

Accounting Alert

Analysis of the latest accounting developments delivered to you via e-mail

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UIG issues final abstract.

Accounting for the Tax Consolidation System

At its meeting held on 6 May 2003, the Urgent Issues Group finalised its discussions on accounting for the tax consolidation system. This *Accounting Alert* provides an overview of the accounting adjustments required and some of the issues that may arise.

A detailed *Discussion Paper* has also been made available on our web site, providing detailed analysis and examples when accounting for income taxes in light of the tax consolidation system.

Key Impacts

In endeavouring to ensure an optimal taxation outcome, entities may not fully contemplate the parallel accounting issues that also need to be considered.

Some key impacts of accounting for the tax consolidation system are as follows:

- Substantive enactment of the tax consolidation system will often give rise to adjustments *prior* to implementation date, affecting reported net profit or loss and net assets.
- Implementation of the tax consolidation system will give rise to the **full restatement** of deferred tax balances, based on their carrying amounts at the tax-consolidated level and reset tax values.
- Any net tax expense or benefit from implementation will be recognised in **net profit or loss** at the implementation date.
- Entities entering or leaving the tax-consolidated group may, through adjustments to deferred tax assets and liabilities, impact net income tax expense or benefit.

The tax consolidation system will impact reported profitability, dividend planning and other matters - both before and after implementation date.

- The accounting requirements will require entities to consider the impact of the tax consolidation system by their next reporting date – bringing forward analysis and preparation, and in some cases, requiring the implementation of inter-entity agreements.
- There will be flow on business issues to consider, including the impact of changes in net assets and profits on banking covenants, dividend planning, bonus schemes and equity-based compensation arrangements and other agreements.

Overview

Accounting for the tax consolidation system depends on the following factors:

- Whether the tax consolidation system is relevant to the entity or not;
- The implementation date of the tax consolidation system;
- The date that a decision is made by the entity to implement the tax consolidation system; and
- Which version of AASB 1020 the entity is applying.

There are two main UIG Abstracts that deal with accounting for the tax consolidation system:

- Abstract 39 ‘Effect of Proposed Tax Consolidation Legislation on Deferred Tax Balances’ (UIG 39) – revised in December 2002; and
- Abstract 52 ‘Income Tax Accounting under the Tax Consolidation System’ (UIG 52) – finalised at the UIG’s meeting held on 6 May 2003 (currently in veto period).

The relevant UIG Abstract to apply depends on if and when a tax-consolidatable group has implemented the tax consolidation system. The ‘implementation date’ of the tax consolidation system for accounting purposes is the date selected by the entity from which it will be required to prepare a consolidated tax return. UIG 39 is applied before implementation date, and UIG 52 applies after implementation date.

The implementation date can be different from the date on which the entity makes the decision to adopt the tax consolidation system, and from the date on which that decision is formally notified to the Australian Taxation Office. Even if the decision is made after reporting date to implement the tax consolidation system in respect of the reporting period, adjustments must be made in accordance with UIG 52 if the financial statements have not yet been issued.

The accounting treatment hinges on the implementation date

Decisions after balance date can have retrospective impacts

Summary of Accounting Requirements

Before Implementation (UIG 39)

Before implementing the tax consolidation system:

Decisions after balance date can have retrospective impacts

- there is an assumption that groups that are eligible to consolidate for tax purposes will do so, even if a decision has not yet been made;
- each entity must continue to recognise its own current deferred tax balances, subject to any write downs or other impacts;
- entities must reassess the carrying value of deferred tax assets attributable to tax losses, and *net* deferred tax assets arising from timing differences – the use of ‘best estimates’ is permitted; and
- subsidiaries may require support from the ‘head entity’ for deferred tax assets, which may require the head entity to recognise a provision for an onerous contract.

After Implementation (UIG 52)

After implementation of the tax consolidation system:¹

Head entity recognises all deferred tax balances

- subsidiaries in the tax-consolidated group must derecognise all deferred tax balances;
- the head entity must recognise deferred taxes for all entities in the tax-consolidated group, based on the consolidated carrying amounts and the tax values applying under the tax consolidation system;
- the impacts of any tax sharing agreement must be reflected as income tax expense or benefits in the entities affected; and
- entities leaving a tax-consolidated group will only recognise deferred taxes once they have left the group, even if it is anticipated that this will occur.

Full restatement of timing differences

The impact of the above requirements is a full restatement of timing differences, even when the entity is applying superseded Accounting Standard AASB 1020 ‘Accounting for Income Taxes (Tax-effect Accounting)’. This will mean that entities will recognise an up-front income tax expense or benefit to reflect the impacts of the tax consolidation system.

¹ Revised UIG 52 was approved by the Urgent Issues Group at its meeting held on 6 May 2003 and is currently subject to veto by the AASB. The analysis in this Accounting Alert is based on the revised abstract.

Unresolved issues remain in some areas



Accounting and tax outcomes will need to be balanced when making decisions about implementation

Issues Arising

The tax consolidation system is complex both from a tax and accounting perspective. Whilst the UIG has addressed the major accounting issues arising, there will be other related issues that may need to be clarified, including the following:

- How the requirements of UIG 52 will interact with the determination of the ‘allocable cost amount’ (ACA) under the tax consolidation legislation.
- Whether the recognition exceptions for deferred taxes in revised AASB 1020 and AAS 3 should be applied (no matter which version of these Standards an entity is applying).
- The accounting treatment for tax instalments paid by an entity during the transitional period.
- Whether head entities should recognise, in the period before implementation, an onerous contract for the deferred tax liabilities of subsidiaries that are expected to become part of the tax-consolidated group.
- Recognition of deferred tax balances arising when applying UIG 52 in relation to fair value adjustments and pre-implementation revaluations.
- Treatment of deferred taxes related to entities that are expected to leave the tax-consolidated group.

Further information about these and other issues can be found in our *Discussion Paper*.

Action Points

Entities should consider the following action points in relation to the matters covered in this *Accounting Alert*:

- Understand the impacts or potential impacts on your organisation.
- Determine when your organisation is likely to elect to implement the tax consolidation system, considering the taxation, accounting and business outcomes of the decision.
- Ensure that adequate resources are available for implementation of the tax consolidation system and to consider the resultant accounting impacts.

Our web site provides a comprehensive starting point for addressing the impacts on your organisation

Other Resources

Deloitte has adopted a multi-disciplinary project management strategy in relation to the tax consolidation system that integrates our tax consulting expertise with specialists in accounting, valuations, tax technology and training.

For more information on tax consolidation system related products and services, or to obtain a copy of our in-depth *Discussion Paper* on accounting for the tax consolidation system, visit our web site: www.deloitte.com.au.

Feedback and Assistance

We welcome your feedback on the matters covered in this *Accounting Alert* – please email your comments to accounting_alerts@deloitte.com.au.

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