers that broad spectrum alignment between accounting and tax systems is neither possible nor desirable, due to competing objectives of the tax and accounting systems.
- However, the Board acknowledges that there may be particular areas of the tax law where greater alignment with accounting practices can create net benefits by reducing compliance costs and improving certainty, without prejudicing tax policy objectives.
- Accordingly, Board considers that it is appropriate to consider areas for greater alignment between tax and accounting on a case-by-case basis to identify situations where greater alignment could be warranted and could be achieved in a simple and targeted fashion.

- 1.1 In Australia, accounting standards and tax laws have different objectives. Tax laws provide a legal basis for raising revenue and seek to drive the Government's policy objectives, whilst accounting standards exist to guide the comparable provision of financial information to existing and potential shareholders, lenders and other creditors on the past performance of the company, and support decision making in relation to investment and future corporate strategies.
- 1.2 Australia's current corporate tax system is not based on alignment between accounting and tax. To the contrary, each system is based on specific and differing objectives (as noted above). Alignment in Australia has occurred on a case by case basis, after weighing up the merits of alignment as against other policy considerations. Refer to Chapter 2 for further details of the Australian experience to date.
- 1.3 The Board of Taxation is of the view that broad spectrum alignment between the accounting and tax system would be neither possible nor desirable. This is because broad spectrum alignment would:
 - Severely restrict the capacity of policy makers to drive objectives other than alignment / simplicity;
 - Compromise the integrity of both the tax and accounting systems by trying to achieve competing objectives through a single system; and

- Require a significant departure from the current basis of Australia's corporate tax system.

1.4 However, there are some compliance cost savings available from increased alignment for companies that already prepare audited financial accounts. These compliance cost savings will largely accrue to companies that prepare accounts in accordance with IFRS, which includes companies based in Australia and a range of other countries, with the notable exception of the United States (which mandates the use of US GAAP). The compliance costs involved are typically one-off, up-front costs and most companies would also bear a compliance cost of transition from any changes to the current system.

1.5 There may also be scope to link to accounting systems to improve administration of taxation (for example in relation to lodgements, calculation of PAYG instalments and transfer of information to the ATO), especially in the small business sector.

1.6 As such, the Board considers that, in relation to **future tax policy and law design initiatives**:

- Specific opportunities for alignment should be considered when designing new business tax policy options. Accounting treatment should be routinely considered as a potential option to deliver the intended tax policy outcomes. Any deviations should be justified on policy grounds.
- There should be increased communication and co-ordination between the relevant agencies (Treasury, ATO and AASB) early in tax policy development and tax law design processes which involve both tax laws and accounting standards. (An ongoing dialogue will also facilitate the ongoing monitoring process referred to below). A concerted focus on knowledge sharing and capacity building in each agency is encouraged.
- Where there is interplay between accounting and tax, the law design process should start with the presumption that reliance on the accounting standards should be "pure" i.e. not modified by the tax law. This is because linking tax outcomes to accounting standards which are themselves modified by the tax provisions is likely to create complexity and uncertainty and should be avoided where possible.

1.7 In relation to **current tax laws**, the Board considers that:

- Specific opportunities for greater alignment in the current law should be considered and implemented on a case-by-case basis to reduce compliance costs or to improve certainty in the context of tax policy objectives. Where such changes are implemented, mitigation strategies should be put in place to manage adverse impacts. This could include, carve outs for companies that do not prepare audited financial statements and/or transition periods.
- Existing provisions within the tax act which rely on accounting standards but where that reliance creates complexity or uncertainty (potentially as a result of a

modified application of accounting standards for tax purposes) and current outcomes are inconsistent with the underlying policy intent of the tax laws should be reviewed.

- 1.8 The Board is of the view that, given the potential for compliance cost savings for small business, the scope to link to accounting and tax systems to improve administration of taxation should be carefully considered in relation to the small business sector.
- 1.9 In addition, the Board considers that there should be an ongoing process to monitor the interplay between tax laws and the accounting standards. This may include where changes in accounting standards or differences of interpretation of such standards have created tax treatment anomalies or opportunities. Australia's approach to alignment should be routinely re-evaluated based on significant changes in accounting standards or significant developments internationally to ensure that Australia's approach remains current and appropriately tailored to suit the needs of all users.

CHAPTER 2: AUSTRALIAN AND INTERNATIONAL EXPERIENCES OF ALIGNMENT

KEY POINTS

- Australia has sought to align tax and accounting in discrete areas including in relation to thin capitalisation, TOFA and tax consolidation.
- The adoption of IFRS globally has seen some jurisdictions which historically had strong links between tax and account systems (for example, the United Kingdom and European Countries) move away from this position.
- Jurisdictions such as the United States and New Zealand have historically not had strong links between tax and account, and have sought to make linkages between the two systems where possible and where the benefits outweigh the costs.

Accounting standards – international trends

- 2.1 Historically, most jurisdictions have developed their own accounting systems and standards, intended to drive specific policy objectives.
- 2.2 Harmonisation of accounting standards first took place in the European Union then grew in demand across the world through the 1980's and 1990's in response to the removal of barriers to the free flow of capital and increased cross-border trade.
- 2.3 The current system of international accounting standards (IFRS) represents a principles based approach rather than a rules-based approach (which prevailed in some jurisdictions beforehand). The application of these standards may require significant judgment in certain circumstances. There are a number of IFRS standards where the use of 'fair value' is required or available as an option. IFRS has been reasonably widely adopted.
- 2.4 The European Union countries adopted IFRS in 2005. In the years since, more than 100 jurisdictions primarily through Europe, the United Kingdom, South America and Asia and have elected to apply IFRS.¹ Consequently, the benefits noted above have been enhanced as more jurisdictions have adopted IFRS.

¹ For further information, see: <http://www.ifrs.org/Use-around-the-world/Pages/Jurisdiction-profiles.aspx> -- accessed in December 2014.

- 2.5 Australia adopted IFRS in 2005. At the time, the main benefits of IFRS adoption were noted as follows²:
- removing barriers to international capital flows by reducing differences in financial reporting requirements for participants in international capital markets and by increasing the understanding by foreign investors of Australian financial reports;
 - reducing financial reporting costs for Australian multinational companies and foreign companies operating in Australia and reporting elsewhere;
 - facilitating more meaningful comparisons of the financial performance and financial position of Australian and foreign public sector reporting entities; and
 - improving the quality of financial reporting in Australia to best international practice.³⁴
- 2.6 However, the United States has not adopted IFRS and prescribes the use of US GAAP (Generally Accepted Accounting Principles). However, there has been harmonisation of many US standards with IFRS.

Accounting standards – the Australian approach

- 2.7 As a consequence of adopting IFRS, Australia applies standards issued by the International Accounting Standards Board with modifications if necessary to fit the Australian context. In practice, IFRS are rarely modified for for-profit entities and are effectively applied in Australia.
- 2.8 The lead time for the development of an accounting standard is typically approximately five years, which includes a consultation period. Furthermore, accounting standards have prospective application and usually allow for a further lead time of at least one year and often two or more where particularly complex.

The Australian experience to date

- 2.9 The Review of Business Taxation (i.e. Ralph Review), sought to ‘align more closely taxation law with accounting principles wherever possible’.
- 2.10 While wholesale changes to more closely align tax and accounting e.g. the ‘tax value method’ have not been successful in Australia, a number of developments in the corporate tax space throughout the 1990’s and 2000’s have sought to align accounting

² As directed by the Financial Reporting Council in its 2002 directive to the AASB, see Financial Reporting Council Bulletin 2002/4 – 3 July 2002 Adoption of International Accounting Standards by 2005.

³ Accounting Standards, Building international opportunities for Australian business – Corporate Law Economic Reform Program, Proposals for Reform: Paper No. 1 - <http://archive.treasury.gov.au/contentitem.asp?ContentID=281>

⁴ Corporate disclosure, Strengthening the financial reporting framework - <http://archive.treasury.gov.au/documents/403/PDF/Clerp9.pdf>

and tax treatments, or leveraged off accounting standards where appropriate, for example:

- Thin capitalisation rules, especially in relation to the measurement of assets and liabilities⁵;
- The TOFA rules, especially in relation to the measurement of gains and losses⁶; and
- Income tax consolidation, especially in relation to the measurement of assets and liabilities.

The international experience⁷

Overview

- 2.11 Historically, most jurisdictions have set their own accounting standards as well as tax policy.
- 2.12 This paradigm has shifted substantially since the introduction and adoption of International Financial Reporting Standards.
- 2.13 Broadly, the link between tax and accounting in the United Kingdom and European countries has historically been strong (by design) but has been deliberately loosened since the adoption of IFRS to allow greater flexibility for domestic policy makers in relation to taxation policy.
- 2.14 Some European countries such as Germany have chosen to maintain strong links between domestic accounting standards and tax laws, but have chosen not to adopt IFRS.
- 2.15 In contrast, jurisdictions such as the United States and New Zealand have historically had weaker links between accounting and tax, but have sought to make linkages between the two systems where possible and where the benefits outweigh the costs.
- 2.16 The Australian system to date is most in line with the approach taken in the United States and New Zealand.

⁵ The Government announced in the 2018-19 Federal Budget that taxpayers will no longer be able to revalue certain assets for thin capitalisation purposes where not permitted for accounting purposes.

⁶ The Government announced further changes to the TOFA regime in the 2015-16 Budget to introduce a stronger link between tax and accounting.

⁷ Most information in this section has been drawn from *An accounting and taxation conundrum: A Pan-European perspective on tax accounting implications of IFRS adoption* published by The World Bank's Centre for Financial Reporting Reform in September 2007: http://siteresources.worldbank.org/EXTCENFINREPREF/Resources/Taxation_Conundrum.pdf

United Kingdom

- 2.17 In the 1980's, the UK's corporate tax system was reformed to make the financial accounting system the basis for a significant percentage of the elements of the taxable profit computation. Notable exceptions include long-term investments in land or shares.
- 2.18 These reforms followed a period of substantial growth in the financial sector in London in the 1980's spurred on by the abolition of currency exchange controls and supply side reforms.
- 2.19 However, the recent drive for harmonisation of financial accounting standards in the European Union and the consequent implementation of IFRS in the UK has led to a rethink about whether the coupling of tax and accounting systems is appropriate.
- 2.20 Presently, the starting point for business tax options in the UK remains the accounting treatment. The choice to adopt or modify the accounting treatment depends on whether this treatment is likely to achieve the intended tax policy outcomes⁸.
- 2.21 Since 2003, significant changes have been made to the UK tax legislation to modify the link between financial and tax accounting in the areas most affected by the adoption of IFRS, particularly in the field of financial instruments⁹.
- 2.22 The *Finance Bill* passed in 2004 permitted the use of IFRS accounts when filing tax returns, made a number of changes to the UK tax law to accommodate IFRS and enabled the government to make further detailed changes by issuing statutory instruments (which are legally binding but are faster to implement than changes to legislation)¹⁰.
- 2.23 Examples of changes made to the UK tax laws to take account of IFRS include:
- Specific tax rules to recognise a wider range of hedges for tax purposes than permitted by IFRS for financial accounting so that companies are in the same position for tax purposes under IFRS as they were under UK GAAP¹¹;
 - In relation to the taxation of securitisation Special Purpose Vehicles, the financial accounting principles that were being used as a measure of taxable profit have been set aside and a new taxation system has been introduced¹²; and
 - The HMRC has recently outlined a number of proposed tax law amendments in response to the introduction of IFRS16 (the new lease accounting standard)¹³.

⁸ The Relationship Between Accounting and Taxation, p13, Simon James, University of Exeter - <https://business-school.exeter.ac.uk/documents/papers/management/2002/0209.pdf>

⁹ See guidance published by HMRC on the tax implications of adopting IFRS:

<https://www.gov.uk/government/publications/accounting-standards-the-uk-tax-implications-of-new-uk-gaap>

¹⁰ See the UK's *Finance Act 2004* at <http://www.legislation.gov.uk/ukpga/2004/12/contents> and also commentary in *Corporate Finance* <https://www.treasurers.org/ACTmedia/sep04TT28-30Amin.pdf>

¹¹ See commentary at http://www.grant-thornton.co.uk/Global/Publication_pdf/FRS102-briefing-paper.pdf

¹² See commentary at <http://www.lexology.com/library/detail.aspx?g=c82ccd6a-3caa-401f-babe-7a7b9078e102>

- 2.24 As IFRSs are unprecedentedly complex, the tax legislation that has been introduced in order to adjust IFRS annual accounts is now also highly complex. In light of this, the merits of closely aligning tax and accounting have been re-evaluated.
- 2.25 Currently, significant parts of the UK corporate tax system are still closely linked to accounting, however the strength of this relationship and the perceived merits of alignment have reduced in the past two decades.

The Netherlands

- 2.26 There is a complete independence between the accounting and tax systems in the Netherlands – by design. The Netherlands authorities do not have a practise of seeking to align tax and accounting treatments.
- 2.27 However, as in Australia, in practice the calculation of taxable income comprises accounting profit with adjustments.
- 2.28 Companies can prepare their accounts in conformity with endorsed IFRSs, Dutch GAAP, or, if so justified by the international structure of the group the company belongs to, in conformity with the GAAP of another EU Member State.
- 2.29 The Dutch Accounting Standards Board now focuses on setting financial reporting standards for non-listed entities.¹⁴ Listed entities are required to conform with IFRS following the adoption of IFRS by the European Union.

France

- 2.30 In France, taxable profit is based on the annual accounts of the relevant company, subject to specific adjustments. In effect, this means that except where a specific tax provision applies, a company is required to prepare its tax return using the same recognition and measurement principles as the ones it uses in its annual accounts i.e. financial accounting recognition and measurement principles. In practice, tax laws also impact on accounting rules e.g. companies tend to record accelerated depreciation (allowable for tax purposes) in their accounts as well.
- 2.31 French national accounting standards are based on legal form and historical cost (as opposed to IFRS).
- 2.32 Historically, France has kept the number of required adjustments to a minimum in order to minimize the administrative burden on companies.

¹³ See <https://www.gov.uk/government/publications/income-tax-and-corporation-tax-response-to-accounting-changes-for-leasing/income-tax-and-corporation-tax-response-to-accounting-changes-for-leasing>

¹⁴ IFRSs and NL GAAP Highlighting the key differences, Deloitte, November 2014 - <http://www.iasplus.com/en/publications/netherlands/ifrs-vs-nl-gaap>

- 2.33 In recent years, French accounting standards started converging with IFRSs to meet the needs of the different users of financial information. That is, some French domestic accounting standards now incorporate IFRS concepts.
- 2.34 The French national authorities have commenced a process (which includes consultation) to manage these changes and related impacts on tax laws.

Germany

- 2.35 Germany has a long, established history and a direct statutory relationship between financial reporting (based on German national accounting standards) and the tax system.
- 2.36 The calculation of taxable profit in Germany is based on the calculation of accounting profit. Some deviations apply, but there is generally a high degree of conformity.
- 2.37 This principle is sometimes applied in reverse in that a company will use a specific financial accounting treatment in its annual accounts in order to achieve a particular tax treatment in its tax return.
- 2.38 The intent of this high degree of conformity is simplicity i.e. to allow companies to prepare one set of accounts for both accounting and tax purposes.
- 2.39 Germany requires the preparation of financial accounts in accordance with German national accounting standards. In some circumstances, companies may *also* prepare separate accounts in accordance with IFRS¹⁵.
- 2.40 Germany has chosen not to mandatorily adopt IFRS for all companies on the basis that IFRS would represent a significant paradigm shift away from the principal idea of the protection of creditors, which lies at the heart of German national accounting standards¹⁶¹⁷.

United States

- 2.41 Despite ongoing debates on the merits of alignment between accounting and tax in the United States, there has been no effort to align these systems. This is despite both the tax and accounting systems being largely set by United States authorities as the United States has not adopted IFRS accounting.
- 2.42 Since the Global Financial Crisis a related public and academic debate has focussed on the potential integrity benefits of aligning “book” and “tax” profits more closely, or at

¹⁵ IFRS versus German GAAP (revised) Summary of similarities and differences, PwC, https://www.pwc.com/gx/en/ifrs-reporting/pdf/ifrs-vs-german-gaap-similarities-and-differences_final2.pdf

¹⁶ *An accounting and taxation conundrum: A Pan-European perspective on tax accounting implications of IFRS adoption* published by The World Bank's Centre for Financial Reporting Reform in September 2007: http://siteresources.worldbank.org/EXTCENFINREPREF/Resources/Taxation_Conundrum.pdf

¹⁷ See also <https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/germany/>

least requiring the public disclosure of a reconciliation of accounting profit to taxable income¹⁸.

- 2.43 The academic research on the impact on integrity of the tax and accounting systems of increasing alignment is inconclusive¹⁹²⁰²¹²², and the United States authorities have not made any public statements or efforts to increase alignment between accounting and tax, especially for simplification purposes.

New Zealand

- 2.44 Historically there has been a low level of alignment between tax and accounting in New Zealand. New Zealand adopted IFRS from 2007 onwards.
- 2.45 Alignment has not been a specific goal or focus for the legislature. For example, alignment was not closely considered or consulted on as part of the recent tax reform process embarked on in New Zealand through the “Tax Working Group”²³.
- 2.46 New Zealand has at times considered specific opportunities for alignment when it came to the adoption of IFRS. The New Zealand revenue authority (“New Zealand Inland Revenue”) has in recent years leveraged accounting standards to reduce the compliance burden and costs of compliance.
- 2.47 One example of this has been the recent introduction of a new way for businesses to calculate and pay provisional tax (i.e. PAYG instalments) using the Accounting Income Method (AIM). From 1 April 2018, small businesses with annual turnover of less than \$5 million are able to use their accounting software to calculate their provisional tax payments throughout the year.²⁴
- 2.48 In effect, the AIM seeks to leverage natural business systems that record accounting data to also record and implement routine tax adjustments throughout the year so that provisional tax payments are based on a more accurate, up to date details of a company’s taxable income.
- 2.49 This method is available in addition to other pre-existing methods and is intended to ameliorate the impact of applying a uniform rule to businesses with seasonal income as

¹⁸ Aligning Taxable Profits and Accounting Profits: Accounting standards, legislators and judges” Judith Freedman [2004] eJlTaxR 4; (2004) 2(1) eJournal of Tax Research 71 <http://www.austlii.edu.au/au/journals/eJlTaxR/2004/4.html>

¹⁹ Does Book-Tax Conformity Deter Opportunistic Book and Tax Reporting? An International Analysis - <https://www.uts.edu.au/sites/default/files/ACCconf14TTang.pdf>

²⁰ The Association between Book-tax Conformity and Earnings Management - <https://wpcarey.asu.edu/sites/default/files/uploads/accounting-degrees/Fabio-Gaertner.pdf>

²¹ Book-Tax Conformity and the Information Content of Earnings - <http://www8.gsb.columbia.edu/rfiles/accounting/HANLON.pdf>

²² Book-Tax Conformity: Implications for Multinational Firms -

https://tippie.uiowa.edu/accounting/mcgladrey/winterpapers/hanlon_maydew.pdf

²³ See “A Tax System for New Zealand’s Future - Report of the Victoria University of Wellington Tax Working Group”

<http://www.victoria.ac.nz/sacl/centres-and-institutes/cagtr/pdf/tax-report-website.pdf>

²⁴ AIM - new provisional tax option for small businesses = <http://www.ird.govt.nz/news-updates/accounting-income-method-prov-tax.html>

it allows such businesses to pay tax as income is earned rather than in equal instalments spread across the year.²⁵

²⁵ Making Tax Simpler – Better Business Tax – An Official’s Issues Paper - <http://taxpolicy.ird.govt.nz/sites/default/files/2016-ip-mts-better-business-tax.pdf>

APPENDIX A: ADVANTAGES AND DISADVANTAGES OF ALIGNMENT BETWEEN THE ACCOUNTING AND TAX SYSTEMS

Advantages

- Reduction in compliance cost for companies who currently need to comply with a tax and an accounting system (i.e. IFRS).
- Compliance benefits of leveraging off the typically rigorous financial auditing process.
- May lead to a convergence of definitions and thresholds from an international perspective as accounting standards are based on international frameworks. This may reduce compliance costs for cross-border transactions as well as bolster the integrity of the international taxation system.

Disadvantages

- Alignment needs to be evaluated from the perspective of *status quo*. In Australia, alignment is likely to require tax law change which is likely to have ramifications for other purposes. For example, greater alignment will result in different tax outcomes for taxpayers and will affect revenue collections, creating winners and losers.
- A commitment to alignment with accounting may restrict capacity of policy makers to drive competing objectives via the tax system.
- Greater alignment may compromise the integrity of both the accounting and tax systems, as the core purpose of these systems differs greatly.
- As only some companies are required to comply with accounting standards, greater alignment could create a two-tiered taxation system, or alternately create obligations on a wider range of companies to comply with accounting standards. For example, small businesses are not required to comply with accounting standards.
- United States-based companies which are required to comply with US GAAP rather than IFRS will likely not see any significant compliance cost reductions as a consequence of increased alignment. Notably, the majority of countries from which foreign investment flows into Australia or in which Australian companies invest require accounts to be prepared in accordance with IFRS.

- Materiality thresholds used in accounting may not be appropriate in the taxation system, and may create integrity risks.
- One-off compliance and training costs of transition to a new system for taxpayers and the revenue authority.
- Enforceability is problematic when a revenue authority is effectively enforcing compliance with accounting standards.
- Financial accounting standards continue to evolve to meet the needs of users of financial information. As such, increased alignment may lead to unwanted changes in tax policy. May result in uncertainty over future tax outcomes.
- No clear evidence as to whether alignment incentivises the over-statement of income (as may be preferable in an accounting context) or understatement of income (as may be preferable in a tax context). The literature suggests that the actual impact of alignment on incentives to under or overstate income, earnings management and tax avoidance is difficult to identify as the actions of specific companies tend to depend on their specific circumstances.²⁶²⁷²⁸²⁹
- IFRS accounting rules are generally principles-based and not intended to be prescriptive in nature. In contrast, tax laws have historically been subject to a very high degree of interpretative pressure. Greater alignment will place a similar degree of interpretative pressure on accounting standards. In addition, questions of interpretation and opportunities for arbitrage could shift from tax law to accounting standards.
- Tax systems of comparable jurisdictions are moving away from or re-evaluating the merits of accounting / tax alignment since the adoption of IFRS.
- May be difficult to achieve consensus for changes to tax law primarily to increase alignment as taxpayers are likely to only be supportive of changes where the outcome is either not detrimental (i.e. no additional tax payable) or the marginal cost of compliance is higher than the marginal cost of the detriment. In general, larger taxpayers are less likely to be attracted to alignment unless the proposed change delivers a more favourable tax outcome.

²⁶ Does Book-Tax Conformity Deter Opportunistic Book and Tax Reporting? An International Analysis - <https://www.uts.edu.au/sites/default/files/ACCconf14TTang.pdf>

²⁷ The Association between Book-tax Conformity and Earnings Management - <https://wpcarey.asu.edu/sites/default/files/uploads/accounting-degrees/Fabio-Gaertner.pdf>

²⁸ Book-Tax Conformity and the Information Content of Earnings - <http://www8.gsb.columbia.edu/rfiles/accounting/HANLON.pdf>

²⁹ Book-Tax Conformity: Implications for Multinational Firms - https://tippie.uiowa.edu/accounting/mcgladrey/winterpapers/hanlon_maydew.pdf

APPENDIX B: RECENT CHANGES TO AUSTRALIAN ACCOUNTING STANDARDS

There are four key accounting standards that have recently come into effect, or are coming into effect in Australia in the next few years, that may have tax implications. These are:

- AASB 9 – Financial Instruments;
- AASB 15 – Revenue from Contracts with Customers;
- AASB 16 – Leases; and
- AASB 17 – Insurance Contracts.

The option for early adoption is available for each standard and guidance material is available from the major accounting firms.

However, in practice, most companies tend to begin applying new accounting standards once compliance is mandatory.

Initial consultation has indicated that tax policy impacts are not considered when accounting standards are developed. The tax implications for preparers are noted where there might be significant impacts on the financial statements.

However, the AASB has been engaging with Treasury and the ATO to update, inform and assist with managing the impact of new accounting standards on the taxation system.

The current system depends on a broad understanding and appreciating of the links between tax and accounting within the ATO, Treasury and AASB. The ATO and Treasury have been building accounting capability within their respective organisations to deepen this understanding.

However, to date no changes have been implemented to ATO systems (e.g. practice statements) or Treasury systems (e.g. reporting requirements through the Regulation Impact Statement process) to ensure that consideration of accounting is systematic and routine.

The Board of Taxation may consider the impacts of these new standards on a case-by-case basis in the future.

Below is a summary table of recent and upcoming changes to accounting standards in Australia.

Standard	Overview	Accounting changes with possible tax impacts	Effective Date
AASB 9 Financial Instruments (December 2014) ³⁰	<p>This standard incorporates the international financial reporting standard IFRS 9 Financial Instruments issued in July 2014, which made changes in relation to:</p> <ul style="list-style-type: none"> • reporting impairment of financial assets; and • classification and measurement of financial assets and financial liabilities, including the introduction of a measurement category of ‘fair value through other comprehensive income’ for debt instruments; and • hedge accounting. <p>The new standard addresses concerns by users of financial statements that the existing standard for recognition of financial losses on loans did not sufficiently incorporate information on expected losses.</p>	<p>The industry expected to be most impacted by the provisioning change are banks and similar financial institutions that prepare general purpose financial statements and must comply with the financial instruments standard. To implement the new approach to financial reporting, Australian banks, plus their auditors, will face both initial and, to a lesser extent, ongoing compliance costs.</p> <p>There may also be costs arising from flow on effects of changes to reported profits and total net assets, such as through making adjustments to existing contractual arrangements and complying with the requirements of prudential and tax regulations.</p> <p>As noted, the new standard also makes significant changes in relation to hedge accounting. This is likely to impact taxpayers that have adopted, or wish to adopt, the TOFA hedge election.</p>	1 January 2018

³⁰ See AASB Regulation Impact Statement – AASB 9 – Financial Instruments - <http://ris.dpmc.gov.au/2015/01/23/revised-accounting-standard-for-financial-instruments-regulation-impact-statement-australian-accounting-standards-board/>

Standard	Overview	Accounting changes with possible tax impacts	Effective Date
AASB 15 Revenue from Contracts with Customers³¹	<p>This Standard addresses the financial reporting of revenue and cash flows arising from an entity's contracts with customers.</p> <p>This includes specifying the accounting for construction contracts and bundled transactions - for example, phone contracts where line service and a phone is provided).</p>	<p>This Standard establishes principles, and includes disclosure requirements, for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.</p> <p>Entities will initially recognise as an asset the incremental costs of obtaining a contract with a customer provided that the entity expects to recover those costs.</p> <p>Revenue is recognised when a product or service is delivered, with the main impact for contracts with bundled services, and where performance may be measured on a different basis.</p> <p>The telecommunications industry will be impacted given the large volume of customers with different plans. Organisations may have to implement system changes to deal with the new requirements and recognise revenue at different points.³²</p> <p>On 18 October 2018, the ATO withdrew Taxation Ruling IT2450 in relation to long-term construction contracts. This ruling has been replaced by TR 2018/3, issued on 7 March 2018, which considers the impact of AASB 15 on the tax treatment of long-term construction contracts.</p>	1 January 2018

³¹See AASB Regulation Impact Statement – AASB 15 – Revenue from Contracts with Customers - <http://ris.dpmc.gov.au/2015/01/23/revised-accounting-standard-for-revenue-from-contracts-with-customers-regulation-impact-statement-australian-accounting-standards-board/> and Pitcher Partners – Changes to Revenue Recognition - <http://www.pitcher.com.au/news/changes-revenue-recognition>

³²Deloitte – Telecommunications sector – Clearly IFRS – Industry insights for IFRS 15 - <http://www2.deloitte.com/content/dam/Deloitte/ca/Documents/audit/ca-en-audit-ifs15-telecommunications.pdf>

Standard	Overview	Accounting changes with possible tax impacts	Effective Date
AASB 16 Leases ³³	This Standard requires most lease agreements to be presented on the financial balance sheet of the lessee.	AASB 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. This will increase both assets and liabilities on an entity balance sheet. The new AASB 16 treatment will result in both a depreciation and interest charge impacting on the Profit and Loss statement, with more front loading of expenses in earlier years of the lease, reducing over time.	1 January 2019
AASB 17 Insurance Contracts	This standard establishes new principles for the recognition, measurement, presentation and disclosure of insurance contracts issued. The objective is to ensure that entities provide relevant information in a way that faithfully represents those contracts. This information gives a basis for users of financial statements to assess the effect that contracts within the scope of AASB 17 have on the financial position, financial performance and cash flows of the entity. ³⁴	The greatest impact of the new standard will be for life insurance companies, and it may have implications for the tax provisions relating to life insurance companies found in Division 320 of the <i>Income Tax Assessment Act 1997</i> . Division 320 draws on the prudential valuation standard for life insurance companies to ensure the appropriate valuation of liabilities. These prudential standards are under review by APRA as a consequence of the issuance of the new accounting standard.	1 January 2021

³³See AASB Regulation Impact Statement – AASB 16 - Leases - <http://ris.dpmc.gov.au/2016/04/19/australian-accounting-standard-aasb-16-leases/>; KPMG IFRS 16 Leases – A more transparent balance sheet – 13 January 2016 Moore Stephens – IFRS 16 Leases – What does it mean for you? - <http://www.moorestephens.com.au/news-and-views/january-2016/ifrs-16-leases-what-does-it-mean-for-you>

³⁴ AASB 17 Explanatory Statement - <https://www.legislation.gov.au/Details/F2017L01184/Explanatory%20Statement/Text>

AASB / IASB work programs

The AASB and IASB are working on a number of other projects that may have tax implications if they result in changes to the accounting standards. Some of these are long term projects in the very early stages of development. These include:

- Amendments to IRFS 3 (Business combinations) regarding the definition of a business.
- Dynamic risk management – expected to mainly affect the accounting by banks for macro hedging activity.
- Financial Instruments with Characteristics of Equity – looking at the classification of financial instruments between liabilities (debt) and equity.
- Business combinations under common control – expected to address diversity in the accounting for restructuring activity within a group.
- Goodwill and impairment – review of the existing accounting requirements for goodwill.