BLIND FREDDY – INCOME TAXES - CONTINUED

LAST MONTH'S BLIND FREDDY ARTICLE ON ACCOUNTING FOR INCOME TAXES RAISED COMMENTS FROM TAX EXPERTS AS TO THE ACCURACY OF OUR ASSERTION THAT "ASSUMING THE COMPANY DOES NOT OPERATE IN A JURISDICTION WITH A TAX RATE BELOW 30 PER CENT, AND THE ENTITY IS NOT BRINGING TO ACCOUNT LOSSES PREVIOUSLY UNRECOGNISED, IF AASB 112 IS BEING APPLIED CORRECTLY, THE EFFECTIVE TAX RATE SHOULD BE SLIGHTLY ABOVE 30 PER CENT."

This is a general 'rule of thumb'. Some entities have a genuine reason for having a tax rate lower than 30 per cent, for example, where there is:

- R&D concessions on qualifying expenditure
- Non-assessable, non-exempt income and expenditure (NANE).

We also received comments from tax experts with regard to our statement that 'Common errors when applying AASB 112 include:

- Not recognising a deferred tax liability (DTL) for profits in an overseas associate
- Not recognising a DTL on profits in an overseas subsidiary when the group's intention is to repatriate these profits to Australia.'

To clarify, these would only be errors where a DTL is not recognised, if in repatriating these overseas earnings to Australia, there are tax consequences as a result of applying Australian and International Tax laws. If there would be no tax consequences from repatriating overseas earnings, then failing to recognise a DTL, in such cases, would not be an error.

Other common errors/issues

Application of AASB 112 also gives rise to some unexpected 'mismatches' when revaluing property, plant and equipment (PPE) or available-for-sale (AFS) financial assets.

When PPE or AFS assets are revalued, the revaluation increment is recorded in a revaluation reserve or AFS reserve rather than in the income statement.

AASB 112 requires that a deferred tax liability be recognised in respect of this revaluation. However the corresponding debit entry goes to the corresponding reserve, not the income statement.

Example

Co A revalues AFS by $1,000

Entries:

Dr AFS	$1,000	
Cr AFS reserve		$1,000
Dr AFS reserve	$300	
Cr DTL		$300

There are many circumstances where the entity concerned is in a loss making situation and only recognises deferred tax assets (DTA) arising from losses to the extent that deferred tax liabilities have been recognised.

In the above example if Co A was loss making and only recognising deferred tax liabilities it would make the following entry:

Dr DTA	$300	
Cr Income statement		$300

If the AFS were subsequently sold for their revalued amount, the revaluation is recycled to the income statement as follows:

Dr AFS reserve	$1,000	
Cr Profit		$1,000
Dr DTL	$300	
Cr AFS reserve		$300
Dr Income tax expense	$300	
Cr DTA		$300

It should be noted that in certain circumstances, if the AFS asset is an overseas asset held by the Australian entity, a DTL may not be recognised on revaluation as the Australian entity is not subject to capital gains on certain overseas assets. Again, Australian and International Tax laws need to be considered. Given the complex nature of this type of investment and tax treatment, it is recommended that this be clarified with your BDO Tax Partner so that the correct impact is correctly recognised and brought to account.