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The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007

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Dear David

AASB Proposed Interpretation 10XX Australian Petroleum Resource Rent Tax

Thank you for the opportunity to comment on the Proposed Interpretation 10XX *Australian Petroleum Resource Rent Tax*.

CPA Australia Ltd's response to the proposed Interpretation has been prepared in consultation with members through its Financial Reporting and Governance Centre of Excellence. An expert member of its Board Tax Practice Committee also provided comment.

CPA Australia agrees there is a need for greater certainty as to the accounting required of an entity when accounting for Australian Petroleum Rent Resource Tax (PRRT). However, it does not support the proposed paragraph 9 consensus statement "Australian PRRT is an income tax within the scope of AASB 112 [Income Taxes]." Instead, it is CPA Australia's contention that following an examination of the substance of what is being paid, it is open to the AASB to characterise the Australian PRRT as an 'economic rent' in place of labelling it as an 'income tax'. The remainder of its letter provides details of CPA Australia's:

- reasons for characterising the Australian PRRT as an economic rent;
- comments re the proposal to restrict the scope of the proposed Interpretation to Australian PRRT; and
- other matters.

Characterising the Australian PRRT as an economic rent

CPA Australia is strongly of the view that the amount remitted under the Australian PRRT Act should in substance be regarded as an economic rent and not an income tax. It acknowledges on a narrow application of paragraphs 2 and 5 of AASB 112, and the March 2006 IFRIC Update, Australian PRRT is prima facie an income tax based on taxable profits imposed by a taxation authority being a tax calculated on a net amount of income imposed by the Commonwealth Parliament under the Australian PRRT Act.

However, applying a narrow view does not appear to be consistent with the purpose of the Australian PRRT. In contrast, a wider interpretation of AASB 112 is supportable. An AASB Interpretations Advisory Panel prepared draft paper noted at paragraph 31:

(a) the circumstances in which Australian PRRT is levied could be economically equated to a joint venture where the Federal Government receive a 40% interest in the joint venture after the initial capital costs of the commercial operator are recovered, and revenue and operating costs shared thereafter on a 60/40 basis; and

(b) that in many other jurisdictions around the world governments do enter into joint ventures with commercial operators under production sharing contracts which are not characterised as being an income tax for IAS 12 purposes.

Applying the logic in (a) above, the return to the Federal Government under such a joint venture arrangement would parallel the imposition of Australian PRRT. Some CPA Australia members have noted that commercial operators (and their advisors) do characterise the relationship between the Federal Government and the entity subject to Australian PRRT in this way. Accordingly, those members do not regard Australian PRRT as being an income tax in the conventional sense.

Proposal to restrict the scope of the proposed Interpretation to Australian PRRT

CPA Australia is not convinced that the AASB is able to restrict the scope of the proposed Interpretation to having opined on the question of whether Australian PRRT is an income tax. In its view paragraphs 11 and 12 of AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* will effectively require management preparing accounts to have regard to this proposed Interpretation when determining appropriate accounting policies which would apply to other generically similar domestic and foreign “royalties, rents and taxes”.

AASB 108.11 requires, amongst other things, that management consider the requirements and guidance in Standards and Interpretations dealing with similar or related issues. This paragraph would arguably require entities to have regard to the interpretation in determining the correct accounting treatment of generically similar taxes such as the East Timor Additional Profits Tax and the Resource Rent Royalty imposed by the WA State Government. Application of the proposed Interpretation would result in an accounting outcome that is not consistent with the typical expectations of users of the financial reports of entities subject to these generically similar imposts.

Further, both AASB 108.12 and IAS 8.12 state that management may also consider the most recent pronouncements of other standard-setting bodies that use a similar accounting conceptual framework to determine the accounting policy of the relevant entities. Thus, to the extent that this guideline provides an accounting characterisation for Australian PRRT its application could be extrapolated to equivalent commercial operations in jurisdictions outside of Australia where there is no current accounting policy.

For the reasons detailed above, CPA Australia strongly suggests that the AASB request the International Financial Reporting Interpretations Committee (IFRIC) to provide guidance on how all rent royalty arrangements and generically similar operations should be characterised for accounting purposes. Whilst such an approach would require IFRIC to reconsider its present position that it will not provide guidance on which taxes are within the scope of IAS 12, the scope of the latter review would extend beyond Australian PRRT to include all generically similar payments.

Other matters

CPA Australia make the following comments on ancillary matters:

- A significant element of the dissenting view reported in a AASB Interpretations Advisory Panel prepared draft paper (and subsequent opinions from Ernst and Young and ExxonMobil) is that Australian PRRT is not an income tax because there can be a marked disparity between accounting profit and taxable profit due to the impact of augmentation.

  As discussed by the AASB Interpretations Advisory Panel, augmentation applies to undeducted expenditures which are annually compounded by an uplift factor akin to the long term bond rate plus a factor of 15% or 5% depending on the expenditure incurred.

  Whilst this uplift factor is an example of where there can be a marked disparity between accounting and tax profits it should be stressed that in reality there can also be marked disparity between such amounts when applying former and current tax legislation.

  For example, there were previous marked differences between accounting profit and taxable profit due to a variety of differences including, amongst others, CGT indexation, incremental R&D deductions under the R&D tax concession, accelerated tax depreciation, immediate deductions for prepayments, investment and development allowances, and specific industry targeted tax concessions.

  Thus, CPA Australia does not find compelling the argument that Australian PRRT is not an income tax merely because there is a significant difference between accounting and taxable profits even though the difference with augmentation may be much more substantial than the norm.

- Prima facie there appears to be a tension between paragraph 2 of AASB 112 and the IFRIC Update from March 2006. The former contends that income taxes can include withholding taxes which are imposed on a gross amount (such as under Australia's double tax treaties). Conversely, the latter stresses that the concept of a taxable profit implies a notion of a net amount. CPA Australia encourages the AASB to bring this apparent inconsistency to the attention of IFRIC.

If you have any queries on our comments, please contact Dr Mark Shying, CPA Australia's Financial Reporting and Governance Senior Policy Adviser at mark.shying@cpaaustralia.com.au.

Yours sincerely

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