STAFF PAPER

10 July–11 July 2012

IFRS Interpretations Committee Meeting

Project	**IAS 1 *Presentation of Financial Statements* and IAS 12 *Income Taxes***
Paper topic	Presentation of payments of non-income taxes

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Introduction

1. The IFRS Interpretations Committee (the Committee) received two requests from different submitters to clarify the presentation in the statement of comprehensive income of royalty payments claimed as an allowance against income tax. The Committee deliberated this issue in the March 2012 meeting and tentatively decided not to add this issue to its agenda.

2. The objective of this paper is to provide the Committee with the summary of comment letters received on the tentative agenda decision reached by the Committee in the March 2012 meeting and with a staff analysis on the comment letters. This paper also includes our analysis on the second submission received in February 2012, which was presented to the Committee but not fully analysed in the March 2012 meeting.

3. The structure of this paper is as follows:

   (a) background information on the issue;

   (b) staff analysis on the comments including arguments presented in the second submission;

   (c) staff recommendation to the Committee; and

(d) question for the Committee.

Background

4. We received two submissions on this issue from different submitters in December 2011 and February 2012, respectively. The submitters were seeking clarification on whether the production-based royalties paid to one taxation authority that are claimed as an allowance against income tax payables to another taxation authority under a proposed tax regime should be presented as operating expense or as a tax expense.

5. In June 2011, the Australian Government released an exposure draft of proposed Minerals Resource Rent tax (MRRT) legislation, which was thereafter approved by the Australian Parliament in March 2012 without any major changes that could affect the discussions on this issue.

6. According to the submissions, under the new tax regime, payments to a local taxation authority for production-based royalties are deductible in calculating the MRRT payables to the government. The submissions also state the following key features of the tax regime relevant to this issue:

   (a) The amount of the deduction ('royalty allowance') is calculated by grossing up the royalty payments by the MRRT tax rate when calculating taxable profit for the MRRT, which results in a 100 per cent credit against the tax payables to the government. Assuming that the tax rate is 25 per cent and that the amount of royalty payments is CU25[1], the entity can deduct CU100 (= CU25/0.25) when arriving at the taxable profit on which the MRRT payables are based.

   (b) The royalty allowance is the first allowance to be applied in the determination of the MRRT payables.

[1] In this Agenda Paper, monetary amounts are denominated in "currency units (CU)".

(c) Unused royalty allowances are subject to augmentation[2] and are carried forward to be applied against the MRRT payables in future tax periods. Those carried-forward allowances are included in the royalty allowance, which is the first allowance to be applied in the determination of the MRRT payables in a particular period.

7. In addition, as the basis for the discussion, the submitter of the first submission assumes that the royalty payments are**, in themselves, outside the scope of IAS 12 *Income taxes*** while MRRT is within the scope of IAS 12. On the basis of this assumption, the submitter states that there are two views on the presentation of the royalty payments in the statement of comprehensive income:

(a) View 1: presented as **operating expenses or production cost** because the royalty payments **do not, in themselves, meet the definition of income taxes under IAS 12; and**

(b) View 2: presented as **tax expense** because the nature of the royalty payments could be considered payments that are, in substance, **prepayment of MRRT even though the royalty payments are not income taxes on a stand-alone basis.**

8. The Committee discussed this issue at the March 2012 meeting. The Committee also used the assumption outlined in the first submission that the production-based royalty payments are, in themselves, outside the scope of IAS 12 while the tax payable to the other taxation authority is within the scope of IAS 12.

9. The Committee observed that the line item of 'tax expense' that is required by paragraph 82(d) of IAS 1 *Presentation of Financial Statements* is intended to require an entity to present taxes that meet the definition of income taxes under IAS 12.

10. The Committee also noted that it is the basis of calculation that determines whether a tax meets the definition of an income tax. Neither the manner of settlement of a tax liability nor the factors relating to recipients of the tax is a determinant of whether an item meets that definition.

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[2] Unused royalty allowances are uplifted at the Long-Term Government Bond Rate (LTBT) + 7 per cent.

11. The Committee further noted that royalty payments should not be treated differently from other expenses that are outside the scope of IAS 12, all of which may reduce income tax payable. Accordingly, because the production-based royalties do not meet the definition of an income tax, they should not be presented as an income tax expense in the statement of comprehensive income.

12. On the basis of the discussions above, the Committee tentatively decided not to add this issue to its agenda. Our full analysis, together with excerpts from the two submissions that were presented at the Committee meeting in March 2012, were set out in Agenda Papers 8[3] and 8A[4], which can be found on the public website.

13. We received six comment letters[5] with respect to the tentative agenda decision. In the following paragraphs, we analyse those comment letters along with the discussions presented in the second submission.

Staff analysis on comments including arguments in the second submission

14. The following paragraphs summarise the comments received on the tentative agenda decision and arguments presented in the second submission, which is followed by our analysis. In analysing the comments and arguments, we categorised them into the following subcategories:

    (a) scope of tax expense under IAS 1;

    (b) 'net' or 'gross' within the context of the scope issue related to IAS 12;

    (c) 'monetary value' or 'physical volume' within the context of scope issue related to IAS 12;

    (d) collective-base assessment of the scope of income taxes under IAS 12;

    (e) adequacy of our outreach activities; and

    (f) proposed changes to the wording of the tentative agenda decision.

[3] http://www.ifrs.org/NR/rdonlyres/5D4BBA39-0FE4-49B7-9C89-1FEE23FBC80F/0/081203AP08IAS1IAS12Presentationofnonincometaxes.pdf

[4] http://www.ifrs.org/NR/rdonlyres/C3A548F0-C87C-49E8-836F-24B8FE78646E/0/081203AP08AIAS1IAS12SupplementPresentationofnonincometaxes.pdf

[5] E&Y, BHP Billiton, DTT, AcSB, Mazars, and Xstrata.

Scope of tax expense under IAS 1

15. All the respondents agreed that the line item of 'tax expense' that is required by paragraph 82(d) of IAS 1 *Presentation of Financial Statements* is intended to require an entity to present taxes that meet the definition of income taxes under IAS 12.

16. However, one respondent[6] proposes that the IASB should amend paragraph 82(d) of IAS 1 to refer to income taxes under IAS 12 through an annual improvement project in order to make the intention of that paragraph clear.

Staff response

17. We agree that amending that paragraph to explicitly refer to IAS 12 might improve IFRSs by clarifying the intention of the paragraph. However, we think that, according to the results of the outreach that we conducted and the nature of the comments that we have received, no significant divergent interpretation of that paragraph has been identified. Accordingly, we think that amending paragraph 82(d) of IAS 1 would not greatly contribute to the improvement of financial reporting by entities. The cost of undertaking due process associated with the annual improvement would not be justified by any benefits that the amendment might provide.

18. Consequently, we think that the Committee should not take any action with regard to this sub-issue.

'Net' or 'gross' within the context of scope issue related to IAS 12

19. All the respondents support the basic principle that it is the basis of calculation that determines whether a tax meets the definition of income taxes. However, one respondent[7] is of the view that the production-based royalty payments could, in themselves, meet the definition of income taxes under IAS 12.

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[6] DTT

[7] BHP Billiton

20. They note that the Committee had observed in the past that the term 'taxable profit' implies a notion of a net rather than a gross amount. They argue in the comment letter and the second submission that the Committee's observation is contrary to the requirements in paragraph 5 of IAS 12, which defines taxable profit as the amount "determined in accordance with the rules established by the taxation authorities". In their view, even if the tax rules established by the taxation authorities do not permit deductions, that fact should not prevent an entity from accounting for the tax as income taxes under IAS 12. They think that the approach taken by the Committee would fail to properly reflect the total amount of taxes levied on an entity, given the significant differences in the treatment of deductions of payments among tax regimes around the world.

21. They also raised a question of what quantum or nature of expense satisfies the notion of a net amount for taxable profit. They think that it is inappropriate if a gross amount with trivial deductions could be viewed as meeting the definition of taxable profit, while a gross amount without any deductions is always viewed as not meeting the definition.

22. On the basis of the discussions above, the respondent believes that the availability of deductible expenses is irrelevant when assessing whether a tax is within the scope of income taxes under IAS 12. Accordingly, they believe that royalty payments could, in themselves, be viewed as income taxes under IAS 12.

Staff response

23. As a reminder, we reproduce below the Committee's decision reached in March 2006 (emphasis added):

IAS 12 Income Taxes – Scope

The IFRIC considered whether to give guidance on which taxes are within the scope of IAS 12. The IFRIC noted that IAS 12 applies to income taxes, which are defined as taxes that are based on taxable profit. That implies that (i) not all taxes are within the scope of IAS 12 but (ii) because taxable profit is not the same as accounting profit, taxes do not need to be based on a figure that is exactly accounting profit to be within the scope. The latter point is also implied by the *requirement in IAS 12 to disclose an explanation of the relationship between tax expense and accounting profit. The IFRIC further noted that the term 'taxable profit' implies a notion of a net rather than gross amount. Finally, the IFRIC observed that any taxes that are not in the scope of IAS 12 are in the scope of IAS 37 Provisions, Contingent Liabilities and Contingent Assets.*

However, the IFRIC also noted the variety of taxes that exist world-wide and the need for judgement in determining whether some taxes are income taxes. The IFRIC therefore believed that guidance beyond the observations noted above could not be developed in a reasonable period of time and decided not to take a project on this issue onto its agenda.

24. The staff think that, as indicated in the Committee's decision above, it is a matter of judgement whether a calculation basis complies with the 'net' notion. The assessment of what extent of deductions is necessary to meet the net notion should be judged by considering the requirements of the tax legislation in the jurisdiction. As explained in the submissions, the details of requirements for royalty payments vary from State to State.

25. Accordingly, we do not think that the Committee should provide further guidance on whether the calculation basis of royalty payments to a specific taxation authority meets the definition of taxable profit under IAS 12 as interpreted by the Committee. In this regard and in the context of the fact pattern described in the submission, we believe that the Committee should retain the premise that royalty payments are not income taxes under IAS 12 on a stand-alone basis when publishing its final decision.

'Monetary value' or 'physical volume' within the context of scope issue related to IAS 12

26. One respondent[8] states that the calculation basis of the royalties is a monetary value rather than a physical volume of production. They argue that this fact also supports the view that the royalty payments could, in themselves, meet the definition of income taxes under IAS 12.

[8] BHP Billiton

Staff response

27. We agree that under IAS 12 'taxable profit' should be a monetary value rather than a physical volume. However, within the context of this issue, we think that this argument is not significant because, as highlighted above, a dominant factor to determining whether the royalty payments are income taxes under IAS 12 is whether the basis of calculation of royalty payments meets the 'net' notion or not.

Collective-base assessment of the scope of income taxes under IAS 12

28. Three respondents[9] argue that the royalty payments could be assessed on a collective basis with the MRRT primarily on the basis of the meaningful relationship between the royalty payments and the MRRT which is stemming from the tax treatments of royalty payments under the MRRT regime described above as well as the background for the legislation of the MRRT. They think that the Committee failed to provide a relevant answer to the issue raised by the submission because of the lack of consideration of the compensation link between the two payments.

29. With regard to the background for the legislation, one respondent[10] states that the MRRT was initially conceived of as a replacement for all royalty payments to State governments. However, the Australian government was unsuccessful in its negotiations with the State governments, and it therefore designed the MRRT legislation to provide affected taxpayers with a full reduction for royalty payments against the MRRT payables.

30. When assessed collectively, one of the respondents[11] thinks that the production-based royalty payments should be accounted for as income taxes under IAS 12, because the royalty payments are by design an integral part of MRRT and should therefore be viewed as prepayment of the MRRT. Even though the calculation basis of the royalty payments had not changed, the new tax regime had changed the nature and substance of the royalty payments. As a result, they think

[9] BHP Billiton, Mazars, and Xstrata

[10] BHP Billiton

[11] BHP Billiton

that the royalty payments were converted into a mechanism that allocates the tax levied on a project between State governments and the Australian government.

31. They argue that, taking into consideration the tax treatments of the royalty allowance and the background of the legislation, presenting the royalty payments as part of the MRRT would enhance the faithful representation, relevance and comparability of financial information related to the taxes.

32. Another respondent[12] states that if analysed on a collective basis, the calculation of the overall amount of taxes would not be production-based at all. This is because, according to them, the royalty payments could be viewed as being fully compensated by the MRRT rather than merely reducing the MRRT payables. In that case, the production-based royalty could be viewed as an allocation of MRRT between State governments and the Australian government, and therefore could be accounted for as income taxes under IAS 12.

33. One of the respondents[13] has the similar view that the MRRT regime converted the royalties into a mechanism which settles or pre pays the MRRT obligation. However, they think that it could be argued that it is appropriate to account for the royalty payments as income taxes only in profitable circumstances. This is because the royalty payments would no longer be part of the MRRT if entities do not need to pay the MRRT due to low profitability. In short, they believe that the accounting for this type of taxes is a matter of judgement on the basis of the facts and circumstances specific to the entities in addition to the facts and circumstances related to the tax legislation.

Staff response

34. As stated above, we think that a dominant factor in determining whether a tax is within the scope of IAS 12 is the calculation basis of the tax. Furthermore, there is guidance provided by the Committee that the calculation basis should be ‘net’ rather than ‘gross’. In this sense, we are of the view that some types of payment, which are not income taxes on a stand-alone basis, would meet the definition of

[12] Mazars

[13] Xstrata

income taxes under IAS 12 if the calculation basis of the total amount of the payment and related income taxes is a ‘net’ amount. In that case, we could argue that the payment is part of, and prepayment of, the income taxes, and should therefore be accounted for as income taxes under IAS 12. In other words, that taxation could be viewed as a mechanism that merely allocates income taxes between the two payment streams to the different taxation authorities.

35. We agree that in some situations entities may need to assess a tax while taking into consideration other taxes that have meaningful relationships to that tax. We also agree that IAS 12 does not preclude entities from concluding that payments to multiple taxation authorities should be assessed on a collective basis. As stated in the submission, the use of the plural term ‘taxation authorities’ in the definition of taxable profit supports this view. This is also consistent with the observation in the tentative agenda decision, which states that “neither the manner of settlement of a tax liability nor the factors relating to recipients of the tax is a determinant of whether an item meets that definition”.

36. However, in this specific case, we think that the royalty payments do not meet the definition of income taxes under IAS 12 even when assessed on a collective basis. If the amount of the MRRT payables is sufficient to absorb the 100 per cent deduction of the royalty payments, the calculation basis of the combined taxes would be the same as the taxable profit for the ‘gross’ MRRT which is calculated without the effects of tax deductions of royalties. We think that the taxable profit for the ‘gross’ MRRT’ is likely to meet the net notion on the basis of the assumption that the MRRT meets the definition of income taxes under IAS 12. However, if not, the combined taxes would no longer be based on a net amount. This is a result of the fact that the royalty payments are assessed on the basis of a gross amount and that the tax rule does not allow an entity to claim refunds for overpayments from the governments. Consequently, the ultimate tax amount calculated in accordance with the tax rule established by the taxation authorities is not always based on a net amount.

37. We further think that entities should determine the accounting for a tax on the basis of the requirements in the relevant tax rules rather than entity specific factors such as estimates of future taxable profits. We think that this view is supported by

the definition of taxable profit in IAS12 which states that taxable profit is the profit determined in accordance with the rules established by the taxation authorities.

38. Furthermore, whether the royalty allowance is regarded as a tax credit or tax deduction concerns only the requirements for the tax treatment of the royalties under the MRRT. This is also true of the seniority of royalty allowances to other allowances and the carry-forward feature. Such requirements do not affect the calculation basis of the total amount of taxes determined by the tax rules.

39. In summary, we are of the view that even though IAS 12 allows entities to analyse multiple taxes on a collective basis when there is an interrelationship among those taxes, the royalty payments in this specific case would not meet the definition of income taxes under IAS 12 even when assessed together with the MRRT. In this circumstance, the application of the relevant tax rules would not necessarily result in the calculation basis of total amount of the two taxes being on a net amount even on a collective basis because the royalty payments are based on a gross amount. When the MRRT payables are insufficient to absorb the royalty allowances, the calculation basis of the total amount of the two taxes would no longer be a net amount by design of the tax rules.

Adequacy of our outreach activities

40. One respondent[14] states that our outreach activity is not detailed enough to conclude that there does not appear to be diversity in practice with regard to the treatment of royalties that are claimable as a deduction against taxable profits. They think that such royalties can be viewed as income taxes or non-income taxes on the basis of their features. However, they maintain that our outreach did not sufficiently examine the difference in practices for such royalty payments.

41. They also state that the outreach does not establish whether there is diversity in practice in the treatment of non-income tax royalties that are fully creditable against income tax payables. They think that the two cases illustrated in our

[14] BHP Billiton

Agenda Paper 8A for the March 2012 meeting are not similar to the case of this issue.

Staff response

42. Admittedly, the facts and circumstances of the two examples presented in the responses to our outreach request might be regarded as being dissimilar from the specific fact pattern in the submission, in that the two examples do not have the feature of a 100 per cent reduction against related income taxes.

43. However, as discussed above, the key observation of the Committee on this issue is that it is the basis of calculation that determines whether a tax meets the definition of an income tax. In our view, the results of our outreach have identified no significant diversity in interpretation of this basic principle.

44. After the March 2012 meeting, we received another response from a constituent in the International Forum of Accounting Standard-Setters (IFASS) to our request for information, which we believe is relevant to this issue. In the fact pattern described in the response, entities in the oil industry in that jurisdiction are required to pay a tax on a monthly basis, which is calculated based on gross revenue (quantities sold x historical prices or market prices). At the end of a fiscal year, the final amount of the tax payable is determined based on net taxable profit. The amount of the monthly payments is claimable as tax credits against the tax liability determined on the basis of the net taxable profit for the year. It is assumed that the tax determined at the end of a fiscal year is income taxes as defined in IAS 12.

45. According to the respondent, entities in that jurisdiction determined that the monthly payments should be accounted for as prepayment of income taxes. The primary rationale is that the calculation basis of the total amount of both taxes meets the definition of taxable profit under IAS 12. Under the tax regime, entities have a right to claim a refund from the taxation authority if the amount of the calculated annual tax is less than the total amount of the monthly payments.

46. Some may argue that this example is also dissimilar from the issue presented in the submission because, in this case, the recipient of the two payments is the same.

However, we believe that this example supports our view that a non-income tax could be viewed as part of and prepayment of the other income tax if it is concluded that the basis of calculation for the combined amount of the taxes is a net taxable profit.

47. We recognise that there are different views on accounting for the royalty payments in this specific case. We also recognise that, as stated in the comment letter, royalty payments could be viewed as income taxes or non-income taxes on a stand-alone basis depending on their features. However, according to the results of our outreach, we think that, in practice, entities judge whether a tax is within the scope of IAS 12 on the basis of the calculation basis of the tax. This is the case even when multiple taxes are analysed on a collective basis.

48. In addition, we stated clearly in our outreach request that the new tax regime will allow entities to claim a 100 per cent reduction against income taxes. All the respondents, except the respondent above, stated that they do not have tax regimes in their jurisdictions under which non-income taxes reduce income taxes by the full amount of the non-income taxes.

49. Consequently, we think that our outreach activities were adequate to conclude that we had not identified significant diversity in interpretation of the relevant requirements in IAS 1 and IAS 12.

Proposed changes to the wording of the tentative agenda decision

50. In addition to the comments above, another respondent[15] suggests revisions to the wording of the tentative agenda decision. Even though they agree with the Committee's decision not to add this issue to its agenda and with the rationale for that decision, they think that there is inconsistency in the tentative agenda decision wording. The assumption that production-based royalty payments are, in themselves, outside the scope of IAS 12 is stated in the second paragraph. However, this then is followed by a number of statements explaining why the

[15] DTT

Committee believes this to be the case. The excerpt from the suggested revisions is presented as follows (new text is underlined and deleted text is struck through):

[…]. The Committee used this same premise when discussing the issue, noting that it is the basis of the calculation that determines whether a tax meets the definition of an income tax rather than the manner of settlement or the identity of the recipient.

The Committee observed that the line item of 'tax expense' that is required by paragraph 82(d) of IAS 1 Presentation of Financial Statements *is intended to require an entity to present taxes that meet the definition of income taxes under IAS 12.* ~~*The Committee also noted that it is the basis of the calculation that determines whether a tax meets the definition of an income tax. Neither the manner of settlement of a tax liability nor the factors relating to recipients of the tax is a determinant of whether an item meets that definition.*~~ *[…]*

Staff response

51. We think that the basic principle that it is the basis of calculation that determines whether a tax meets the definition of an income tax should be clearly linked to the Committee's agenda decision, because that is a key to concluding that the royalty payments should not be viewed as prepayment of the MRRT payables. However, we note that the current wording might be viewed as not responding directly to the request in the submissions. Accordingly, we propose to amend the wording of the tentative agenda decision as presented in Appendix A to this Agenda Paper.

Summary of staff analysis

52. All the respondents agree with our view that the line item of 'tax expense' that is required by paragraph 82(d) of IAS 1 *Presentation of Financial Statements* is intended to require an entity to present taxes that meet the definition of income taxes under IAS 12. We think that we have identified no significant diversity in interpretation of this requirement.

53. We are of the view that it is the basis of calculation that determines whether a tax meets the definition of an income tax. In some situations, entities might need to

assess some different taxes together on a collective basis to determine whether each tax meets the definition of income taxes under IAS 12. We think that the basic principle also applies to the case when assessed on a collective basis. In our view, the royalty payments should not be viewed as prepayment of the MRRT. This is because, in accordance with the relevant tax rules, the calculation basis would not necessarily be a net amount even when assessed in combination with the MRRT.

54. In addition, we believe that our outreach was adequate to conclude that we did not identify a significant diversity in interpretation of the relevant accounting requirements under IAS 1 and IAS 12. In particular, our outreach identified no significant diversity in interpretation of the basic principle that it is the basis of calculation that determines whether a tax meets the definition of an income tax.

55. However, as pointed out by the two comment letters, we think that the Committee's agenda decision could be worded more helpfully and precisely. Consequently, we propose to amend the wording of the tentative agenda decision as presented in Appendix A to this Agenda Paper.

Staff recommendation

56. On the basis of the analysis above, we recommend that the Committee should reaffirm its decision not to add this issue to its agenda, but with changes to the wording to the tentative agenda decision as illustrated in Appendix A to this Agenda Paper.

Question to the Committee

Questions—final agenda decision
1. Does the Committee agree with the staff recommendation to reaffirm its decision not to add this issue to its agenda? 2. Does the Committee agree with the staff recommendation to amend the wording of the tentative agenda decision, and with the suggested wording in Appendix A?

Appendix A—Proposed wording for final agenda decision

A1. The staff propose the following wording for the final agenda decision (new text is underlined and deleted text is struck through):

IAS 1 *Presentation of Financial Statements and IAS 12 Income Taxes*—Presentation of payments of non-income taxes

The Interpretations Committee received a request seeking clarification of whether production-based royalty payments payable to one taxation authority that are claimed as an allowance against taxable profit of another taxation authority should be presented as an operating expense or a tax expense in the statement of comprehensive income.

As the basis for this request, the submitter assumed that the production-based royalty payments are, in themselves, outside the scope of IAS 12 *Income Taxes* while the tax payable to the other taxation authority is within the scope of IAS 12. On the basis of this assumption, the submitter asks the Committee to clarify whether the production-based royalty payments can be viewed as prepayment of income tax payables to the other taxation authority. The Committee used this same premise when discussing the issue.

The Committee observed that the line item of 'tax expense' that is required by paragraph 82(d) of IAS 1 *Presentation of Financial Statements* is intended to require an entity to present taxes that meet the definition of income taxes under IAS 12. The Committee also noted that it is the basis of calculation determined by the relevant tax rules that determines whether a tax meets the definition of an income tax. Neither the manner of settlement of a tax liability nor the factors relating to recipients of the tax is a determinant of whether an item meets that definition.

The Committee observed that IAS 12 does not preclude entities from analysing multiple taxes on a collective basis. The Committee noted that even in that case, the basis of calculation of the total amount of those taxes would be a determinant factor in deciding whether those taxes meet the definition of income taxes under IAS 12.

The Committee further noted that royalty payments should not be treated differently from other expenses that are outside the scope of IAS 12, all of which may reduce income tax payable. Accordingly, as the production-based royalties do not meet the definition of an income tax either in themselves or in combination with the other tax, ~~they~~ the royalty payments should not be presented as an income tax expense in the statement of comprehensive income.

On the basis of applying the analysis above the Committee ~~[~~decided~~]~~ not to add this issue to its agenda.

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27 April 2012

Dear IFRS Interpretations Committee members,

Tentative Agenda Decision – IAS 1 *Presentation of Financial Statements* and IAS 12 – Presentation of payments of non-income taxes

The global organisation of Ernst & Young is pleased to submit its comments on the Tentative Agenda Decision relating to IAS 1 *Presentation of Financial Statements* and IAS 12 *Income Taxes* – Presentation of payments of non-income taxes as published in the March 2012 *IFRIC Update*.

In providing our comments, we note that the request assumed that the production-based royalties in question are outside the scope of IAS 12. On this basis, we agree with the Committee that production-based royalties which may be allowed as a deduction from income tax payable should be presented as part of gross operating expenses or production costs and not as part of income tax expense.

Our view is based upon similar reasons to those outlined in the *IFRIC update*. “Income tax expense” is directly linked to “income taxes” and, therefore, when complying with the IAS 1 *Presentation of Financial Statements* requirement to separately disclose income tax expense, such an amount should only comprise items within the scope of IAS 12. We also concur with the view that a significant factor in determining whether a certain expense meets the definition of an income tax is the way in which it is calculated, i.e., based on a measure of taxable profit. The fact that a tax regime allows certain expenses to be deducted against income tax payable on a grossed up basis should not alter the nature of that expense.

We concur with the Committee in that we would expect to see the amount of the production-based royalty presented as part of operating expenses or production costs and, therefore, within the calculation of profit before tax and not as part of income tax expense.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully

Ernst & Young

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7 May 2012

Wayne Upton
Chairman
IFRS Interpretations Committee
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Dear Wayne

Presentation of payments of non-income taxes

We welcome the opportunity to comment on the IFRS Interpretation Committee's tentative decision at its March 2012 meeting in relation to the 'Presentation of payments of non-income taxes'.

We submitted a letter in relation to this issue for the Committee's consideration prior to its March 2012 meeting (letter dated 27 February 2012, hereafter referred to as 'our original letter'). However, we understand that due to time constraints, IFRS IC staff were not able to review and analyse our letter prior to the meeting, although it was provided to IFRS IC members in the agenda papers. For completeness, we have included our original letter as an attachment to this letter. We believe it provides IFRS IC with accurate factual information on the Minerals Resource Rent Tax (MRRT)[1] as well as our rationale for why we believe the State-based royalties[2] that are fully creditable against an MRRT liability should be considered to be an income tax. The comments made in this letter should be considered in conjunction with those made in our original letter.

We have read the IFRS IC tentative decision in relation to 'Presentation of payments of non-income taxes' and have also listened to the audio of the Committee's deliberations and wish to comment on some of the points raised, specifically:

- items included in tax expense
- use of the plural term 'taxable authorities' in the definition of taxable profits;
- meeting the definition of income tax; and
- the results of the IFRS Interpretation Committee (IFRS IC) staff outreach.

[1] An overview of the calculation of the MRRT is included in the Appendix to our original letter.

[2] Consistent with our original letter, we use the term State-based royalties to refer to mining royalty taxes paid to Australian State and Territory governments that are fully creditable against an entity's MRRT obligations to the Federal government.

Items included in tax expense

We note that the second paragraph of the tentative decision states the following:

"The Committee observed that the line item of 'tax expense' that is required by paragraph 82(d) of IAS 1 *Presentation of Financial Statements* is intended to require an entity to present taxes that meet the definition of income taxes under IAS 12. The Committee also noted that it is the basis of the calculation that determines whether a tax meets the definition of an income tax. Neither the manner of settlement of a tax liability nor the factors relating to recipients of the tax is a determinant of whether an item meets that definition."

We wish to respond to a number of points raised in this paragraph. Firstly, we agree that the line item 'tax expense' required by paragraph 82(d) relates to taxes that meet the definition of income tax under IAS 12. In other words, we acknowledge that there may be government taxes imposed on an entity which do not meet the definition of income tax and should therefore be excluded from the tax expense line item in the statement of comprehensive income.

Secondly, we also agree that it is the basis of the calculation that determines whether a tax meets the definition of an income tax.[3] It is on this basis that we, along with others in the accounting community, consider the MRRT to be an income tax within the scope of IAS 12. With regard to the State-based royalties, we acknowledge that the implementation of the MRRT does not change the basis of the calculation of these royalties (in terms of calculating the amounts payable to the State and Territory governments). However, the MRRT clearly changes the character and substance of the State-based royalties under an MRRT regime. Under the MRRT, the State-based royalties effectively function as a prepayment of an entity's MRRT obligation and no longer represent a cost to the entity. On that basis we consider the royalty payments should also be treated as an integral part of the MRRT income tax regime. Our rationale for treating the State-based royalties as an income tax is discussed in more detail below under the heading 'Meeting the definition of income tax'.

Use of the plural term 'taxation authorities' in the definition of taxable profits

We note the comment in the tentative decision that 'neither the manner of settlement of a tax liability nor the factors relating to the recipient of the tax is a determinant of whether an item meets the definition of income tax'. We understand this comment to be in reference to the argument being put forward by the Australian Accounting Standards Board (AASB) in its submission dated 22 December 2011 about the use of the plural term 'taxation authorities' in the definition of taxable profits. We also made reference to the use of the plural term 'taxation authorities' in our original letter. In light of the IFRS IC staff analysis in Agenda paper 8[4] and the comments made by Committee members during their deliberations, we would like to clarify our position in this regard.

We note that paragraphs 24 and 26 - 28 of Agenda paper 8 state the following:

24. The staff agree with the view that multiple taxation authorities could be recipients of taxes that meet the definition of income taxes under IAS 12. However, we disagree with the interpretation that some non-income tax payments to an authority are considered as part of income taxes to another authority *only because of the use of the plural term in the definition of taxable profit* under IAS 12. (italicised for emphasis)

[3] Note, however, our comments in our original letter regarding IFRS IC's view that the term 'taxable profit' implies a notion of a net rather than gross amount. We believe this view is contrary to the requirements of IAS 12 which defines taxable profit (the 'assessable amount') as the amount determined in accordance with the rules established by the taxation authorities. The absence of allowable deductions in determining the assessable amount, as specified by applicable rules, does not remove the arrangement from the definition of taxable profit.

[4] Agenda paper 8 'Presentation of payments of non-income taxes' of IFRS IC 13-14 March 2012 meeting.

26. … an entity is required to judge whether some taxes fall within the scope of income taxes under IAS 12. In making this judgement, the entity should take into consideration relevant tax rules and legislation in the jurisdiction. We believe that this process generally involves considerations to the factors relating to authorities to which those taxes are payable.

27. In our view, however, if those taxes are determined to be outside the scope of IAS 12 because the taxes are calculated based on gross revenue, further considerations to the factors relating to the taxation authorities would no longer be relevant and cannot override the conclusion reached. … whether the amounts of taxes are based on net profit or not would be a key to determining whether the taxes are within the scope of IAS 12. *Even though the word of 'taxation authorities' is part of the definition of income taxes, that factor is not a determinant by itself.* (italicised for emphasis)

28. Consequently, we are of the view that the *use of the plural term in IAS 12 is not intended to mean that priority of consideration is to be given to taxation authorities* in the judgement of the scope of income taxes. (italicised for emphasis)

We also note that IFRS IC members indicated their agreement with the staff analysis in the agenda paper.

We would like to stress that the interpretation described in the above paragraphs does not represent our interpretation of the use of the plural term 'taxation authorities' in the definition of taxable profits. Specifically, we do not consider the State-based royalties to be part of income taxes payable to another taxation authority *only because of* the use of the plural term 'taxation authorities. Nor do we believe that use of the plural term is intended to mean that *priority of consideration* is to be given to taxation authorities in the judgement of the scope of income taxes. Our rationale for why the State-based royalties should be considered income tax is outlined below under the heading 'Meeting the definition of income tax'.

As indicated in our original letter we believe that use of the plural term taxation authorities simply means that the payment of amounts to more than one taxation authority *does not prohibit* the payments from being considered on a collective basis, particularly when those payments to different authorities are inter-dependent.

Meeting the definition of income tax

We note that the third paragraph of the tentative decision states the following:

"The Committee further noted that royalty payments should not be treated differently from other expenses that are outside the scope of IAS 12, all of which may reduce income tax payable. Accordingly, because the production-based royalties do not meet the definition of an income tax they should not be presented as an income tax expense in the statement of comprehensive income."

In contrast to the Committee's tentative decision, prior to evaluating the nature of State-based royalties in their own right, we believe the State-based royalties are an income tax within the scope of IAS 12 because in our view they represent an in-substance prepayment of an entity's MRRT obligation. We believe this treatment is consistent with the IASB's Conceptual Framework for Financial Report ('the Framework'). We comment further on the possible classification of State-based royalties as income taxes in their own right under the heading 'Results of the IFRS IC staff outreach' later in this response.

Faithful Representation

Paragraph QC12 of the Framework states:

“Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent. …”

Paragraph BC3.26 of the Basis for Conclusions that accompanies the Framework states:

“Substance over form is not considered a separate component of faithful representation because it would be redundant. *Faithful representation means that financial information represents the substance of an economic phenomenon rather than merely representing its legal form*. Representing a legal form that differs from the economic substance of the underlying economic phenomenon could not result in a faithful representation.” (italicised for emphasis)

As indicated in our original letter, the following points are important in understanding the substance of the MRRT arrangements and their inter-relationship with State-based royalties:

- the MRRT was initially conceived as a replacement for all State-based royalties. However, the Federal government was unsuccessful in its negotiations with the State and Territory governments and therefore designed the MRRT to provide affected taxpayers with a full credit for any State-based royalties paid in respect of a mining project (i.e. the State-based royalties ultimately reduce an entity’s MRRT obligation, via the royalty allowance, on a dollar-for-dollar basis);

- the royalty allowance is the first MRRT allowance to be applied in the determination of an entity’s MRRT obligation. This was done with intent to ensure, as much as possible, that an entity did not bear both a royalty and a MRRT burden; and

- to the extent that State-based royalties paid in a particular period are not used to reduce an entity’s MRRT obligation (because there is no MRRT liability for that period), those unused royalty credits are subject to uplift[5] and are carried forward to be applied against an entity’s MRRT obligations in later years. Those carried forward royalty credits are included in the royalty allowance which is the first MRRT allowance to be applied in the determination of an entity’s MRRT liability in a particular period.

The MRRT legislation prescribes a particular approach for the treatment of State-based royalties in the determination of an entity’s MRRT liability. That is, the State-based royalties are ‘grossed up’ to provide a full credit for the royalty payments made.[6] This grossed up amount (royalty allowance) is used to reduce the mining profit before calculating a MRRT liability. This approach provides the same outcome as calculating a prima facie MRRT liability (based on mining profit) and then reducing that liability for the amount of State-based royalties paid (i.e. treating the State-based royalties as a tax credit against tax payable). It is noteworthy that the ‘gross-up’ approach was chosen by the Federal Government to ensure that any royalty payments made by the entity would ultimately reduce any MRRT liability before any other MRRT allowance. It is possible that the Federal Government may have considered the ‘gross up’ approach to be preferable to the ‘tax credit’ approach in terms of avoiding potential Constitutional

[5] Unused royalty credits are uplifted at the Long-Term Government Bond Rate (LTBR) + 7% (LTBR is approx. 6% therefore uplift factor is approx. 13% p.a.).

[6] State-based royalties are grossed up by dividing the royalties paid by the MRRT rate (22.5%). For example, assuming royalties paid of $1,000, the grossed up amount (royalty allowance) would be $4,444 ($1,000/22.5%).

challenges to the MRRT from the State and Territory Governments. By design, the MRRT legislation nullifies the economic effect of the State-based royalties, converting them into a mechanism which settles the MRRT obligation - the State-based royalties are not merely treated as a deductible item in the determination of the MRRT assessable amount.

Whilst a consideration of the legal form of the State-based royalties may result in some being classified as an operating cost, we consider that the design of the MRRT clearly changes the character and substance of the State-based royalties under an MRRT regime. We believe that treating the State-based royalties as an integral part of the MRRT, as an in-substance prepayment against an entity's MRRT obligations, provides a more faithful representation of the integral nature of the State-based royalties within the MRRT regime compared to treating them as an operating cost.

Comparability

Paragraph QC20 of the Framework states:
"…information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date."

Paragraph QC23 of the Framework states:
"For information to be comparable, like things must look alike and different things must look different. Comparability of financial information is not enhanced by making unlike things look alike any more than it is enhanced by making things look different."

We believe that treating the State-based royalties as an integral part of the MRRT and therefore as an income tax is consistent with the enhancing qualitative characteristic of comparability.

For example, assume Miner 1 and Miner 2 each operate a single mine. The mines are located in different states. Miner 1 operates in State A which charges royalties and Miner 2 operates in State B which does not charge royalties. Ignoring royalty payments, both miners have an MRRT obligation of $1,000. However, Miner 1 has paid $1,000 in royalties to State A. Under the MRRT, Miner 1 is entitled to a full credit for its State-based royalties against its MRRT obligation via the royalty allowance. Miner 1's MRRT liability is therefore $0. The total tax impost to the two miners is the same, it is just directed to different levels of government. Treating the royalty payments as an operating cost would result in Miner 1 reporting the tax impost in operating expenses (pre-tax profit) and Miner 2 reporting it in income tax. We consider that this treatment causes 'like things to look different'. We believe that comparability would be enhanced, and the information reported more useful, if the royalties paid were considered a part of the MRRT and presented as part of income tax. In that case, both Miner 1 and 2 would show a tax impost of $1,000 in their income tax expense line.

Relevance and Understandability

As mentioned in our original letter, income tax accounting is without doubt a complex topic. While sophisticated users of financial statements seek greater clarity in the meaning of tax balances presented, we suspect many less sophisticated users are totally bewildered. The debate around the accounting treatment of MRRT and State-based royalties provides an opportunity to further bewilder, or preferably, to further clarify the meaning of income tax balances.

The treatment of State-based royalties as an integral part of the MRRT, as an in-substance prepayment against an entity's MRRT obligations, ensures that the total tax impost on the entity is presented in a manner that is relevant and understandable to users of the financial statements. To do otherwise would cause the reported MRRT expense to be reduced by the significant offset of State-based royalties, for the ‘cost’ of that offset to be reported in pre-tax profit, but for the consequential income tax effects of both those charges to be presented in income tax expense. Such an outcome would be difficult to comprehend, difficult to explain, and fail the test of relevance to the user.

It is also interesting to consider how carryforward royalty credits may be classified in the balance sheet. As indicated above, where State-based royalties paid in a particular period are not used to reduce an entity’s MRRT obligation (because there is no MRRT liability for that period), these unused royalty credits are subject to uplift and are carried forward to be applied against an entity’s MRRT obligations in later years. To the extent it is probable that an entity will use the carryforward royalty credits (because it expects to have an MRRT obligation in later years) there is clearly a future economic benefit to be derived from those royalty credits.

For example, assume Miner has paid $1,000 in State-based royalties. Also assume that Miner incurred an MRRT mining loss before MRRT allowances and therefore does not have an MRRT liability for the period. Miner is able to carry forward the $1,000 State-based royalties paid in order to reduce its MRRT obligations in later years.

To the extent the royalty payments could be considered an integral part of the MRRT and therefore classified as an income tax, we consider that the carryforward royalty credits would simply be classified as a deferred tax asset (i.e. similar to unused carryforward tax losses/tax credits). Accordingly, Miner would classify the $1,000 royalties paid as a deferred tax asset.

To the extent the royalty payments are considered to be an operating cost, the question arises as to how Miner would account for the carryforward royalty credits. One approach may be that Miner recognises the royalty payment as an asset (because of the future economic benefit to be derived) however this raises the question as to how such an asset should be classified. We note that the Committee briefly considered this issue as part of its deliberations at its March 2012 meeting however there did not appear to be a clear answer. Committee members seemed to be of the view that the asset could not be considered to be a deferred tax asset. This would appear to be on the basis that the asset does not arise by virtue of a deductible temporary difference, nor does it (arguably) represent a carryforward of unused tax losses or tax credits. Given the asset would not constitute a financial asset or an item of property, plant and equipment it is perhaps likely that the asset may be classified as an intangible asset or some ‘other asset’. Classifying the $1,000 royalty payment as an intangible asset, or some ‘other asset’, does not provide useful information. The future economic benefit to be derived is a reduction to future income tax (MRRT) payable. We believe that classification other than a deferred tax asset diminishes the understandability of the financial statements.

Alternatively, the Miner may recognise the royalty payment as an operating cost and subsequently recognise a deferred tax asset and corresponding income tax benefit for the royalty credit that it is entitled to under the MRRT legislation (assuming the recognition criteria for deferred tax assets is met). This results in the $1,000 State-based royalty being included in profit before tax and a $1,000 income tax benefit being recognised in income tax expense. Whilst this treatment results in the carryforward royalty credits being recognised as a deferred tax asset (which we believe is appropriate), we consider the “gross up” that occurs in the income statement in order to achieve this is inappropriate.

Results of the IFRS IC staff outreach

We note that the IFRS IC staff sent a request to the National Standard-Setters Group in order to help assess the Committee's agenda criteria.

Paragraph 5 of Agenda paper 8A[7] indicates that two respondents answered that they were aware of "similar tax regimes" in their jurisdictions, in particular, in the mining, and oil and gas industries.

Based on the description of the tax regimes in paragraphs 6 – 11 of Agenda Paper 8A, we do not consider these tax regimes to be similar to the MRRT and its treatment of State-based royalties. The royalty taxes referred to in paragraphs 6 and 9 are claimable as an income tax deduction, whereas the MRRT provides a full credit for the State-based royalties.

BHP Billiton has instances where production-based royalties paid to taxation authorities are claimable as an income tax deduction in various jurisdictions (as opposed to providing a tax credit against taxes payable). In these instances, we account for the royalties as either an operating cost or an income tax based upon whether they meet the definition of income taxes in their own right (i.e. on the basis of calculation of the royalty). This would appear to be consistent with the treatment of the royalty taxes referred to in Agenda paper 8A. Our commentary in preceding pages of this response has regard to the MRRT and the State-based royalties as an integral part of the MRRT regime, the facts and circumstances of which cause us to believe that the *substance* of the State-based royalties is that they are an integral part of the MRRT and should therefore be accounted for as an income tax. However, when assessed in their own right, many of the State-based royalties may be regarded as income taxes. Such a conclusion may be reached on the basis that the assessable amount for such royalties is based on a monetary value of production, rather than physical volumes of production. Certain deductions may be available to varying degrees when measuring the assessable amount, however as previously stated, we do not believe the availability of deductible expenses to be relevant when assessing the nature of a legislative arrangement as an income tax.

We do not accept the IFRS IC staff conclusion that based on the outreach conducted there does not appear to be diversity in practice with regard to the treatment of royalties that are claimable as a deduction against taxable profits. Such arrangements can be treated as income tax or non-income tax arrangements based on their features. While we do not believe that differential treatment based on different features represents diversity in practice, we also do not believe that the outreach was sufficiently detailed to examine this practice. We also note that the outreach does not establish whether there is diversity in practice in the treatment of non-income tax royalties that are fully creditable against an income tax obligation.

Conclusion

In conclusion, we believe that treating the State-based royalties as an in-substance prepayment of MRRT and therefore as an income tax within the scope of IAS 12 is consistent with the IASB's Conceptual Framework for Financial Reporting ('the Framework'). We believe such a treatment satisfies the fundamental characteristics of relevance and faithful representation as well as the enhancing qualitative characteristics of comparability and understandibility.

We therefore disagree with the Committee's tentative decision. We would ask the Committee to reconsider their tentative decision in light of our comments in this letter. Fundamentally, we believe that the accounting treatment of items such as the State-based royalties depends on the facts and circumstances. We believe that it would be more appropriate for the Committee to issue a rejection

[7] Agenda paper 8A 'Supplement – Updates on outreach activity for the issue of presentation of payments of non-income taxes' of IFRS IC 13-14 March 2012 meeting.

notice indicating that the accounting for such items is ultimately a matter of judgement based on the facts and circumstances.

If you would like any further information regarding this issue please the undersigned at brett.rix@bhpbilliton.com.

Yours sincerely,

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27 February 2012

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Dear Wayne

Accounting for royalty payments claimed as an allowance against income tax payable

In December 2011 the Australian Accounting Standards Board submitted a potential agenda item for consideration by the IFRS Interpretations Committee (the "Committee") relating to the accounting for royalty payments claimed as an allowance against income tax payable. We understand that the Committee may be considering this issue at its March 2012 meeting and would like to submit our view for the Committee's consideration.

This issue arises in relation to the proposed Minerals Resource Rent Tax ("MRRT"). By way of background, the MRRT is an Australian Federal Government initiative which seeks to tax the resource rent profits attributable to the extraction of coal and iron ore in Australia. The MRRT is levied at an effective rate of 22.5% on the MRRT profit of a mining project interest. MRRT profit is calculated as mining profit less MRRT allowances. The MRRT allowances include, amongst others, a royalty allowance and a starting base allowance.[8] The MRRT allowances are required to be applied against mining profit in a particular order, beginning with the royalty allowance. An overview of the calculation of the proposed MRRT is included in an Appendix to this letter.

There is general consensus amongst the accounting community that the MRRT is an income tax within the scope of IAS 12 *Income Taxes*, although we are aware of some diversity in views as to how IAS 12 should be applied to certain aspects of the MRRT.

Mining royalties paid to Australian State and Territory governments ('State-based royalties') in relation to a mining project are claimable as a royalty allowance against any MRRT liability to the Federal Government.[9] The operation of the Stated-based royalties varies from State to State. While some royalties are levied as a percentage of gross sales revenue, others are calculated as a percentage of revenue less allowable deductions. Such arrangements are often classified as an operating cost and accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, although treatment of State-based royalties under IAS 12 has also been applied by some entities depending on their chosen policy. Because these royalty payments reduce the MRRT liability the question arises as to whether they should be treated as income tax rather than an operating cost.

[8] The starting base allowance recognises the past investment in assets of a mining project. A miner may elect to use either book or market value as at 1 May 2010 as the starting base for project assets.
[9] References to royalty payments throughout this letter are only to those royalties which are creditable against the MRRT.

We consider that there are three key aspects to this issue, being:

- Reclassification of royalty payments in the context of the MRRT
- Classification of royalty payments as an income tax in their own right
- Relevance and understandability to users of the financial statements

Reclassification of royalty payments in the context of the MRRT

The following points are important in understanding the substance of the MRRT arrangements and their inter-relationship with State-based royalties:

- the MRRT was initially conceived as a replacement for all State-based royalties. However, the Federal government was unsuccessful in its negotiations with the State and Territory governments and therefore designed the MRRT to provide affected taxpayers with a full credit for any State-based royalties paid in respect of a mining project (i.e. the royalties paid reduce the MRRT liability, via the royalty allowance, on a dollar-for-dollar basis);

- the royalty allowance is the first MRRT allowance to be applied against any MRRT liability. This was done with intent to ensure, as much as possible, that an entity did not bear both a royalty and a MRRT burden; and

- unused royalty credits are subject to uplift[10] and carried forward to be applied against MRRT liabilities in later years. These carried forward royalty credits are included in the royalty allowance which is the first MRRT allowance to be applied against any MRRT liability in a particular period.

Whilst the implementation of the MRRT does not change the basis of the calculation of the State-based royalties, the MRRT clearly changes the character and substance of the royalties under an MRRT regime. Accordingly, the classification of the royalty payments should be determined in the context of the MRRT. More specifically, under the MRRT regime, the royalty payments effectively function as a prepayment of MRRT and no longer represent a cost to the entity. Because the MRRT is accounted for as income tax the royalty payments should also be classified as part of that income tax arrangement.

Some may argue that treating the royalty payments as a prepayment of MRRT is not appropriate because in the event that there is no MRRT liability for the period, the royalty payments are not refundable (i.e. the royalties paid can not be viewed as a prepayment of MRRT tax if there is no MRRT liability). However, as noted above, the royalty allowance is the first MRRT allowance to be applied to a MRRT liability and any unused royalty credits are carried forward to be applied to MRRT liabilities in future years. It is therefore extremely unlikely that royalty payments would not be recovered against MRRT obligations, and for this reason, we consider the treatment of royalties as a prepayment of MRRT to be the most appropriate.

Some may also argue that because the State-based royalty is payable to one taxation authority (i.e. a State Government) and the MRRT is payable to a different taxation authority (i.e. the Federal Government), it is necessary to consider them separately for the purpose of classification. Proponents of this view would argue that to the extent the royalties are considered to be an operating cost when considered in isolation from the MRRT, it is not appropriate to classify those royalties as income tax. However, we do not believe there is any basis to determine the accounting treatment for related taxation arrangements only because the 'counterparty' to each arrangement is different. In particular, we note that IAS 12 defines taxable profit as "the profit for a period, determined in accordance with the rules established by the *taxation authorities*, upon which income taxes are payable" (italicised for emphasis). We believe that the reference to taxation authorities 'plural' means that the payment of

[10] Unused royalty credits are uplifted at the Long-Term Government Bond Rate (LTBR) + 7% (LTBR is approx. 6% therefore uplift factor is approx. 13% p.a.).

amounts to more than one taxation authority does not prohibit the payments from being considered on a collective basis, particularly when those payments are inter-dependent. Similar situations exist in other jurisdictions, such as the United States, where State based taxation imposts are creditable against Federal tax obligations.

In conclusion, in light of the inter-dependencies between MRRT and royalty obligations, we believe it is most appropriate to classify State-based royalties as part of the accounting for income tax arising under the MRRT,

Classification of royalty payments as an income tax in their own right

The analysis above considers whether it is appropriate to classify State-based royalties as part of the income tax accounting for MRRT, in light of the operation of the MRRT which provides a full credit for the State-based royalties paid. We believe such a classification is most appropriate. However, notwithstanding that view, we also believe it is acceptable for the State-based royalties to be classified as an income tax when considered on a stand-alone basis.

Paragraph 2 of IAS 12 states “For the purpose of this Standard, income taxes include all domestic and foreign taxes which are based on taxable profits.”

As noted above, paragraph 5 of IAS 12 defines taxable profit (tax loss) as “the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable)”.

Whilst these references appear circular, we note that IAS 12 does not provide any further guidance on what may be considered to be ‘taxable profit (tax loss)’ and therefore an ‘income tax’. IFRIC considered the issue in 2006 and provided the following non-authoritative guidance:

a) “the term ‘taxable profit’ implies a notion of a net rather than gross amount”; and

b) “because taxable profit is not the same as accounting profit, taxes do not need to be based on a figure that is exactly accounting profit to be within the scope. The latter point is also implied by the requirement in IAS 12 to disclose an explanation of the relationship between tax expense and accounting profit”.

In our view, IFRIC’s first point that the term ‘taxable profit’ implies a notion of a net rather than gross amount is contrary to the requirements of IAS 12. As noted above, IAS 12 defines taxable profit (the ‘assessable amount’) as the amount *determined in accordance with the rules established by the taxation authorities.* To the extent that the rules established by the taxation authorities do not permit deductions in the determination of the assessable amount this should not prevent an entity from treating the tax as an income tax. This would ensure that government taxes levied on gross amounts are included within income tax expense thereby providing a better reflection of the total tax impost on the entity.

We assume that the IFRIC’s guidance on this point stem from the use of the word ‘profit’ in the definition of taxable profit and the definition of profit or loss in IAS 1 and the Framework.[11] However, this approach seems unworkable when different tax regimes around the world operate with intent to allow or disallow the deduction of a wide variety of ‘outgoings’ in determining taxable profits.

[11] IAS 1.7 defines profit or loss as “the total of income less expenses, excluding the components of other comprehensive income”. Paragraph 4.60 of the Conceptual Framework states: “…profit is the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. If expenses exceed income the residual amount is a loss.”

IFRIC's second point makes it clear that taxable profit is not the same as accounting profit. However, in conjunction with the first point, this raises the question as to what quantum or nature of expenses (deductions) satisfies the IFRIC's notion of a net amount for taxable profit? For example, if a taxation authority imposes a tax which is a percentage of gross sales, but permits minor 'prescribed' deductions, does this cause the tax to be included in the scope of IAS 12, compared to a tax which prohibits all such deductions?

As noted above, State-based royalties are often classified as an operating cost, particularly when they are levied on a gross amount rather than a net amount. To the extent that entities applied the definition of taxable profits within IAS 12, which requires reference to the amount *determined in accordance with the rules established by taxation authorities*, such an arrangement would be within the scope of IAS 12 and there would be no need to consider the classification of the expense in light of the implementation of the MRRT.

Relevance and understandability to users of the financial statements

Income tax accounting is without doubt a complex topic. While sophisticated users of financial statements seek greater clarity in the meaning of tax balances presented, we suspect many less sophisticated users are totally bewildered. The debate around the accounting treatment of MRRT and State-based royalties provides an opportunity to further bewilder, or preferably, to further clarify the meaning of income tax balances.

Given the clear design intent of the MRRT and the agreement between Federal, State and Territory governments to treat the MRRT and State-based royalties as one cohesive fiscal regime for the coal and iron ore mining sector, IFRIC should seek to encourage entities to present those taxes accordingly.

The treatment of State-based royalties as an integral part of the MRRT, as an in substance prepayment against an entity's MRRT obligations, ensures that the total tax impost on the entity is presented in a manner that is relevant and understandable to users of the financial statements. To do otherwise would cause the reported MRRT expense to be reduced by the significant offset of State-based royalties, for the 'cost' of that offset to be reported in pre-tax profit, but for the consequential income tax effects of both those charges to be presented in income tax expense. Such an outcome would be difficult to comprehend, difficult to explain, and fail the test of relevance to the user.

If you would like any further information regarding this issue please contact me at brett.rix@bhpbilliton.com.

Yours sincerely,

Brett Rix
Vice President External Reporting and Governance

Appendix: Overview of MRRT

The following tables outline the calculation of the MRRT liability as well as key features of the proposed MRRT.[12]

Calculation of MRRT liability

Mining profit	Mining revenue (at valuation point) **less** mining expenditure (upstream)
Less	
MRRT Allowances (applied in this order)	Royalty allowance* Transferred royalty allowance Pre-mining loss allowance Mining loss allowance* Starting base allowance* Transferred pre-mining loss allowance Transferred mining loss allowance * Including carried forward amounts.
X	
MRRT rate	22.5%
=	
MRRT liability	

Key MRRT features and glossary of terms

Commencement date	1 July 2012
Rate	Effective rate of 22.5% (30% headline rate less the 25% extraction allowance)
Coverage	Iron ore, coal and incidental coal seam gas projects
Mining project interest	MRRT is payable based on a 'project' (identification of project is significant because it determines how losses within projects are treated) A project consists of a single production right (it is common for a single mine to be covered by more than one production right) Rules exist for combining mining project interests (i.e. where integrated)
Taxable profits	Mining profit less MRRT allowances Mining profit = Mining revenue less mining expenditure (upstream)
Mining revenue	Value of the resource at valuation point Valuation point will generally be immediately after extraction - before the resource leaves the run-of-mine (ROM) stockpile and before any processing or value add Typically no observable price at the ROM stockpile. A 'netback' transfer pricing approach is likely to be applied whereby the final sale price to a customer is reduced for the value added in downstream activities (processing, rail, port)

[12] Based on the MRRT bills and explanatory material introduced and passed by the House of Representatives in November 2011.

Mining expenditure	Costs incurred upstream of valuation point (costs of extracting resource and getting resource to valuation point) Includes expenditure of a revenue (but not depreciation of pre-existing assets) and capital nature (i.e. immediate deduction for eligible capital expenditure) Excluded costs (e.g. costs of acquiring project interests; financing costs; hire purchase and finance leases; hedging losses or foreign exchange losses)
MRRT allowances	Royalty allowance Pre-mining loss allowance Mining loss allowance Starting base allowances
Royalty allowance	Mining royalties paid to State's and Territories reduce MRRT liabilities for a mining project interest Calculated by dividing royalty by MRRT rate Unused royalty credits uplifted at the LTBR[13] + 7% and applied to MRRT profits in later years May be transferable to other integrated project mining interests (i.e. conditions apply)
Pre-mining loss allowances	Expenditure incurred during the period before a mining project interest comes into existence (e.g. exploration expenditure) reduce MRRT liability for a mining project interest for a MRRT year Uplifted at LTBR + 7% for first 10 years then LTBR thereafter Transferable to other projects producing same taxable resource
Mining loss allowances	Occur if mining revenue less than mining expenditure Can be carried forward, uplifted (LTBR + 7%) and applied against mining profits in future MRRT years May be transferable to other project mining interests under certain conditions

Starting base allowances	Relate to the investments in assets of upstream mining operations of a mining project interest before 1 May 2010
	Miner may elect to use either book or market value as at 1 May 2010 as the starting base for project assets
	- Market value option[14]
	  - Includes rights to resources and goodwill
	  - Depreciated over a period of up to 25 years
	  - Undepreciated value not uplifted
	  - Carried forward losses uplifted by CPI
	- Book value option
	  - Excludes rights to resources and goodwill
	  - Depreciated over a period of up to 5 years
	  - Undepreciated value uplifted by LTBR + 7%
	  - Carried forward losses uplifted by LTBR + 7%
	Eligible capital expenditure incurred between 1 May 2010 and 1 July 2012 is added to the starting base and deducted accordingly

Income tax treatment	MRRT payments are deductible for income tax purposes

[13] Long-term government bond rate – currently ~ 6%, therefore uplift ~ 13%

[14] At its 9 December 2011 meeting the AASB considered a number of potential accounting issues relating to the proposed MRRT, including the accounting for the 'starting base market value uplift'. The AASB agreed the application of IAS 12 would require an entity to reflect an increase in the deductions available (resulting in future tax payments being smaller than if no uplift were to occur) as a deductible temporary difference giving rise to a deferred tax asset to the extent it meets the recognition criteria in IAS 12. As part of its deliberations the AASB considered and rejected alternative treatments including: (i) accounting for the starting base allowance as a tax holiday; and (ii) not recognising a deferred tax asset by virtue of the initial recognition exception.

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Mr Wayne Upton
Chairman
International Financial Reporting Interpretations Committee
30 Cannon Street
London
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EC4M 6XH

Email: ifric@ifrs.org

15 May 2012

Dear Mr Upton,

Tentative agenda decision: IAS 1 Presentation of Financial Statements and IAS 12 Income Taxes – Presentation of payments of non-income taxes

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretation Committee's publication in the March 2012 *IFRIC Update* of the tentative decision not to take onto the IFRIC's agenda a request for Interpretation of IAS 1, *Presentation of Financial Statements* and IAS 12 *Income Taxes* with respect to the presentation of production-based royalty payments payable to one taxation authority that are claimed as an allowance against taxable profit of another taxation authority.

Whilst we agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision, we note that there appears to be an inconsistency in the tentative agenda decision as drafted in that the production-based royalty payments being, in themselves, outside the scope of IAS 12 is stated as an assumption but this then is followed by a number of statements explaining why the Committee believes this to be the case.

Accordingly, we recommend that the tentative agenda decision be amended to read as follows:

"The Interpretations Committee received a request seeking clarification of whether production-based royalty payments payable to one taxation authority that are claimed as an allowance against taxable profit of another taxation authority should be presented as an operating expense or a tax expense in the statement of comprehensive income. As the basis for this request, the submitter assumed that the production-based royalty payments are, in themselves, outside the scope of IAS 12 Income Taxes while the tax payable to the other taxation authority is within the scope of IAS 12. The Committee used this same premise when discussing the issue<u>, noting that it is the basis of the calculation that determines whether a tax meets the definition of an income tax rather than the manner of settlement or the identity of the recipient</u>.

The Committee observed that the line item of ‘tax expense’ that is required by paragraph 82(d) of IAS 1 Presentation of Financial Statements is intended to require an entity to present taxes that meet the definition of income taxes under IAS 12. ~~The Committee also noted that it is the basis of the calculation that determines whether a tax meets the definition of an income tax. Neither the manner of settlement of a tax liability nor the factors relating to recipients of the tax is a determinant of whether an item meets that definition.~~

The Committee further noted that royalty payments should not be treated differently from other expenses that are outside the scope of IAS 12, all of which may reduce income tax payable. Accordingly, because the production-based royalties do not meet the definition of an income tax they should not be presented as an income tax expense in the statement of comprehensive income.

On the basis of applying the analysis above the Committee decided not to add this issue to its agenda.”

In addition, we suggest that the intention of paragraph 82(d) of IAS 1 referred to in the tentative agenda decision could be made clearer through the Annual Improvements Project by amending that paragraph to refer to income tax expense (as defined in IAS 12).

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely,

Veronica Poole
Global Managing Director
IFRS Technical

Accounting Standards Board
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May 17, 2012

(by e-mail to ifric@ifrs.org)

IFRS Interpretations Committee
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

Re: Tentative agenda decision on IAS 1 *Presentation of Financial Statements* and *IAS 12 Income Taxes* – Presentation of payments of non-income taxes

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's tentative agenda decision on the presentation of payments of non-income taxes in the statement of comprehensive income. This tentative agenda decision was published in the March 2012 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the AcSB staff but do not necessarily represent a common view of the AcSB or its staff. Views of the AcSB are developed only through due process.

We agree with the Committee's decision not to add this item to its agenda for the reasons provided in the tentative agenda decision.

We would be pleased to provide more detail if you require. If so, please contact me at +1 416 204-3276 (e-mail peter.martin@cica.ca), or Kathryn Ingram, Principal, Accounting Standards at +1 416 204-3475 (e-mail kathryn.ingram@cica.ca).

Yours truly,

Peter Martin

Peter Martin, CA
Director,
Accounting Standards

MAZARS

Mr Wayne Upton

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH

United Kingdom

Paris, May 22, 2012

Tentative Agenda Decisions – IAS 1 *Presentation of Financial Statements* and IAS 12 *Income Taxes* – Presentation of payments of non-income taxes

Dear Sir,

We have examined the IFRS Interpretations Committee tentative rejection for a possible agenda item relating to the payments of non-income taxes.

We believe it is difficult not to agree with the *Wording For Rejection* as it is drafted, when taken in isolation from the submission received. All what is written is clear and cannot be challenged:

- the line item of 'tax expense' required by IAS 1 is dedicated to taxes that meet the definition of income taxes under IAS 12;
- the definition of income taxes is based on the calculation of such tax, and it is clear that production-based royalties are outside the scope of IAS 12. This statement is consistent with previous agenda decisions taken by the Committee;
- the fact that a specific tax reduces income tax payable does not allow a reclassification to the 'tax expense' line item.

Nevertheless we strongly believe that the tentative agenda decision does not provide a relevant answer to the issue raised by the submission. The committee has considered that the submission was based on the assumption that the production-based royalty payments are outside the scope of IAS 12, and has answered the question without considering the other features of the fact pattern.

We believe this issue cannot be answered without considering the unusual link that exists between the MRRT expense and the production-based royalty already paid. The submitter wrote: '*(...) Payments made to State Governments for production based royalties are permitted to be claimed as an allowance against MRRT/PRRT payable to the Federal Government. (...) For example, if an entity has a gross MRRT liability of $10 million, and has already paid $3 million in production based royalties, the net MRRT liability (the amount payable to the Federal Government) would be $7 million ($10m - $3m). (...) On their own, the production based royalties do not meet the definition of income taxes in IAS 12* Income Taxes. *For the purpose of this request, it should be assumed that MRRT/PRRT are considered to be income taxes within the scope of IAS 12.*'

Therefore we are convinced that all the following features shall be considered when addressing the issue:

- production-based royalty payments, when taken in isolation, do not meet the definition of income taxes in IAS 12;

- MRRT meet the definition of income taxes in IAS 12;

- there exists a direct compensation link between the production-based payment made to the State Government and the MRRT to be paid to the Federal Government, so that the sum of both payments equals the amount of 'gross' MRRT.

We believe that the question was whether those Australian State Government taxes were to be analysed in isolation, or together with the Federal Government MRRT, rather than whether a production-based royalty could be presented within the 'Tax expense' line item.

When taken in isolation, the royalty payment does not meet the definition of income tax in IAS 12. But from what is exposed in the submission there is rationale for analysing it together with the Federal Government MRRT.

- Those taxes do not 'reduce' MRRT payable to the Federal Government. They are not 'deductible' for tax purposes, they are fully compensated, so that the calculation of the overall amount of taxes payable to both State and Federal governments is not production-based at all.

- Therefore the production-based calculation should be viewed as an allocation of MRRT between State and Federal governments, rather than a separate tax that would not meet the definition of income tax.

For those reasons, we disagree with the tentative agenda decision as drafted. We believe that it is misleading, since it provides an answer that is undisputable on its own but that does not address the specific question raised by the submission. Moreover we strongly believe that the answer is not relevant to the specific issue.

We hope you will consider our view and stay at your disposal for further discussion. Should you have any questions regarding the above comments, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully

Michel Barbet-Massin

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14 June 2011

Mr Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir

Tentative Agenda Decision: IAS 1 Presentation of Financial Statements and IAS 12 Income Taxes – Presentation of payments of non-income taxes

We appreciate the opportunity to comment on the IFRS Interpretation Committee's publication in the March 2012 *IFRIC Update* on the tentative decision not to take onto the IFRIC's agenda a request for Interpretation of IAS 1 *Presentation of Financial Statements* and IAS 12 *Income Taxes* with respect to the presentation of production-based royalty payments payable to one taxation authority that are claimed as an allowance against taxable profit of another taxation authority.

Firstly, we agree with the IFRS Interpretations Committee ('the Committee') Staff Paper *Presentation of payments of non-income taxes* paragraph 27 that if taxes are determined to be outside the scope of IAS 12 because the taxes are calculated based on gross revenue, further considerations to the factors relating to the taxation authorities would no longer be relevant and cannot override the conclusion reached. Therefore it is important to first assess whether the tax falls within the scope of IAS 12.

We agree with the Committee's observation that it is the basis of the calculation that determines whether a tax meets the definition of an income tax and within the scope of IAS 12. It is on this basis we, along with others in the accounting community, consider the Minerals Resource Rent Tax ('MRRT') calculation to be within the scope of IAS 12. With regard to the production-based royalty payments, we acknowledge that the implementation of the MRRT does not change the basis of the calculation of these royalties (in terms of calculating the amounts payable to the State and Territory governments). On their own, the production-based royalties do not meet the definition of income tax within the scope of IAS 12. However the introduction of the MRRT does change the effect of the production-based royalty payments when assumed into the MRRT calculation. The perspective on production based royalties' changes when 'over-laid' with an MRRT style profit-based tax. We believe the current presentation of production-based royalties in its legal form would not result in faithful representation in accordance with paragraph BC3.26 of the Basis for Conclusions that accompanies IASB's Conceptual Framework for Financial Reporting.

In our view the production-based royalty payments represent in-substance a prepayment of an entity's MRRT obligation and so is treated wholly within the scope of IAS 12. This presentation provides a more faithful representation of the integral nature of the production-based royalties within the MRRT legislation compared to treating them as an operating cost. Under the MRRT, xstrata

entities are effectively permitted to claim a tax credit for payments of production-based royalties made to the State and Territory governments over the resources concerned. We emphasise that production-based Government royalties are not treated as a deductible item in the determination of the MRRT assessable amount but, alternatively, are treated as a full credit against what would otherwise be the MRRT liability. This tax credit is designed to avoid double taxation.

By design, where the MRRT liability exceeds Government royalties paid for any period (before taking into account royalties), the MRRT legislation nullifies the economic effect of the production-based royalties, converting them into a mechanism which settles or 'pre-pays' the MRRT obligation. The principle being that Government royalties also represent a return to the community for diminution of natural resources and, therefore, are taken into account when applying the MRRT to the profit-oriented tax base. If Government royalties collect an insufficient amount of tax (as defined by a set portion of the MRRT 'profitability' base, 22.5%) MRRT applies an alternative minimum tax to 'top-up' mineral specific taxes applicable to coal and iron ore. Therefore the income tax expense arising from MRRT should be measured as the total amount of taxes payable under the MRRT legislation (i.e. net MRRT payable plus production-based royalties paid).

We therefore disagree with the Committee's tentative decision. We would ask the Committee to reconsider their tentative decision in light of our comments in this letter. In essence, we believe that the accounting treatment of items such as the production-based royalties depends on the facts and circumstances and in profitable circumstances MRRT can become the predominant tax. We also acknowledge that at low levels of profitability some mining companies may never pay MRRT and it is then appropriate for Government production based royalties be shown in their current form. Yet in present circumstances, it would be more appropriate for the Committee to issue a rejection notice indicating that the accounting for such items is ultimately a matter of judgement based on the facts and circumstances.

If you would like any further information regarding this issue contact me at +41 41 726 7419.

Yours faithfully

Mark Moffett
Group Controller