

Accounting alert

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

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Partial restatement to be required, and only where resetting of tax values has occurred

Accounting requirements for tax consolidation to be revised

At its meeting held on 12-13 November 2003, the Australian Accounting Standards Board (AASB) met with the Urgent Issues Group (UIG) Tax-Consolidation Sub-Committee to discuss accounting for the tax consolidation system. As a result of this meeting, the AASB has instructed the UIG to revise Abstract 52 'Accounting for the Tax Consolidation System' to clarify certain matters.

This *Accounting alert* provides an overview of our understanding of the outcome and an analysis of the issues arising.

Overview

The AASB has directed the UIG to revised Abstract 52 so that when the superseded AASB 1020 is applied and the tax consolidation system has been implemented in respect of a financial reporting period:

- where tax values have not be reset on an entity joining a tax consolidated group, no adjustment to deferred tax balances will be permitted – existing consolidated deferred tax balances will be recognised by the head entity on adoption of the tax consolidation system
- where tax values have been reset:
 - deferred tax balances are remeasured by reference to the differences between consolidated carrying amounts and reset tax values and recognised by both the head entity and the economic entity on the adoption of the tax consolidation system
 - the recognition of deferred taxes that would not be 'traditionally' tax-effected under the superseded AASB 1020 (eg: non-tax-depreciable intangibles) are prohibited
 - adjustments to past acquisition entries would neither be required or prohibited for any newly recognised deferred taxes that effectively arise from fair value adjustments recognised for past acquisitions – entities will therefore have a choice whether to remeasure goodwill
- it permits entities that have already reported using the May 2003 abstract to continue to do so on a go-forward basis.

This outcome is a short-term pragmatic solution to a difficult issue.



The deferred tax associated with many items now 'preserved'

Differences from the existing abstract

The revised abstract is expected to clarify that, in general terms, deferred taxes are not remeasured or initially recognised where differences exist between carrying amount and the associated tax values of the following items on implementation of the tax consolidation system:

- any asset that does not have its tax base reset
- liabilities
- non tax-depreciable intangible assets
- investments
- any other asset that only has a CGT cost base (or no cost base) and no tax-depreciable amount.

Any deferred tax balances previously recognised in relation to the above items will continue to be measured based on their pre-implementation values and recognised in the head entity. Any adjustment to deferred taxes associated with these items will therefore only be made on application of either the revised AASB 1020 or the forthcoming Australian equivalent of IAS 12 'Income Taxes'.

There is expected to be a choice in the treatment of that part of any adjustment that relates to fair value adjustments on acquisition

Impact on past acquisitions

It is expected that the revised Abstract 52 will neither require nor prohibit the restatement of goodwill arising in past acquisitions for the impacts of any remeasured deferred taxes that effectively arise from fair value adjustments on tax-depreciable assets acquired in those past acquisitions.

Therefore, we understand that where the tax value is reset on an entity joining a tax consolidated group, entities will have a choice how to treat these amounts on consolidation (any deferred taxes arising will always be recognised in income tax expense in the head entity's own financial report).

Entities will need to consider the impacts of not reopening past acquisition entries and the interaction with IFRS 1

Where deferred taxes have not been recognised in the past in relation to large fair value uplifts for tax-depreciable assets, there may be beneficial outcomes in reopening past acquisition entries, so that some of the deferred tax balance recognised on implementation of the tax consolidation system results in increased goodwill (net of subsequent amortisation and other adjustments), rather than reduced retained earnings.

Where a past acquisition has been adjusted in this manner on the application of the forthcoming Abstract 52, this may also present an opportunity to partially adjust prior acquisitions before taking advantage of the optional exemptions for business combinations in the IFRS 1 'First-time Adoption of International Financial Reporting Standards'.

Entities that have already reported using an alternate approach are expected to have that approach 'grandfathered'

Transitional provisions

It appears that entities that have already reported using a calculation methodology that is consistent with the May 2003 version of Abstract 52 may be able to continue to use that methodology, as these methodologies are more closely aligned with the revised AASB 1020 and IAS 12.

However, this 'grandfathering' benefit is expected to be effectively limited to those entities that have implemented the May 2003 version of Abstract 52 in a financial reporting period ending before the issue of the revised abstract, expected to be finalised at the next UIG meeting on 4 December 2003.

More information about the implementing the revised AASB 1020 can be found in the Deloitte 'Accounting for Income Tax' publication available on our web site

Deloitte *Discussion paper* will be reissued once the UIG deliberations are concluded

Should entities consider early adoption of the revised AASB 1020?

Some entities may be advantaged by early adopting the revised AASB 1020 in conjunction with implementation of the tax consolidation system. This may be particularly evident where it increases recognised deferred tax liabilities that may be able to be taken into account when determining the 'allocable cost amount' for implementation purposes.

However, entities would need to consider other issues, such as:

- preparedness for the full implementation of the revised AASB 1020, including comparative requirements, systems issues and availability of tax base information for assets and liabilities outside the tax-consolidated group
- the impact on the financial position and results, particularly net assets and reported profits, budgets, forecasts and analysts
- the interaction with the IFRS convergence project, particularly in light of possible further changes to IAS 12 'Income Taxes' that might be able to be early adopted.

Action points

Eligible groups will need to consider the following points:

Implementation considerations

- has a decision to implement the tax consolidation system been made, or are we waiting on further information before finalising our approach?
- how will we respond to the assumption in UIG Abstract 39 that eligible groups will implement the tax consolidation system on or before 1 July 2003?
- does the implementation date fall within the current or prior reporting period, therefore requiring the use of Abstract 52?

Resetting of tax bases

- will the information about reset tax values be available in time for our next reporting date so that deferred tax balances can be calculated?
- what impact will complying with the forthcoming abstract have on our reported net assets and earnings?
- will prior acquisition entries be reopened in relation to the deferred tax associated with fair value adjustments?

Other considerations

- has the May 2003 version of Abstract 52 already been applied? If so, what approach was taken and is this consistent with the forthcoming abstract?
- has the early adoption of the revised AASB 1020 been considered? Are there any benefits from doing so?
- what systems changes, information gathering and other administrative and procedural issues need to be addressed?

Other resources

We will reissue our *Discussion paper* on 'Accounting for the Tax Consolidation System' once the UIG has finalised its deliberations on the revised Abstract 52. Entities will also find our 'Accounting for Income Tax' publication a useful resource for understanding and applying the revised AASB 1020/IAS 12 in the Australian context.

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.

For assistance in applying the requirements outlined above in your organisation, please contact your local Deloitte office or contact our Lead National Technical Partner, Bruce Porter on (03) 9208 7490, or by email to bruporter@deloitte.com.au.

Appendix: History of developments

Background

The UIG has debated various issues relating to the tax consolidation system for nearly three years, issuing and reissuing three different abstracts during this time.

Complex issues arise when accounting for the tax consolidation system under the superseded Accounting Standard AASB 1020 'Accounting for Income Tax (Tax-Effect Accounting)', as this Standard does not contemplate accounting for the tax consolidation system. (The accounting outcomes are much clearer under the revised AASB 1020 'Income Taxes' or its international equivalent IAS 12 'Income Taxes').

May 2003 revision of Abstract 52

After initially moving towards treating the entire effect of implementing the tax consolidation system as a 'permanent difference', the UIG decided in May 2003 to effectively move towards the approach of the revised AASB 1020/IAS 12, by treating the impact of tax consolidation as an external event and measuring deferred taxes by reference to accounting carrying values and the tax values (reset or otherwise) that apply under the tax consolidation system.

Many commentators understood the May 2003 version of Abstract 52 to effectively require the early adoption of the revised AASB 1020 within the tax consolidated group. This was seen as appropriate given the impending move to IAS 12 'Income Taxes' and the fact that implementation of the tax consolidation system would effectively determine the 'tax bases' required for the deferred tax calculations. This view was expressed in our *Discussion paper* issued in May 2003 to coincide with the reissue of Abstract 52.

Why the AASB directed the UIG to amend Abstract 52

The UIG began discussing additional guidance on the application of the May 2003 version of Abstract 52 at its September 2003 meeting. This guidance was designed to clarify the treatment in more complex areas, such as fair value adjustments, intangibles and revaluations.

It became apparent that many entities did not interpret Abstract 52 to be an effective early adoption of the revised AASB 1020, including the logical extension that some of the initial adjustments on implementing the tax consolidation system would relate to past fair value adjustments, revaluations and intangibles, and so require reopening of past acquisition entries, or recognition of certain deferred taxes directly in equity. The AASB have indicated that it was not their intention to require this approach when they chose not to veto Abstract 52.

Therefore, in order to achieve a short-term pragmatic solution, the AASB directed the UIG to amend Abstract 52 to address the following contentious areas:

- remeasurement of deferred taxes even where asset values have not been reset
- recognition of deferred taxes in relation to intangibles and other non-tax-depreciable assets
- the interpretation that the abstract effectively required the restatement of past acquisitions within the tax-consolidated group.

The superseded AASB 1020 does not contemplate the tax consolidation system

Tax consolidation was seen as an 'external event'

Abstract 52 issued in May 2003 was generally viewed as the early adoption of the revised AASB 1020 in many respects

Differing interpretations and approaches under the May 2003 version of Abstract 52 gave rise to additional implementation issues