# *Tax accounting issues for December year end/June half year*

*19 December 2014*

## *In brief*

As always, an approaching year end brings with it a need to reconsider tax accounting treatments - both for the impact of new tax rules and developments in accounting guidance. A number of the issues that were flagged at 30 June 2014 are still in the 'wait and see' basket as the majority of the Federal Budget announcements are yet to be legislated. However, as set out below there are a number of enacted laws to consider, together with other recent developments.

## *In detail*

### *Tax treatment of outbound instruments*

The proposal to align the treatment of dividends from foreign companies to the debt equity tax rules has now been legislated - the new rules apply to distributions and non-share dividends made after the date of Royal Assent, being 16 October 2014.

The key change to the rules is to remove the exemption for foreign dividends where the shares are otherwise treated as debt for tax purposes (ie these dividends will now be taxable). This change in treatment is most relevant for certain hybrid instruments (such as certain redeemable preference shares) which previously were entitled to the dividend exemption as the previous rule looked to the legal character of the instrument.

The tax accounting considerations were explored in our June edition of *TaxTalk*. To summarise the key matters:

- If you hold such instruments, deferred tax will need to be recognised unless you fall within the recognition exemption in AASB 112 relating to investments in subsidiaries, associates and joint arrangements. To be eligible for that exemption, the company needs to establish that it can control the timing of the reversal of any temporary difference, and that it is not likely that it will reverse for the foreseeable future. This can be difficult to establish for preference shares.
- The impact can be magnified where the shares are denominated in a foreign currency. That is, similar to the position for dividends, deferred tax for temporary differences due to foreign currency movements may not have been recognised historically as the foreign exchange amounts were also likely to be exempt, but that tax technical outcome is now uncertain.

### *Thin capitalisation*

The long anticipated change to the thin capitalisation rules has now also been enacted, and has effect for income years starting on or after 1 July 2014. The key change is that the thin capitalisation 'safe harbour' percentage has reduced from 75 per cent to 60 per cent. In terms of what this means for tax accounting positions:

- For 30 June year ends looking at their 31 December half year position, thin capitalisation calculations must be prepared using the revised safe harbour rule
- For 31 December year ends, the new law does not yet apply – ie it will first apply to the year commencing on 1 January 2015.

Some additional matters to watch out for at 31 December include:

- To the extent that any restructuring has been undertaken in light of the changes, have the tax issues been fully considered and documented ahead of year end? For instance, the impact of debt forgiveness rules and any implications for available fractions on losses?
- If losses are being carried forward, do the changes impact on taxable income forecasting – ie has the position changed with respect to the probability of recovery of the tax losses?

### *Repeal of MRRT and Carbon tax*

The MRRT was repealed in September 2014 with effect from 1 October 2014. To the extent that companies had booked deferred tax assets or liabilities in respect of the MRRT these will now need to be de-recognised.

The repeal of the Carbon tax was substantively enacted on July 2014, with effect from 30 June 2014.

### *Recap on impending legislative changes*

There are a number of proposed but unenacted law changes that have been in the pipeline for some time. Until these changes are substantively enacted they cannot be taken into account for tax accounting purposes. Given that there are no Parliamentary sitting days left this year these changes will not be substantively enacted by 31 December. Some of the proposed changes that could have tax accounting consequence upon substantive enactment are as follows:

- Tax consolidation and future deductible liabilities. This is a change that was announced in the 2013 Federal Budget and is still proposed to have effect from that night. Under the proposal, where a company is acquired by a consolidated group, and future deductible liabilities are included in the Allocable Cost Amount calculation, the amount of the future deductible liability will be included in assessable income over either 12 months (for current liabilities) or 48 months (for non-current liabilities) . For groups that have made company acquisitions since May 2013, upon substantive enactment it will be necessary to immediately book a current and/or deferred tax liability through the P&L in connection with the future deductible liabilities. Acquisition accounting cannot be adjusted since the change relates to a change in law after the acquisition date).
- There are two proposed changes in relation to the R&D tax offset. The first is a proposal to remove the concession for companies with turnover of greater than $20bn – this change was originally proposed to be effective from 1 July 2013, but as part of the Mid-Year Economic and Fiscal Outlook the start date was delayed to 1 July 2014. The second is a proposal to reduce the refundable R&D tax offset from 45 per cent to 43.5 per cent (for eligible companies with turnover less than $20 million) and to reduce the non-refundable R&D tax offset from 40% to 38.5% (for eligible companies with turnover of greater than $20 million). This second change is also proposed to have effect for income years starting on or after 1 July 2014. There are bills currently before Parliament in respect of both of these changes, although they now cannot be enacted prior to 31 December 2014.
- Reduction in the corporate tax rate to 28.5 per cent, and new 1.5 per cenr Paid Parental Leave (PPL) levy. We believe that the PPL will be treated as an 'income tax' under AASB 112, with the result that for many larger companies, the average effective tax rate will not materially change. For companies with taxable income of less than $5m the effective tax rate will change to 28.5 per cent, and deferred tax balances will likely need adjusting as a consequence.

### *Uncertain tax positions and disclosures*

ASIC's focus areas for 2015 include tax accounting and disclosures for estimates and accounting policy judgements. An area where these items intersect is in tax accounting for uncertain tax positions.

We continue to see tax laws and interpretations changing, which creates inherent uncertainty in both historic and new tax positions. Tax accounting for uncertain tax positions becomes particularly sensitive during tax disputes, although disputes are not the only circumstances in which positions may need careful initial assessment and/or revisiting. Uncertainties in income taxes are not specifically addressed in IAS 12, but rather the general measurement principles should be applied. Some points to note:

- The accounting standards require that a liability should be recognised in a company's accounts where it is not probable that the position will be sustained upon examination by the tax authority. That assessment must be based on the application of the tax law (including legislation and cases) as at the relevant balance date. Tax liabilities can be measured using either a "single best estimate" of the most likely outcome (for instance where the outcome is binary), or using an "expected value" approach, i.e. a weighted average probability calculation. .
- A company may need to reassess this position, in particular if new information comes to light during the course of a tax dispute, or independently of any ATO enquiry.
- Where a position paper or amended assessment is issued by the tax authorities companies will need to evaluate the reporting implications. Factors such as likelihood of successfully objecting to the position paper or assessment and considerations as to potential settlement outcomes will all be relevant.

Beyond considerations as to the direct impact on financial outcomes (ie the measurement of any Uncertain Tax Position), it is necessary to determine what is appropriate in terms of disclosures. This is important and often challenging for items that are inherently judgemental, as can be the case with complex tax matters. The challenge in terms of appropriate disclosures is heightened in the case of a revenue authority dispute.

## *Let's talk*

For a deeper discussion of how these issues might affect your business, please contact:


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