


TD 2006/D18 - Income tax: consolidation: is a deferred tax liability recognised and measured in accordance with AASB 1020 (AAS 3) 'Income Taxes' (the 1999 standard) an accounting liability under subsection 705-70(1) where the 1999 standard was not adopted for the recognition and measurement of the liability for financial reporting purposes for the period within which the joining time occurred?

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This document has been finalised by TD 2006/60.



Draft Taxation Determination

Income tax: consolidation: is a deferred tax liability recognised and measured in accordance with AASB 1020 (AAS 3) '*Income Taxes*' (the 1999 standard) an accounting liability under subsection 705-70(1) where the 1999 standard was not adopted for the recognition and measurement of the liability for financial reporting purposes for the period within which the joining time occurred?

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Ruling

1. No. A deferred tax liability recognised and measured in accordance with AASB 1020 (AAS 3) '*Income Taxes*' (the 1999 standard) cannot be adopted for the purposes of recognising and measuring a liability of the joining entity at the joining time under subsection 705-70(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) where AASB 1020 (AAS 3) '*Income Taxes*' (the 1999 standard) was not adopted for the recognition and measurement of the liability for financial reporting purposes in the period within which the joining time occurs.
2. For the purposes of recognising and measuring liabilities of the joining entity at the joining time:
 - Joining entities that are reporting entities can only early adopt AASB 1020 '*Income Taxes*' (the 1999 standard) if the directors of the joining entity have elected to early adopt that standard in accordance with subsection 334(5) of the *Corporations Act 2001* for financial reporting purposes for the reporting period within which the joining time occurs.

- Joining entities applying Australian Accounting Standards (AAS) for financial reporting purposes during the reporting period within which the joining time occurs can only early adopt AAS 3 'Income Taxes' (the 1999 standard) if they have elected to apply this standard early for financial reporting purposes for the reporting period within which the joining time occurs.

Example

3. *H Co, a reporting entity and the parent entity of an accounting group, elects to form a tax consolidated group with Sub Co from 1 July 2002. For the financial year to 30 June 2003 Sub Co applied AASB 1020 (AAS 3) 'Accounting for Income Tax (Tax-effect Accounting)' (the 1989 standard) as the relevant accounting standard for financial reporting purposes. The directors of Sub Co have not elected to early adopt AASB 1020 (AAS3) 'Income Taxes' (the 1999 standard) in accordance with subsection 334(5) of the Corporations Act 2001 for that financial year. The relevant accounting standard for the recognition and measurement of current and deferred tax assets and liabilities of Sub Co at 1 July 2002, being the formation time under subsection 705-70(1) of the ITAA 1997, is AASB 1020 (AAS 3) 'Accounting for Income Tax (Tax-effect Accounting)' (the 1989 standard).*

4. *In August 2004, the directors of Sub Co elect before the date of the Directors Report attached to the financial statements for the year to 30 June 2004 to early adopt AASB 1020 'Income Taxes' (the 1999 standard) for the financial year ended 30 June 2004. This election is not for the financial year within which the formation of the group (on 1 July 2002) occurred and cannot be retrospectively applied to that date. The relevant accounting standard for the recognition and measurement of Sub Co's current and deferred tax assets and liabilities at 1 July 2002, being the formation time under subsection 705-70(1) of the ITAA 1997, is AASB 1020 (AAS 3) 'Accounting for Income Tax (Tax-effect Accounting)' (the 1989 standard).*

5. *On 1 January 2003, J Co, not previously controlled for accounting purposes by H Co, joins the tax consolidated group of H Co. For the financial year to 30 June 2003 and before the acquisition by H Co the Directors of J Co had elected to early adopt AASB 1020 'Income Taxes' (the 1999 standard) for financial reporting purposes. The relevant accounting standard for the recognition and measurement of J Co's current and deferred tax assets and liabilities at 1 January 2003, being the joining time under subsection 705-70(1) of the ITAA 1997, is AASB 1020 (AAS 3) 'Income Taxes' (the 1999 standard).*

6. *On 1 July 2003, Z Co, an entity controlled for accounting purposes by H Co becomes a joining entity of H Co's tax consolidated group. In August 2004 before the date of the Directors Report attached to the financial statements for the year to 30 June 2004 the directors of Z Co elect in accordance with subsection 334(5) of the Corporations Act 2001 to early adopt AASB 1020 (the 1999 standard) for the financial year ended 30 June 2004. The relevant accounting standard for the recognition and measurement of Z Co's current and deferred tax assets and liabilities at 1 July 2003, being the joining time under subsection 705-70(1) of the ITAA 1997, is AASB 1020 (AAS 3) 'Income Taxes' (the 1999 standard).*

Date of effect

7. This Ruling applies to years of income commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling.

Commissioner of Taxation

24 May 2006

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.*

Explanation

8. Taxation Ruling TR 2004/14¹ deals with the recognition and measurement of accounting liabilities of a joining entity under subsection 705-70(1) of the ITAA 1997 where a joining entity joins a tax consolidated group. The term 'accounting liability' refers to a liability at the joining time that can or must be recognised in the joining entity's statement of financial position in accordance with the accounting standards or statements of accounting concepts issued by the Australian Accounting Standards Board (AASB).

9. Paragraph 4 of TR 2004/14 in part states that 'the purpose of subsection 705-70(1) is to recognise and measure accounting liabilities at step 2 of the ACA [allocable cost amount] process in accordance with the established accounting framework that applies in Australia'. Paragraphs 21 to 23 of the Ruling discuss the accounting framework.

10. Paragraphs 8 to 15 of TR 2004/14 discuss the phrase 'in accordance with accounting standards, or statements of accounting concepts'. These paragraphs do not mandate the use of an existing audited statement of financial position for the recognition and measurement of accounting liabilities at subsection 705-70(1). However, if an entity has previously produced a statement of financial position then the accounting policies adopted at the joining time would usually be expected to be consistent with those previous statements.

11. Paragraph 10 of TR 2004/14 recognises three circumstances in which a different choice of accounting policy can be adopted to recognise and measure an accounting liability at the joining time. These choices are further outlined at paragraph 42 of the Ruling. The first circumstance is 'when new accounting standards, statements of accounting concepts and other authoritative pronouncements are required to be, or can be, adopted on or before the joining time'.

12. The choice that entities may have in recognising and measuring accounting liabilities are only to the extent that those choices are permitted under the accounting standards. Paragraph 95 of TR 2004/14 states in part that:

This choice of whether an amount can be recognised does not, however, override the recognition and measurement of those liabilities as required by a relevant accounting policy within the account framework. That is, where the accounting framework requires that joining entities must recognise and measure a liability in a particular way under the accounting standard 'can' does not override this requirement.

13. Paragraph 17 of TR 2004/14 states that 'in order to recognise and measure [accounting] liabilities in accordance with subsection 705-70(1) means that the joining time has to be treated, effectively, as a reporting date'.

¹ TR 2004/14 Income tax: consolidation: recognising and measuring liabilities of a joining entity under subsection 705-70(1) of the *Income Tax Assessment Act 1997*, issued 29 September 2004.

14. The joining time as a reporting date is further explored in paragraphs 72 to 78 of TR 2004/14. Paragraph 72 describes the lodgement date of the first relevant consolidated income tax return which includes the joining time of the joining entity as a report date. Paragraph 76 of the Ruling states:

Recognition of the joining time as a reporting date means that all accounting standards, authoritative pronouncement or statement of accounting concept of the AASB, which are applicable as at that date are applied to the recognition and measurement of liabilities at that time. Accounting standards, authoritative pronouncements and statements of accounting concepts are applicable to the joining time where they apply:

- for financial reporting periods beginning at a date before the joining time, or on the same date as the joining time;
- for financial reporting periods ending on a date later than the joining time where the financial reporting period either begins on or includes the joining time;
- from a specific date or event that has occurred before the joining time takes place; or
- in accordance with subsection 334(5) of the *Corporations Act 2001* the directors of the entity have elected for early adoption of the accounting standard for financial statement purposes and that election is dated on or before the lodgement date of the relevant consolidated income tax return. (This early adoption is not available to joining entities that do not fall within the scope of subsection 334(5)).

15. The reference in paragraph 76 of TR 2004/14 to subsection 334(5) of the *Corporations Act 2001* election being made before the lodgement date of the relevant consolidated income tax return highlights the use of the concept of a report date for the purposes of recognising and measuring liabilities at the joining time. This reference does not replace the operation of the accounting framework that underpins TR 2004/14. Early adoption of an accounting standard under subsection 334(5) is only relevant to the joining time where the Directors' election applies to the financial reporting period within which the joining time occurs.

16. Paragraph 77 of TR 2004/14 further clarifies which accounting standards are not relevant to the joining time. It states:

Accounting standards (except in respect of the early adoption of a standard noted above), other authoritative pronouncements and statements of accounting concepts are not relevant to the joining time where they apply:

- to financial reporting periods beginning after the joining time date;
- to financial reporting periods ending after the joining time where the first day of that period is also after the joining time date; or
- from a specific date or event that has occurred after the joining time date.

17. Paragraph 78 of that Ruling follows on by stating:

Adoption of different accounting standards, other authoritative pronouncements and statements of accounting concepts at a later time that are considered to be not relevant to the joining time do not retrospectively impact on the recognition and measurement liabilities at step 2 of the ACA process.

The Standards: AASB 1020 'Accounting for Income Tax (Tax-effect Accounting)', and AASB 1020 'Income Taxes'

18. AASB 1020 'Accounting for Income Tax (Tax-effect Accounting)', the 1989 standard, was approved on 30 October 1989 to be effective for financial years ending on or after 31 December 1989. Reporting entities applying AASB standards must apply AASB 1020 'Accounting for Income Tax (Tax-effect Accounting)' (the 1989 standard) for all accounting periods beginning before 1 January 2005 unless the entity elects to early adopt AASB 1020 'Income Taxes' (the 1999 standard) in accordance with subsection 334(5) of the *Corporations Act 2001*.

19. AASB 1020 'Income Taxes' (the 1999 standard), issued in December 1999, was initially intended to be operative for half-years ending 31 December 2002 and full-years ending on or after 30 June 2003. Entities could early adopt AASB 1020 'Income Taxes' (the 1999 standard) for financial years ending before 30 June 2003 if an election was made in accordance with subsection 334(5) of the *Corporations Act 2001*. Entities that early adopt AASB 1020 (the 1999 standard) were then not required to comply with the superseded AASB 1020 (the 1989 standard).

20. In June 2002 amendments were made to the operative date of AASB 1020 'Income Taxes' (the 1999 standard). For reporting periods beginning on or after 13 June 2002, the standard applied to half-years ending on or after 31 December 2003 and full-years ending on or after 30 June 2004.² Further amendment was made to the operative date of the AASB 1020 'Income Taxes' (the 1999 standard) in November 2002; the AASB 1020 (the 1999 standard) was to now apply for half-years ending on or after 30 June 2005 and full-years ending on or after 31 December 2005.³

21. From 1 January 2005 entities are required to apply the new Australian equivalent to International Financial Reporting Standards. AASB 112 'Income Taxes' is now applicable to annual reporting periods beginning on or after 1 January 2005. An early adoption of AASB 112 'Income Taxes' for reporting periods beginning before 1 January 2005 is not permitted.

22. These amendments to the operative date of AASB 1020 'Income Taxes' (the 1999 standard) described above mean that an entity can continue to prepare financial statements by applying AASB 1020 'Accounting for Income Tax (Tax-effect Accounting)' (the 1989 standard) until the adoption of AASB 112 'Income Taxes', unless the entity elected to early adopt AASB 1020 'Income Taxes' (the 1999 standard) in accordance with subsection 334(5) of the *Corporations Act 2001* for reporting periods that commenced prior to 1 January 2005.

23. If a joining entity reporting under the *Corporations Act 2001* has not elected to early adopt AASB 1020 'Income Taxes' (the 1999 standard) in accordance with subsection 334(5) of the *Corporations Act 2001* for financial reporting purposes for the reporting period within which the joining time occurs, then AASB 1020 'Income Taxes' (the 1999 standard) cannot be applied at the joining time for step 2 purposes. Adoption of AASB 1020 (the 1999 standard) for the purposes of step 2 of the ACA process without the election for early adoption made in accordance with subsection 334(5) of the *Corporations Act 2001* for financial reporting purposes would not be 'in accordance with accounting standards' and would not be consistent with the established accounting framework that is set out in TR 2004/14.

² AASB 1020A Amendments to Accounting Standard AASB 1020 and Australian Accounting Standard AAS 3, issued June 2002.

³ AASB 1020B Amendments to Accounting Standard AASB 1020 and Australian Accounting Standard AAS 3, issued November 2002.

AAS 3 ‘Accounting for Income Tax (Tax-effect Accounting)’, and AAS 3 ‘Income Taxes’

24. Australian Accounting Standard AAS 3 ‘*Accounting for Income Tax (Tax-effect Accounting)*’ (the 1989 standard) and AAS 3 ‘*Income Taxes*’ (the 1999 standard) are applicable to reporting entities that are not required to apply AASB accounting standards. Paragraph 20 of TR 2004/14 states that:

The application of the accounting framework to the recognition and measurement of liabilities at step 2 of the ACA process is undertaken within the context of developing a notional statement of financial position at the joining time. This notional statement is otherwise part of a general purpose financial report. The application of the accounting framework should consistently apply to all joining entities, whatever their structure or legal status. The consistent application also applies whether the joining entities are reporting or non-reporting entities.

25. This Tax Determination is applicable to reporting entities utilising AAS accounting standard AAS 3 ‘*Accounting for Income Tax (Tax-effect Accounting)*’ (the 1989 standard) or electing to early adopt AAS 3 ‘*Income Taxes*’ (the 1999 standard).

26. Early adoption of AAS 3 ‘*Income Taxes*’ (the 1999 standard) is permitted at paragraph 2.2 when an entity elects to do so. That Standard does not describe the mechanism for evidencing that election. However, for the purposes of recognising and measuring accounting liabilities under subsection 705-70(1) of ITAA 1997, evidence of the decision to early adopt AAS 3 ‘*Income Taxes*’ (the 1999 standard) from a specific date should be similar to, or equivalent to, the evidence required under subsection 334(5) of the *Corporations Act 2001*.

Appendix 2 – Alternative views

❶ *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.*

Alternative views

27. It has been suggested that the phrase ‘can or must be recognised’ in subsection 705-70(1) of ITAA 1997 provides joining entities with a choice of what accounting standard can be adopted for determining the amount of accounting liabilities at the joining time. The word ‘can’ is acknowledged at paragraph 93 of TR 2004/14 as meaning ‘to able to’, ‘Can’ may therefore be applied to the measurement of deferred tax liabilities under AASB 1020 (the 1999 standard) notwithstanding the absence of an appropriate election to early adopt the standard for financial reporting purposes for the period within which the joining time occurs.

28. The Commissioner’s view of ‘can or must’ is expressed in TR 2004/14 at paragraphs 19 and 93 to 95 of TR 2004/14. Paragraph 94 states that ‘must’ ‘...in context of subsection 705-70(1) of ITAA 1997 is taken to mean an obligation or a necessity’. Any liability that ‘must’ be recognised and measured under the accounting framework is required to be recognised and measured according to the accounting policy set out within the framework. In accordance with the accounting framework Accounting Standard AASB 1020 (AAS 3) ‘*Accounting for Income Tax (Tax-effect Accounting)*’ (the 1989 standard) must be applied to the joining entity unless the joining entity has for financial reporting purposes early adopted AASB 1020 (AAS 3) ‘*Income Taxes*’ (the 1999 standard) for the reporting period within which the joining time occurs.

29. It is further suggested that the circumstances in which choice of using a different accounting policy at the joining time is first identified at paragraph 10 of TR 2004/14, and then further explained at paragraph 42 specifically allows the adoption of AASB 1020 ‘*Income Taxes*’ (the 1999 standard) for the measurement of liabilities under subsection 705-70(1) of ITAA 1997. Paragraph 42 states, in part:

Within the accounting framework the choice of accounting policies for recognising and measuring liabilities at the joining time may be different to those policies that were used previously for financial statement or other reporting purposes. This may occur where either:

- new accounting standards, statements of accounting concepts or other authoritative pronouncements are required to be, or can be, adopted on or before the joining time;
- ...; or
- existing accounting standards, statements of accounting concepts or other authoritative pronouncements in Australia allow the adoption of a different accounting policy that is relevant.

30. Paragraph 42 of TR 2004/14 refers to ‘policies that may be different to those that were used in previous financial statements’. The reference highlights that joining entities may apply a different accounting policy from previous reporting periods through a new or existing standard or other authoritative pronouncement. This may occur where the new or existing standard is adopted as a choice of accounting policy for financial reporting purposes of the entity in the year within which the joining time occurs.

31. Paragraph 42 of TR 2004/14 refers to the adoption of new accounting standards on or before the joining time. AASB 1020 *'Incomes Taxes'* (the 1999 standard) was first promulgated in December 1999. A choice has been available to early adopt the standard for financial reporting periods since this point. If the choice to early adopt AASB 1020 *'Income Taxes'* (the 1999 standard) for the financial reporting period within which the joining time occurs has not been made by a reporting entity in accordance with subsection 334(5) of the *Corporations Act 2001* the Commissioner is of the view that the relevant accounting standard that must be adopted for the recognition and measurement of deferred tax liabilities at the joining time for a joining entity is AASB 1020 *'Accounting for Income Tax (Tax-effect Accounting)'* (the 1989 standard).

Appendix 3 – Your comments

32. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

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References

Previous draft:

Not previously issued as a draft

- reporting entity
- reporting period
- recognising and measuring a liability

Related Rulings/Determinations:

TR 2004/14

Legislative references:

- Corporation Act 2001 334(5)
- ITAA 1997 705-70(1)

Subject references:

- accounting standards
- accounting framework
- accounting liability
- allocable cost amount
- can or must
- consolidation
- deferred tax liability
- joining time
- reporting date

Other references:

- AASB 1020 (AAS3) – Income Taxes (the 1999 standard)
- AASB 1020 (AAS 3) – Accounting for Income Tax (Tax-effect Accounting) (the 1989 standard)
- AASB 112 – Income Taxes

ATO references

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