

STAFF PAPER

13–14 March 2012

IFRS Interpretations Committee Meeting

Project	IAS 1 <i>Presentation of Financial Statements</i> and IAS 12 <i>Income Taxes</i>		
Paper topic	Supplement—Updates on outreach activity for the issue of presentation of payments of non-income taxes		
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Objective and introduction

1. The objective of this Agenda Paper is to provide the IFRS Interpretations Committee (the Committee) with an update on our outreach activity relating to the issue of presentation of the production-based royalty payments, which is discussed in Agenda Paper 8. This paper also includes a staff recommendation to the Committee which has been updated on the basis of the staff's analysis of the result of the outreach activity.
2. This Agenda Paper includes:
 - (a) staff analysis on the result of the outreach;
 - (b) agenda criteria and staff recommendation; and
 - (c) questions for the Committee.

Updates on the result of outreach

3. As stated in Agenda Paper 8, we asked the following questions in our request for information to the National Standard-Setters Group:
 - (a) *In your jurisdiction, is there a similar tax regime with those described above? If similar, but not identical, please tell us about the differences.*

(b) If there is a similar tax regime, what is the prevalent accounting for the payments?

(c) Would your view be that there is diversity in practice for these types of payments?

4. The views expressed below are informal feedback from the National Standard-Setters Group. They do not reflect the formal views of the boards of those organisations. In addition, they exclude the views of the submitter because the submitter is also a national standard-setter. The geographical breakdown for the responses is as follows:

Geographical area	Number of respondents
South America	0
Asia/Oceania	5
Africa	1
Europe	4
North America	2
Total respondents	12

5. Two respondents answered that they were aware of similar tax regimes in their jurisdictions, in particular, in the mining, and oil and gas industries.
6. One respondent stated that a mining company in the jurisdiction is subject to a revenue-based royalty tax that is levied by the central government. The royalty tax is calculated on a sliding scale commencing at 0.5 per cent of turnover to a maximum of 5 per cent of turnover. In determining corporate income tax for a fiscal year, the royalty is not treated as a tax credit against corporate income tax payables, but is deductible against taxable profit. That is, the tax regime does not allow a 100 per cent tax reduction for the amount of the royalty tax against corporate income tax payables.
7. With regard to the prevalent accounting for the royalty tax, the respondent stated that because the basis for the royalty tax is a gross amount, the royalty tax is considered to be outside the scope of IAS 12 *Income Taxes*.

8. Instead, mining companies in the jurisdiction generally account for the royalty tax as operating expense or production cost, and therefore present it within operating expense or production cost rather than in the tax expense.
9. The other respondent mentioned that there are various forms of royalty payments made by mining, and oil and gas companies to government agencies in the jurisdiction. The amounts of those royalty payments are determined mostly based on production or volume. Similarly to the case in the previously mentioned other jurisdiction, those royalties are deductible against taxable profit for income taxes, and therefore, the royalty payments will generally reduce income tax payables by the product of the royalty payments multiplied by the income tax rate.
10. According to the response, most of the royalties paid to federal or provincial agencies in the jurisdiction do not meet the definition of income taxes under IAS 12 and are not presented as income taxes. The respondent further stated that the fact that they are deductible in determining taxable profit does not affect the way of presentation of the royalty tax.
11. In addition, both respondents stated that those jurisdictions have some multinational companies that have operations in foreign jurisdictions. Royalty payments in those foreign jurisdictions may be considered to be income taxes under IAS 12 and are presented in tax expense in the statement of comprehensive income depending on the basis for the calculation of the amounts of the taxes.

Agenda criteria and staff recommendation

12. We have assessed the submission against the Committee's criteria as follows:

(a) The issue is widespread and has practical relevance.

Yes. According to the result of our outreach, there are similar tax regimes in two other jurisdictions. We think that this issue is widespread and has practical relevance.

(b) The issue indicates that there are significant divergent interpretations (either emerging or existing in practice).

No. The result of outreach indicates that non-income taxes are presented as operating expense or production cost in those jurisdictions.

(c) Financial reporting would be improved through the elimination of the diverse reporting methods.

No. The results of outreach indicate that there is no divergence in practice.

(d) The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.

Yes. We think that the Committee does not need to review principles in existing IFRSs.

(e) It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.

Yes. We think that the Committee should not add this issue to its agenda, and so no discussion will be needed.

(f) If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?

No. In paragraph 38 of Agenda Paper 8, we already concluded that this issue meets criterion (f).

13. In summary, our outreach that we have conducted indicates that there are no significant divergent interpretations of the requirements in IAS 1 *Presentation of Financial Statements* and IAS 12, and that consequently this issue does not meet the Committee agenda criteria.

14. Accordingly, if the Committee agrees with our technical analysis as shown in paragraph 13-33 of Agenda Paper 8, we recommend that the Committee should not take this issue onto its agenda. We have included draft rejection wording in Appendix A to this paper.

Questions for the Committee

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1. Does the Committee agree with the staff recommendation not to take this issue onto its agenda?
2. If the Committee agrees with the staff recommendation, does the Committee agree with the proposed rejection wording in Appendix A?

Appendix A—Proposed wording for tentative agenda decision

The staff propose the following wording for the tentative agenda decision:

IAS 1 Presentation of Financial Statements and IAS 12 Income Taxes—Presentation of payments of non-income taxes

The IFRS Interpretations Committee (the Committee) received a request seeking clarification on whether production-based royalty payments to one taxation authority that are claimed as an allowance against income tax payables to another taxation authority under a proposed tax regime should be presented as operating expense or a tax expense.

In June 2011, the government in the jurisdiction released an exposure draft of a new tax regime which would apply to the mining of iron ore and coal in the jurisdiction. Under the proposed tax regime, the production-based royalty payments to a local taxation authority can be claimed as an allowance against income tax payables to the government. As the basis for this submission, the submitter assumes that the royalty payments are, in themselves, outside the scope of IAS 12 *Income Taxes* while the tax payable to the government is within the scope of IAS 12.

The submitter states that there is a view that the non-income tax payments could be considered as prepayment of income tax payables to the government and presented as income taxes. The supporters of the view argue that the use of the plural term ‘taxation authorities’ in the definition of taxable profit under IAS 12 indicates that the distinction between which taxation authority the taxes are payable to is not relevant when determining the scope of income taxes under IAS 12.

The Committee observed that the line item of ‘tax expense’ that is required by paragraph 82(d) of IAS 1 *Presentation of Financial Statements* is intended to require an entity to present taxes that meet the definition of income taxes under IAS 12.

The Committee also noted that it is the basis of calculation alone that determines whether a tax is classified as an income tax, and that the manner of settlement of the tax liability does not change that classification. Accordingly, the allowance of a non-income tax as a deduction against the amount payable for an income tax does not change the nature of the former tax, ie, it remains a non-income tax. The non-income tax should therefore not be presented as an income tax expense in the statement of comprehensive income.

On the basis of the above, the Committee noted that it did not expect diversity in practice on the presentation of non-income tax payments to emerge. Consequently, the Committee [decided] not to add this issue to its agenda.