ASAF meeting, December 2016, Agenda Ref 10A

Australian Government
Australian Accounting Standards Board

Country-by-country reporting: Update on AASB approach

Current landscape

- OECD Action Plan targeting base erosion and profit shifting
  - measures to improve tax transparency of MNCs
- Australian measures:
  - Country-by-country reports for ‘significant global entities’ to be submitted to the Australian tax authorities
  - Public disclosure of key income tax attributes for private and public entities meeting certain turnover thresholds
  - Voluntary Tax Transparency Code (TTC) to improve the understandability by general public of corporate taxpayers’ income tax affairs
- US, UK and EU bodies also developing proposals/ enacted law to improve tax transparency

Current landscape

The AASB has been asked to provide guidance on meeting the minimum standard of the TTC, and also calculation of the ETR

The voluntary TTC requires disclosure of:

Part A (turnover A$100m – A$500m)	Part B (turnover > A$500m)
• Reconciliation of accounting profit before tax (APBT) to income tax expense (ITE), to income taxes paid or payable • Identification of material temporary and non-temporary differences • Accounting effective company tax rates (ETR) for Australian and global operations	• Approach to tax transparency and governance • Tax contribution summary for corporate taxes paid • Information about international related party dealings

Question for ASAF members

Question 1 to ASAF members

Do ASAF members agree, given the global focus on improving the tax transparency of multinational enterprises, it is timely for accounting standard-setters to take a leadership role in improving income tax disclosures for users of financial reports?

Should IAS 12 be amended?

- AASB staff conducted research to understand:
  - how entities currently present income tax disclosures under IAS 12 and other domestic laws
  - whether income tax disclosures could be improved to meet the needs of users
- Research covered:
  - Discussions with preparers, analyst, tax bodies, other standard-setter
  - Financial report review
  - Academic literature review

Observations and findings

- Review of income tax disclosures
  - Significant variation in format, presentation and level of detail presented in income tax disclosures
  - ETR calculated as income tax expense / accounting profit before tax, <u>but generally subjected</u> <u>to corporate group specific adjustments</u>
- Stakeholder feedback
  - More clarity required in tax disclosures to better enable users to:
    - determine a sustainable tax rate to support earnings quality assessments
    - understand why income tax obligation deviates from corporate income tax rate x accounting profit before tax
  - Disclosures must be useful otherwise disclosure overload

Analysis and recommendations

In summary our research suggests IAS 12 could be amended to allow users to better understand why:

- ITE (or income tax payable) deviates from the corporate income tax rate;
- the relationship ITE bears to income taxes paid and payable; and
- the overall relationship between the income tax amounts reported in the financial statements.

Suggested changes to IAS 12

Disclosure objective

IAS 12 could be amended to require an entity to disclose sufficient information to enable users of financial statements to understand:

- the relationship between income tax amounts reported in the financial statements; and
- why reported tax expense deviates from the corporate income tax rate.

Analysis and recommendations

Additional disclosures recommended:

- require clear presentation of the entity's income tax paid and payable referable to the income of the financial year accompanied by clear explanation of material adjustments.
- require corporate groups to provide information at both a domestic (eg Australia) and group level.
- require preparation a reconciliation of opening to closing current tax liability.

Analysis and recommendations

Additional disclosures recommended:

- encourage presentation of both a domestic (eg Australia) and global income taxes paid and payable / APBT ratio.
- encourage corporate groups to include narrative discussion providing context to the income taxes paid and payable ratio.
- encourage corporate groups to disclose significant amounts of income tax paid during the financial year in foreign jurisdictions.

Suggested changes to IAS 12

Global Group Pty Ltd
Income tax disclosures - 30 June 2016
(Amounts are for illustrative purposes only)

		Group (A$ millions)	
Accounting profit before tax - Group		568.9	
Tax at the Australian tax rate (30%)		170.67	
Add:			
Taxable unfranked dividend	1	6.4	
Net movement in provisions and accruals	2	10.1	
Net unrealised foreign exchange loss	3	11.8	
Non-deductible interest expense	4	5.7	
Taxable gain on equity accounted investment	5	15.2	
Net difference between accounting and tax depreciation	6	1.3	
Impairment of intangibles	7	1.3	
(Over) / under provision - current		3.1	
Other non-deductible items [disaggregate where material]		4.3	
Deduct:			
Post tax associate earnings	8	-11.1	
Tax deductible goodwill	9	-6.6	
Research and development claim	10	-10.1	
Net fair value gain on investments	11	-12.9	
Overseas tax rate differential	12	-12.7	
Other deductible items [disaggregate where material]		-2.0	
Current tax expense (profit and loss statement)		**174.47**	(c)
Current tax expense (equity)			
Share issuance costs	13	-1.7	(b)
2016 Group income tax paid and payable		**172.77**	
Current tax expense		**174.47**	
Deferred tax expense		4.3	(a)
Income tax expense reported in the profit and loss statement		**178.77**	(d)

Income tax paid and payable ratio

	2016 income taxes paid and payable (A$ millions)	Accounting profit before tax (A$ millions)	Ratio
Australia	97.6	360.4	27.08%
Group	172.77	568.9	30.37%

[To the extent additional context to the income taxes paid and payable ratio is required beyond the 'explanation of key items' as below, this should also be included as part of the disclosure. For example, should the income taxes paid or payable metric deviate significantly from the prior year result, the key drivers should be explained.]

Explanation of key items

1	Unfranked dividends received from foreign subsidiary
2	Net increase in employee and other provisions and accruals
3	Non-deductible unrealised foreign currency loss on trade payables, loans
4	Non-deductible interest expense pursuant to thin capitalisation rules
5	Difference between tax and accounting gain on disposal of investment
6	Represents the net difference between depreciation of assets for accounting and income tax
7	Non-deductible impairment of intangible assets
8	Share of profit from associates and join ventures taken up net of tax expense
9	Goodwill amortisation is deductible in a foreign jurisdiction
10	Research and development incentives utilised
11	Non-assessable fair value gain recognised on financial instruments
12	International profits taxed at local tax rates different from the Australian statutory rate
13	Current tax items recognised in equity

These disclosures are already required to be made by IAS 12.79 and have been presented as part of this example for contextual purposes. AASB staff note that the reconciliation of APBT to income tax paid and payable, in conjunction with the existing ITE disclosure requirements, should continue to satisfy the overall disclosure requirements of IAS 12.

Analysis and recommendations

2016 Significant amounts of income tax paid in foreign jurisdictions	Amount (A$ millions)
[Country 1]	
[Country 2]	
[Country 3]	

Reconciliation to net group current tax liability	A$ millions
Opening net group current tax liability	55.0
Add: 2016 income tax payable	172.8
Less: income tax paid in Australia	-60.0
Less: income tax already paid in foreign jurisdictions	-50.0
Closing net group current tax liability	**117.8**

Includes payments in respect of the current and prior year income tax liability.

Analysis and recommendations

Disclosure	Pros	Cons
Alternative A (**Black** only)		
• Reconciliation of APBT to income tax paid and payable • Explanation of key items adjusting APBT to current tax expense • Group and Australian income tax paid and payable ratio	• Clear presentation of corporate taxpayer's income tax liability referable to an income year • Leverages existing underlying income tax provision calculations	• No information regarding a corporate taxpayer's foreign income tax position relative to its domestic position • Difficult to 'standardise' the reconciliation format

Analysis and recommendations

Disclosure	Pros	Cons
Alternative B (**Black**, **red** and **blue**)		
All alternative A disclosures, and: • Reconciliation of group net current tax liability • Disaggregation of domestic and foreign APBT, income tax paid and payable	• Ties together income tax numbers reported in the financial statements • Better informs relative foreign and domestic income tax position, including franking capacity	• Disaggregating domestic and foreign disclosures may be challenging for some corporate groups

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Analysis and recommendations

Disclosure	Pros	Cons
Alternative C (**Black**, **red**, **blue** and **green**)		
All alternative B disclosures, and: • Significant amounts of income tax paid in foreign jurisdictions	• Addresses key area of interest for users • Minimal cost of preparation for entities subject to country-by-country reporting	• Cost of preparation to entities not required to prepare country-by-country reports • Term 'significant' is subjective • Paid and payable amounts disclosed may not correlate and may require further reconciliation

Question to ASAF members

Question 2 to ASAF members

Do ASAF members consider the proposed income tax disclosures to provide users of general purpose financial statements with a better understanding of the income tax position of an entity? Do ASAF members have specific comments in respect of the four components? Do ASAF members have any other comments in this regard?