

# ***TD 2014/12EC - Compendium***



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## **Ruling Compendium – TD 2014/12**

This is a compendium of responses to the issues raised by external parties to Draft Taxation Determination TD 2013/D8 *Income tax: can a financial report prepared by an entity in accordance with those accounting standards it is required to apply, but not in accordance with other relevant accounting principles, satisfy paragraphs 230-150(1)(a), 230-210(2)(a), 230-255(2)(a), 230-315(2)(a) and 230-395(2)(a) of the Income Tax Assessment Act 1997?*

This compendium of comments has been edited to maintain the anonymity of entities that commented on the Draft Determination.

### **Summary of issues raised and responses**

<b>Issue No.</b>	<b>Issue raised</b>	<b>ATO Response/Action taken</b>
<b>1</b>	<b>Which accounting standards apply in interpreting ‘the accounting principles’</b>	
1.1	<p>The ATO should interpret ‘the accounting principles’ to mean in accordance with accounting standards relevant to the financial arrangement (this will include AASB 7) and not accounting standards in its entirety.</p> <p>The ATO should recognise that a taxpayer has met the eligibility requirements to apply the elective methods where it has produced financial reports prepared in accordance with accounting standards relevant to those methods and to its affairs. This includes the most relevant accounting standards in applying the TOFA elective methods listed in the Explanatory Memorandum (EM) to Division 230 of the <i>Income Tax Assessment Act 1997</i> (ITAA 1997) at paragraph 5.20 to include AASB 139 <i>Financial Instruments: Recognition and Measurement</i>, AASB 121 <i>The Effects of Changes in Foreign Exchange Rates</i> and AASB 127 <i>Consolidated and Separate Financial Statements</i>; however there may be other accounting standards that may also be relevant.</p>	Agree. See paragraphs 2 and 21-29 of the Final Taxation Determination.

1.2	<p>In regards to applying 'all accounting standards', the word 'all' does not appear in the definition of accounting principles in section 995-1 of the ITAA 1997, or as a qualifier in the relevant accounting standards in Division 230 of the ITAA 1997, or the EM. The definition does not require adoption or compliance with matters which are irrelevant to Division 230.</p> <p>The ATO has placed too much emphasis on the word 'the' in 'the accounting principles'. The word 'the' does not appear in the definition of 'accounting principles' as defined by section 995-1 of the ITAA 1997. Therefore relevant accounting standards should be applied, as opposed to accounting standards in their entirety.</p>	<p>The term 'accounting principles' is addressed in section 995-1 to essentially mean 'accounting standards' (or, if none apply to a relevant matter, any other authoritative pronouncements of the AASB). The definition does not identify a discrete group of such standards or principles. The term 'accounting standards' as defined in section 995-1 together with section 9 of the <i>Corporations Act 2001</i> (Corporations Act) means essentially instruments in force under section 334 of the Corporations Act. Again, the definition does not identify a discrete group of such standards. The meaning of '<i>the</i> accounting principles' as it appears in Division 230 of the ITAA 1997 has therefore been interpreted as being a reference to all such principles and standards. However, as set out in the Final Determination and the Alternative views in the Draft, the preferred view is that a literal interpretation of these terms can be departed from bearing in mind the policy intent as set out in the EM and particularly the legislative context in which the provisions appear. See also issue 1.1 above.</p>
1.3	<p>The Draft Determination departs from the views expressed in NTLG TOFA Issue 606, where the ATO did not express all accounting standards needed to be complied with.</p>	<p>NTLG TOFA Issue 606 did not express a limited set of accounting standards needed to be complied with. The minutes of the NTLG discussion identify the documents that are required to be prepared in accordance with the relevant accounting standards. The reference to 'relevant' was not elaborated on. The Final Taxation Determination now clarifies (at paragraph 30) that relevant standards are those which are relevant to the disclosure, recognition and measurement of financial arrangements.</p>

1.4	The Draft Determination departs from the views expressed in NTLG TOFA Issue 607, where the ATO concluded that where a company <b>omits 'not insignificant' or 'not merely trifling' disclosures</b> that would be required under the accounting standards from its financial report, then the financial report of the company is not 'prepared in accordance with the accounting principles'. The Professional Bodies consider that the significant words in the minute of the NTLG discussion refer to the absence of 'not insignificant' or 'not mere trifling' accounting standards, which again must be judged in the context of relevant disclosures or standards.	Disagree. NTLG TOFA Issue 607 relates to the disclosure requirements under the accounting standards, specifically whether a financial report prepared in accordance with the reduced disclosure requirements (RDR) under AASB 1053 will satisfy the accounting requirement. Neither the issue nor the minute on the issue were addressing a failure to accord with the accounting standards more generally (that is, beyond the disclosure requirements).
<b>2</b>	<b>Draft Determination inconsistent with policy intent of Division 230 to assist</b>	
2.1	The EM supports the use of existing financial reports and no requirement to recreate financial statements as long as there is no derogation of integrity standards.	The EM supports the use of existing financial reports where they have been prepared with sufficient integrity in accordance with the accounting principles. The EM does not identify precisely what that level of integrity is. In this sense the EM alone does not precisely inform on the scope of the term 'in accordance with the accounting principles' as it appears in Division 230 of the ITAA 1997, nor how practically this translates into a financial report which will satisfy the accounting requirement.

2.2	<p>The benchmark in testing the quality of the financial report as a whole is not supported by legislation. If the legislature had intended that to be eligible to adopt the TOFA elective methods all accounting standards had to be applied, then the legislation could have limited the use of elective methods only to 'reporting entities' – as referenced and defined under <i>SAC 1 Definition of a Reporting Entity</i>, AASB 101 and those prescribed under Chapter 2M of the Corporations Act – as these entities are compelled to produce GPFS. However, as the legislation has a broader application, there is support that not all accounting standards are required to be adopted.</p>	<p>Division 230 of the ITAA 1997 requires all entities that access such elective methods to produce financial reports that meet the accounting requirements in applying the accounting principles. The absence of a reference to 'reporting entities' is not indicative that all non-reporting entities will be able to access the elective methods based on their existing financial reports. It indicates only that the elective methods are not necessarily limited to reporting entities. A literal reading of the relevant provisions does support testing the quality of the financial report as a whole. But bearing in mind the policy intent as evidenced in particular by the legislative context in which the provisions appear, we agree that it is appropriate to depart from such a literal reading. See further issue 1.1 above.</p>
2.3	<p>Increase in major compliance difficulties as many entities have used existing financial reports as a basis for adopting TOFA elective methods. Without access to these elective methods, entities would be forced to create costly standalone tax systems.</p>	<p>The accounting requirement – as now explained in the Final Taxation Determination – in applying all standards capable of applying to an entity that are relevant to financial arrangements, presents a balance between compliance cost to taxpayers and maintaining the integrity of preparing financial reports to an objective standard in order to access and apply the elective tax-timing methods.</p>

<b>3</b>	<b>Draft Determination inconsistent with legislative focus and policy intent of Division 230</b>	
3.1	<p>The objects of each of the TOFA elective methods (Fair Value, Foreign Exchange Retranslation, Hedging and Financial Reporting) focus on the treatment of the relevant financial arrangement and not on the entirety of the financial statements of the taxpayer. The ATO's assertion that insignificant and mere breaches of accounting standards may deny entities access to TOFA elective methods is unjustified.</p> <p>Other provisions, such as paragraphs 230-395(2)(c) and 230-395(2)(e) of the ITAA 1997 which relate to the audit requirement, focus on the financial report only to the extent that it is relevant to the taxation of financial arrangements. This evidences a policy intent that similar flexibility should be applied in assessing whether financial reports are in accordance with accounting standards</p>	Agree. Appropriate changes have been made. See also issue 1.1 above
<b>4</b>	<b>Special Purpose Financial Statements might be acceptable where there is no derogation of integrity standards</b>	
4.1	<p>Special Purpose Financial Statements (SPFS) which comply with the requirements under Chapter 2M of the <i>Corporations Act 2001</i> should be sufficient to allow a taxpayer to utilise Division 230 elective methods. These adhere to the same integrity standard as GPFS via the application of AASB 139 with the exception of disclosures. Disclosures are not mandatory for SPFS. In this form, it is consistent with reduced disclosure reports prepared under AASB 1053, where AASB 1053 is accepted in the Draft Tax Determination.</p>	Disagree. If a SPFS applies only a subset of the accounting standards, and this subset does not include standards relevant to financial arrangements (including the disclosure requirements, as modified by AASB 1053 if applicable) it will not satisfy the accounting requirement in Division 230 of the ITAA 1997.

4.2	SPFS should be considered to comply with accounting principles where differences with GPFS only arise from additional information requirements, and do not directly impact the profit and loss statement or the balance sheet.	Disagree. SPFS will not satisfy the accounting requirement where these additional information requirements form part of the requirements set out by the accounting standards relevant to financial arrangements, even where they do not directly impact the profit and loss statement or the balance sheet. Disclosure requirements, for example, are relevant to the transparency and integrity of financial reports which is a key policy consideration of Division 230 of the ITAA 1997.
4.3	The Draft Tax Determination states that the primary view in that Draft 'best ensures that (elective methods) are only available where there is a <i>sufficient level of integrity</i> ...'. This statement disregards various discretions and protections to the ATO provided in the elective methods. The assertion that the proposed approach will 'best ensure' the ATO's desired integrity is incorrect in our view	While it is correct that various discretions and protections are available, the EM clearly states that the accounting requirement in Division 230 of the ITAA 1997 itself is intended to provide sufficient integrity (see paragraphs 5.15, 5.18 and 5.19 of the EM). However, the Final Determination accepts that there will be sufficient integrity where accounting standards relevant to financial arrangements have been followed (and the auditing requirement is satisfied). See also issue 1.1 above.
4.4	The ATO should identify circumstances where SPFR are acceptable in order for entities to access elective tax-time methods.	Agree. The Taxation Determination has been updated to state that a financial report containing SPFS will satisfy the accounting requirement where it applies the accounting principles relevant to financial arrangements. See paragraphs 2 and 29 to 33 of the Final Taxation Determination.
<b>5</b>	<b>Two or more relevant, but inconsistent accounting standards applicable to an entity</b>	
5.1	Where two or more accounting standards are relevant to an entity but inconsistent with each other, choosing one standard over another should not disqualify an entity from accessing the TOFA elective methods. The ATO should consider that, where two particular accounting standards are inconsistent, but both are potentially applicable, then the adoption of one instead of the other does not result in the relevant TOFA elections being unavailable	Agree. The Determination has been updated to include this at paragraph 33. Where a standard cannot be applied by an entity or it is inconsistent with another applicable accounting standard which the entity has applied, failing to apply that standard will not result in the financial report failing the accounting requirement.

<b>6</b>	<b>Draft Determination sets out an approach that is inconsistent with TD 2013/21</b>	
6.1	<p>The regulation addressed in TD 2013/21 and the TOFA accounting requirement is essentially identical.</p> <p>The ATO has adopted a narrow interpretation as compared with TD 2013/21 in allowing SPFR under some circumstances. The ATO should be more flexible and consider the practical compliance issues involved, and therefore adopt the alternative view that a financial report prepared in accordance with the relevant standards (expressed at paragraph 28 to 31) are in compliance with accounting standards.</p>	<p>Disagree. The regulation addressed in TD 2013/21 provides a different standard to that of this Final Determination. The requirement in TD 2013/21 is that the financial report 'complies with the accounting standards under the <i>Corporations Act 2001</i>'. This is a lower threshold than the requirement under Division 230 of the ITAA 1997. Division 230 requires an entity's report to be 'in accordance with the accounting principles'. The purpose and scope of each set of provisions differs correspondingly.</p>
<b>7</b>	<b>Consideration to recent legislative amendments in clarifying policy intent</b>	
7.1	<p>The introduction of section 230-527 of the ITAA 1997 allows for a different level of integrity for Australian branch reports of foreign ADIs. This suggests that the broader policy intention that integrity is only required for accounting principles relevant to the taxation of financial arrangements.</p>	<p>Agree in part. Section 230-527 of the ITAA 1997 was necessary to explicitly import a lesser level of consistency with accounting standards in the specific circumstances of a relevant branch of a foreign ADI (bearing in mind the prudential reporting standards of the Australian Prudential and Regulation Authority (APRA) they are subject to). But the specific limitation to the recognition and measurement standards in section 230-527 indicates that the accounting requirement outside section 230-527 is not limited to recognition and measurement.</p>



<b>8</b>	<b>Application of AASB 1053</b>	
8.1	The ATO should adopt an approach that where entities would have complied with AASB 1053, prior to its mandatory application and where there has been no early adoption, had that standard in fact applied, they will be taken to have satisfied the accounting requirement in paragraphs 230-210(2)(a), 230-255(2)(a), 230-315(2)(a) and 230-395(2)(a) of the ITAA 1997.	Disagree. The definition of ‘accounting standard’ under section 334 of the Corporations Act is an instrument that is ‘in force’. In the context of AASB 1053, an accounting standard under section 334 of the Corporations Act, financial reports prepared are ‘in force’ when they are in operation, not merely in existence. Even for entities which would otherwise have complied with AASB 1053 had the application date arrived or early adoption occurred, AASB 1053 can nevertheless not be said to be in force prior to the application date or early adoption of the standard.
<b>9</b>	<b>Period of application</b>	
9.1	The ATO should apply the Final Determination on a prospective basis	Disagree. The criteria outlined in the ATO’s administrative treatment found in Law Administration Practice Statement PS LA 2011/27 <i>Matters the Commissioner considers when determining whether the Australian Taxation Office (ATO) view of the law should only be applied prospectively</i> are not met in respect of this Taxation Determination.