



Guidance Note AGN 111.4

Capital Deductions

Deferred tax assets and deferred tax liabilities

1. An authorised deposit-taking institution (**ADI**) must net from Tier 1 capital, at Level 1 and Level 2, the amount of its:
 - (a) deferred tax assets - excludes any deferred tax assets associated with collective provisions eligible to be included in the General Reserve for Credit Losses (refer *Guidance Note 220.2 Impairment, Provisioning and the General Reserve for Credit Losses*); and
 - (b) deferred tax liabilities - excludes any amounts associated with surpluses in any ADI (or other group member) employer-sponsored superannuation funds.

An ADI must net these items on a consistent basis for the purposes of *Prudential Standard APS 111 Capital Adequacy: Measurement of Capital (APS 111)* and its associated Guidance Notes. In the event that deferred tax liabilities exceed the amount of deferred tax assets, the excess cannot be added to Tier 1 capital (i.e. the net deduction is zero).

2. Netting of deferred tax assets and deferred tax liabilities must only be applied where:
 - (a) an ADI or member of a group which the ADI heads has a legally enforceable right to set-off current tax assets against current tax liabilities where they relate to income taxes levied by the same taxation authority and the taxation authority permits the ADI or group members to make or receive a single net payment; and
 - (b) the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same authority on either:
 - (i) the same taxable member of a group; or
 - (ii) different taxable members of a group for which group policies and procedures have been established which provide for the relevant group members to settle current tax assets and liabilities on a net basis, or to realise the assets and liabilities simultaneously, in each

future period in which significant amounts of deferred tax assets or liabilities are to be settled or recovered; and

- (iii) for direct or indirect subsidiaries of the ADI incorporated outside Australia for which:
 - (A) it is claimed current tax assets and liabilities will be settled on a net basis; and
 - (B) netting may have a material impact on any amount of deferred tax assets as ADI may be required to deduct from its capital

the group headed by the ADI must have written opinions from relevant external auditors and legal advisors that the relevant tax authorities allow, or would allow, netting of deferred tax assets and deferred tax liabilities. An ADI must be able to provide relevant written auditor or legal opinions to APRA, if requested.

- 3. An ADI must:
 - (a) have procedures in place to monitor changes in relevant laws and taxation practices which may affect the written opinions it is required to have covering netting of deferred tax assets and deferred tax liabilities; and
 - (b) ensure that the written opinions are updated in the event of changes in laws or taxation practices overseas that could materially impact on overseas taxation authorities continuing to allow netting of deferred tax assets and deferred tax liabilities.

Investments

- 4. For the purposes of APS 111, the amount of equity investments, and any other capital investments, including any excess equity holdings in non-subsidiary entities that are not operating in the field of finance, that must be deducted from capital is the book value of the investment, including any amount by which the investment has been revalued. Any intangible component of the investment, calculated as the excess of the book value over the net tangible assets of a subsidiary, must be deducted from Tier 1 capital.
- 5. Where the amount of an equity investment, and any other capital investments, including any excess equity holdings in non-subsidiary entities that are not operating in the field of finance (refer APS 111), held by an ADI is revalued, and the ADI is permitted to include in its capital only a discounted portion of the increase in value of an investment, the ADI need only deduct from its capital the value of the investment incorporating the discounted portion of any revaluation included in the ADI's capital.
- 6. Where any investments in non-consolidated subsidiaries (refer *Guidance Note AGN 110.2 Non-consolidated Subsidiaries (AGN 110.2)*) have been incorporated for accounting purposes into the ADI's consolidated group accounts, the consolidation of these entities must be reversed prior to the

calculation of risk-based capital ratios at Level 2. That is, any retained earnings, other reserves or minority interests of these entities included in, and any other items impacting on Level 2 Tier 1 capital as a result of the accounting consolidation must be removed from Level 2 Tier 1 capital for capital adequacy purposes. Goodwill and any other intangible component of the investments in non-consolidated subsidiaries must be deducted from the ADI's Tier 1 capital at Level 2.

Holdings of own capital instruments

7. For the purposes of APS 111, an ADI or member of a group headed by an ADI may, as a result of membership of a dealer panel, trading or other activities agreed with APRA, undertake limited purchases of its own Tier 1 and Tier 2 capital instruments, or capital instruments issued by other members of the group (refer *Guidance Note AGN 110.6 Reductions in Capital (AGN 110.6)*). Such purchases are subject to a limit agreed with APRA, and the amount equal to the limit (or alternatively any actual holdings plus unused limit) must be deducted from Tier 1, Upper or Lower Tier 2 capital as appropriate, both at Level 1 and Level 2. This requirement does not apply to holdings of capital instruments by members of a group on behalf of third parties (refer APS 111).

Capitalised expenses

8. For the removal of any doubt, intangible assets include capitalised expenses and capitalised transaction costs. These expenses must be deducted from Tier 1 capital at both Level 1 and Level 2, and include:

Loan/lease origination/broker fees and commissions

- (a) loan/lease origination/broker fees and commissions that are capitalised as an asset are to be set off against the balance of upfront loan/lease fees associated with the lending portfolios that are treated as deferred income and recognised as a liability. The positive balance of the net loan/lease origination fees and commissions must be deducted from Tier 1 capital. A negative balance may be added to Tier 1 capital provided the net deferred income satisfy the criteria in APS 111. Otherwise a negative balance should not be added to capital;

Securitisation establishment costs

- (b) the balance of any securitisation establishment costs that are capitalised and deferred as an asset are to be set off against the balance of fee income relating to securitisation schemes that is recognised and deferred as a liability. Any positive net balance of capitalised securitisation establishment costs must be deducted from Tier 1 capital in accordance with APS 111. In accordance with *Guidance Note AGN 120.3 Purchase & Supply of Assets (including Securities Issued by SPVs) (AGN 120.3)*, any excess deferred fee income over capitalised securitisation establishment costs may be added to Tier 1 capital provided the net deferred income

receivable satisfies the criteria set out in APS 111. Otherwise net deferred income receivable should not be added to capital;

- (c) costs associated with debt raisings and other similar transaction related costs that are capitalised as an asset; and
 - (d) other capitalised expenses including capitalised expenses of a general nature such as strategic business development initiatives. These also include, in addition to the above listed items, other forms of transaction costs (e.g. fees and commissions paid to agents, advisers, brokers and dealers, transfer tax and duties) and like costs required to be deferred/capitalised and amortised as part of the measurement of assets and liabilities under Australian accounting standards.
9. The balance of any transaction costs and like items that are capitalised and deferred as an asset are to be netted off against the balance of any income deferred as a liability relating to the products giving rise to the capitalised transaction costs (i.e. only deferred costs and income in particular product portfolios may be netted). Any positive net balance of capitalised transaction costs must be deducted from Tier 1 capital in accordance with APS 111. Any surplus of deferred income over deferred costs may be added to Tier 1 capital provided the net deferred income satisfies the criteria set in APS 111. Otherwise net deferred income should not be added to capital.

Surpluses on employer-sponsored defined benefit superannuation funds

10. Unless otherwise agreed with APRA, any surplus in an ADI (or member of the ADI's group) employer-sponsored defined benefit superannuation fund must be deducted from Tier 1 capital unless it has already been excluded from Tier 1 capital. An ADI may make representations to APRA to include a surplus as an asset for capital adequacy purposes where the ADI (or member of the ADI's group) employer-sponsor is able to demonstrate unrestricted and unfettered access to a fund surplus in a timely manner. Where APRA is satisfied about such access, an ADI may include the surplus in its risk-weighted assets at a 100 per cent risk weight. This surplus will no longer be required to be deducted from Tier 1 capital.