

# ASSURANCE AND ACCOUNTING

# CANADIAN GAAP – IFRS

# COMPARISON SERIES

## Issue 13: Income Taxes

Both IFRS and Canadian GAAP are principle based frameworks and, from a conceptual standpoint, many of the general principles are the same. However, the application of those general principles in IFRS can be significantly different from Canadian GAAP. Therefore, to understand the magnitude of the differences between IFRS and Canadian GAAP, it is essential to look beyond the general principles and look at the detailed guidance provided in the standards. This is our thirteenth issue in a series of publications, which will provide detailed information on the key differences between IFRS and Canadian GAAP.

This issue will focus on the significant differences between current Canadian GAAP requirements for income tax accounting and the current IFRS income tax accounting requirements of IAS 12 - Income Taxes (IAS 12). These differences relate mainly to:

- The definition and scope of each standard;
- Exceptions to the recognition and measurement of temporary differences;
- Measurement of deferred tax assets and liabilities;
- Recognition of deferred tax assets;
- Allocation of tax to components of comprehensive income or equity; and
- Balance sheet classification.

Be advised that this publication is a guide to the differences between Canadian GAAP and IFRS and is not meant to be a comprehensive manual. Please contact a BDO Dunwoody representative for specific details and information.

### Introduction

Fundamentally, Canadian GAAP and IFRS, in particular Section 3465 and IAS 12 are based on the same method of measuring income taxes for accounting purposes. Both apply a balance sheet approach that requires an entity to recognize a deferred tax asset or liability for the temporary differences arising with respect to the entities assets and liabilities, operating loss carry forwards and other credits. However, it is the detailed requirements or application of these requirements that creates differences in the amount of income tax that is measured or recognized in the financial statements in accordance with Canadian GAAP or IFRS.

### References

IFRS: IAS 12 Income Taxes, SIC 21 Income Taxes – Recovery of Revalued Non-Depreciable Assets, SIC 25 Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders  
Canadian GAAP: Section 3465 Income Taxes, EIC 104 Impact of Refundable Taxes on Future Income Tax Calculations, EIC 106 Application of CICA 3465 to Investments Accounted for by the Equity Method, EIC 107 Application of CICA 3465 to Mutual Fund Trusts, Real Estate Investment Trusts, Royalty Trusts and Income Trusts, EIC 109 Accounting for Resource Allowance under CICA 3465, EIC 110 Accounting for Acquired Future Tax Benefits in Certain Purchase Transactions that are Not Business Combinations, EIC 111 Determination of Substantively Enacted Tax Rates under CICA 3465. EIC 120 CICA 3465 - Future Income Taxes Related to Intangible Assets Acquired in a Business Combination, EIC 136 Income Tax Considerations in Applying the Goodwill Impairment Test in CICA 3064, EIC 146 Flow-through shares. EIC 167 Future Income Tax Liabilities – Income Trusts and Other Specified Investment Flow-Throughs, EIC 171 Future Income Taxes Consequences of Exchangeable Interests in an Income Trust or Specified Investment Flow Through, EIC 172 Income Statement Presentation of a Tax Loss Carry Forward Recognized Following an Unrealized Gain Recorded in Other Comprehensive Income.



## Definitions and Scope

Canadian GAAP and IFRS are similar standards in that they both include definitions of current income taxes, tax basis of an asset or liability (IFRS uses the term tax base) and temporary differences. The definitions in each are very similar. For example, both Canadian GAAP and IFRS determine the temporary difference of an asset or liability using the difference between an assets or liability's carrying amount on the balance sheet and the amount attributed for tax purposes. There are differences in the scope of each standard.

However, there is a difference in when the standard is applicable.

CANADIAN GAAP	CURRENT IAS 12
<p>Section 3465 provides specific guidance on refundable taxes, alternative taxes and the treatment of regulated entities within its scope.</p>	<p>The scope of IAS 12 includes all domestic and foreign taxes which are based on taxable profits.</p> <p>No guidance is specifically provided for refundable taxes, alternative taxes and the treatment of regulated entities are not specifically covered by IAS 12.</p>
<p>Investment tax credits are not within the scope of 3465. As a result, the definition of future income tax assets specifically excludes investment tax credits.</p> <p>These are covered in Section 3805, Investment Tax Credits, which requires the use of the cost reduction approach (similar to accounting for government grants).</p>	<p>Accounting for government grants and investment tax credits are excluded from the scope of IAS 12, however, unlike Canadian GAAP, IAS 12 does deal with temporary differences that arise from these credits.</p>

## Recognition

The recognition of current income taxes under Canadian GAAP and IFRS is similar. Both require a liability to be recognized to the extent that current tax is unpaid, or an asset to be recognized where the amount already paid with respect to the current or prior periods exceeds the amount due. Both Canadian GAAP and IFRS also require the benefit relating to any tax loss arising in the current period that will be carried back to recover income taxes of a previous period to be recognized as a current asset rather than future taxes.

However, there are differences in the recognition of future taxes.

CANADIAN GAAP	CURRENT IAS 12
<p>Canadian GAAP refers to future income tax assets and/or future income tax liabilities being recognized.</p>	<p>IAS 12 refers to deferred tax assets and/or deferred tax liabilities being recognized.</p>
<p>Generally, future income taxes are recognized for all temporary differences.</p> <p>Exceptions to this rule are for temporary differences arising from:</p> <ul style="list-style-type: none"> <li>• Any portion of goodwill that is not deductible for tax purposes;</li> <li>• The difference between the historical exchange rate and the current exchange rate translations of the cost of non-monetary assets or liabilities of integrated foreign operations;</li> <li>• Intra-group transfer of assets between enterprises in a consolidated group;</li> <li>• The difference between the carrying amount of investment in subsidiaries and / or interests in joint ventures and the tax basis of that investment; or</li> <li>• Deductible temporary differences and loss carry forwards (i.e. future tax assets) that are <u>not likely to be realized</u>.</li> </ul>	<p>Generally, deferred income taxes are recognized for all temporary differences, except to the extent that the deferred tax arises from:</p> <ul style="list-style-type: none"> <li>• The initial recognition of goodwill (effectively the same as Canadian GAAP);</li> <li>• Investments in <u>all</u> subsidiaries, associates, branches and interests in joint ventures;</li> <li>• The initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); or</li> <li>• Deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized.</li> </ul>
<p>An event is more likely than not when the probability that it will occur is greater than 50 percent.</p>	<p>Probable is interpreted as being the same as more likely than not.</p>

## Recognition: Temporary Difference Exceptions

As discussed above, deferred taxes are generally recognized for all temporary differences. However, both Canadian GAAP and IFRS include exceptions to this general rule. In certain cases the exceptions under Canadian GAAP are different to the exceptions under IFRS.

CANADIAN GAAP	CURRENT IAS 12
<b>Translation of foreign non-monetary assets and liabilities from local currency to functional currency</b>	
No future tax asset or future tax liability is recognized for exchange gains or losses with respect to the translation of foreign non-monetary assets and liabilities into the functional currency using historical rates for an integrated foreign operation.	No temporary difference exemption exists for foreign non-monetary assets and liabilities that are remeasured from the local currency into the functional currency using historical exchange rates.  An entity must recognize a deferred tax asset or deferred tax liability for the temporary differences.
<b>Intra-group transfer of assets between enterprises in a consolidated group<sup>1</sup></b>	
No future tax asset or future tax liability is recognized in the consolidated financial statements for any temporary differences arising from the transfer of assets between entities, and any current taxes of the seller are deferred until the related asset is sold or disposed of.  Any taxes paid or recovered are recognized as an asset or liability in the consolidated financial statements until the gain or loss from sale or disposal is recognized by the consolidated group.	The temporary differences arising from the transfer between entities are required to be recognized with the deferred tax being determined based on the buyers tax basis and buyers tax rate.  Taxes paid on intercompany profits are recognized as incurred.
<b>Investment in Subsidiaries and related entities (outside basis differences)</b>	
No future tax asset or future tax liability is recognized for the temporary differences arising from investments in any subsidiaries, associates and interests in joint ventures when it is apparent that this difference will not reverse in the foreseeable future.  Any future income tax asset should be recognized only to the extent that it is more likely than not that the benefit will be realized.	No deferred tax liability or deferred tax asset is recognized for the temporary differences arising from investments in all subsidiaries, associates, branches and interests in joint ventures to the extent that: <ul style="list-style-type: none"> <li>• The parent, investor or venturer is able to control the timing of the reversal of the temporary difference; and</li> <li>• It is probable that the temporary difference will not reverse in the foreseeable future.</li> </ul> A deferred tax asset is not recognized for all deductible temporary differences arising from investments in subsidiaries, associates, branches and interests in joint ventures to the extent that it is probable that: <ul style="list-style-type: none"> <li>• The temporary difference will reverse in the foreseeable future; and</li> <li>• Taxable profit will be available against which the temporary difference can be utilised.</li> </ul>
<b>Initial recognition of an asset outside of a business combination</b>	
When an asset is acquired other than in a business combination and the tax basis of that asset is less than its cost, the cost of future income taxes recognized at the time of acquisition should be added to the cost of the asset.  When an asset is acquired other than in a business combination and the tax basis of that asset is greater than its cost, the benefit related to future income taxes recognized at the time of acquisition should be deducted from the cost of the asset.	No deferred tax liability or deferred tax asset is recognized on temporary differences, arising for asset acquisitions that are not business combinations.
The temporary difference is included in the cost of the acquired asset.	No adjustment to the cost of the acquired asset is made.

<sup>1</sup> When preparing consolidated financial statements under Canadian GAAP and / or IFRS inter-company transactions, including the sellers gain or loss are eliminated, with the asset (inventory in this case) being recorded at the sellers carrying amount prior to the transaction. A temporary difference will arise as a taxable event has occurred. The difference is between the carrying amount of the asset (the sellers position) and the new tax basis (the buyers position).

**CANADIAN GAAP****CURRENT IAS 12**

## Recognition: Business Combinations

When, at the time of a business combination, the acquirer considers it more likely than not that it will realize a future income tax asset of its own that was previously unrecognized, it includes the future income tax asset as an identifiable asset when allocating the cost of the purchase.

When a future income tax asset acquired in a business combination was not recognized as an identifiable asset by the acquirer at the date of acquisition (i.e. business combination date) is subsequently recognized by the acquirer, the benefit first reduces goodwill to zero, and then reduces unamortized intangible assets to zero. The remainder, if any, is recorded as a reduction in income tax expense.

This is the case whether or not subsequent measurement of the future income tax is within the 'measurement' period or result from new information from facts at the acquisition date.

Note that, upon adoption of CICA 1582, the treatment will be the same as that required under IFRS.

The recognition of deferred tax assets of the acquirer that was previously unrecognized, arising as a result of the business combination are recorded as a separate transaction from the purchase price allocation.

Goodwill is not affected by recognition of acquirer deferred tax assets.

When a deferred tax asset acquired in a business combination is not recognized as an identifiable asset at the business combination date and is subsequently recognized by the acquirer within the measurement period (as a result of new information about facts and circumstances that existed at the measurement date), the carrying amount of goodwill is reduced.

If goodwill has been brought to zero, the deferred tax benefits are recognized in earnings.

All other acquired deferred tax benefits (i.e. those that result from new information and all those outside of the maximum one-year measurement period) are not adjusted to goodwill when recognized.

## Allocation of Taxes

Generally, Canadian GAAP and IFRS require income taxes to be recognized in a manner consistent with the underlying transaction when the transaction occurs in the same period as the income tax effects are being recognized. However, there is a difference when accounting for tax related to an item that was recognized outside profit and loss in a prior year.

**CANADIAN GAAP****CURRENT IAS 12**

Generally, when the income taxes are being recognized in a subsequent period, they are required to be charged to the income statement, before discontinued operations and extraordinary items.

The allocation of tax related to an item that was recognized outside profit and loss in a prior year is recognized outside profit and loss during the current year.

This is commonly referred to as requiring 'backwards tracing' (e.g. Current tax and deferred tax that relates to items that are recognized, in the same or a different period in other comprehensive income are also recognized in other comprehensive income).

## Measurement

The measurement of future income tax liabilities and future income tax assets is similar under Canadian GAAP and IFRS. The tax amount reflects the way in which the entity expects to recover the asset or liability (i.e. through use or sale).

**CANADIAN GAAP****CURRENT IAS 12**

Income tax liabilities and income tax assets are measured using the income tax rates and income tax laws that, at the balance sheet date, are expected to apply when the liability is settled or the asset is realized, which would normally be those enacted at the balance sheet date.

EIC-111, Determination of Substantively Enacted Tax Rates under CICA 3465, provides additional interpretation specifically for the Canadian context.

Income tax liabilities and income tax assets are measured using the income tax rates and income tax laws that are expected to apply to the period when the asset is realized or the liability is settled, that have been enacted or substantively enacted at the end of the reporting period.

CANADIAN GAAP	CURRENT IAS 12
Canadian GAAP does not include specific guidance on recognition and measurement for any uncertain tax position adjustment.	IAS 12 does not include guidance on recognition and measurement for any uncertain tax position adjustment.  Although not covered specifically by IAS 12, an entity may need to apply IAS 37 Provisions, Contingent Liabilities and Contingent Assets to the provision. Refer to Issue 7 Provisions of our Canadian GAAP – IFRS Differences Series.

### Compound Financial Instruments

Compound financial instruments are those instruments, such as convertible debt, which have both a debt and an equity component. The allocation of deferred tax on these instruments is different under Canadian GAAP and IFRS. Canadian GAAP has special rules relating to compound financial instruments, which often do not result in the recognition of temporary differences relating to the liability component, even though the tax basis would generally differ from the accounting basis.

CANADIAN GAAP	CURRENT IAS 12
<p>The component of a compound financial instrument classified as a liability will normally be different from the tax basis of the instrument. If the liability component were to be settled for its carrying amount, this would otherwise give rise to taxable or deductible amounts that would be included in the determination of taxable income.</p> <p>However, CICA 3465 recognizes that settlement of the instrument in accordance with its terms, either through settlement on maturity or conversion, might not result in the incidence of tax to the issuer. Therefore, when an entity is able to settle the instrument without the incidence of tax, the tax basis of the liability component is considered to be the same as its carrying amount and there is no temporary difference.</p>	<p>IAS 12 does not contain any special exemption relating to the recognition of deferred taxes arising on compound financial instruments.</p> <p>An illustrative example on compound financial instruments accompanies IAS 12. In this, an entity recognizes the resulting deferred tax liability by adjusting the initial carrying amount of the equity component of the convertible liability.</p>

### Interpretation and Guidance for Special Taxes and Tax Entities

Canadian GAAP has a number of EIC interpretations specifically for the Canadian tax environment. For example, there are interpretations directly related to accounting for flow-through shares and accounting for Mutual Funds, Real Estate Investment Trusts (REITs). No unique tax specific transaction or industry specific tax guidance or interpretations are included in IFRS.

CANADIAN GAAP	CURRENT IAS 12
<p><b>Flow through Shares</b></p> <p>Under Canadian GAAP, the accounting treatment of flow-through shares is addressed by EIC 146, Flow-Through Shares.</p>	IAS 12 contains no specific guidance on the appropriate accounting for flow-through shares.
<p><b>Flow through Shares</b></p> <p>For example, guidance is provided on the date that the future income tax liability should be recognized and the shareholder's equity reduced (i.e. the date that the company files the renouncement documents with the tax authorities to renounce the tax credits associated with the expenditures provided there is reasonable assurance that the expenditures will be made).</p>	Therefore, entities will need to apply judgment in developing an appropriate model accounting policy based on the principles of the standard (and IFRS in general).
<p><b>Share Based Payments</b></p> <p>Under Canadian GAAP, there is no explicit guidance on the accounting for the tax consequences of share based payments.</p>	IAS 12 caps the deferred tax asset for share based payment transactions at the intrinsic value of the award at the date of measurement.

## Classification

Canadian GAAP and IFRS require future/deferred tax assets and future/deferred liabilities to be classified differently on the balance sheet.

CANADIAN GAAP	CURRENT IAS 12
<p>The current and non-current portions of future income tax liabilities and future income tax assets should be segregated, based on the classification of the related liabilities and assets to which the future income tax liabilities and future income tax assets relate.</p> <p>If unrelated to a liability or an asset the future tax liability or future tax asset is classified according to the expected reversal date of the temporary difference. Future income tax assets related to unused tax losses and income tax reductions are classified based on the date on which a benefit is expected to be realized.</p>	<p>Deferred tax assets or deferred tax liabilities are not classified as current assets (liabilities).</p>

## Transition for First Time Adopters

No specific exemptions are provided for in IFRS 1 for the first time adoption of IAS 12. Therefore, on adoption of IFRS an entity is required to make full retrospective adjustments. One of the areas where a number of Canadian entities may be required to make an adjustment is with respect to the initial recognition of deferred taxes (See above details).

## The Future

In March 2009, the International Accounting Standards Board (IASB) issued an ED proposing a replacement of IAS 12. The objective of a new income tax standard is to clarify some of the issues that have arisen in interpretation of the existing IAS 12 and also to remove a number of the exceptions that are included in the existing IAS 12. The IASB believes that it is the exceptions that are largely creating interpretation and application confusion.

Based on the current IASB workplan, a new standard is expected to be finalized in 2010, with mandatory adoption likely to be from 2012, after Canadian adoption of IFRS has taken place.

The ED proposed some significant changes from the existing IAS 12. Some of these changes would actually bring IFRS income tax accounting into line with current Canadian GAAP requirements. For example, the presentation of deferred tax assets and liabilities would be segregated into current and non-current portions. However, some changes proposed are likely to have the opposite impact. For example, the ED proposes the current exemption for investments in all subsidiaries, associates, branches and interests in joint ventures is restricted to being an exemption for investment in a foreign subsidiary or a foreign joint venture to the extent that the investment is essentially permanent in duration and it is apparent the temporary difference will not reverse in the foreseeable future.

Another significant proposal in the ED is with respect to measurement of uncertain tax positions. The ED specifically requires measurement using a probability weighed average amount for all possible outcomes, assuming that the tax authority will examine the amounts reported to them and have full knowledge of all relevant information.

Another notable proposal for Canadian entities in the proposals was the inclusion of amendments to IFRS 1. These exemptions are specifically for countries where the new standard is likely to be issued after the date of transition to IFRS but prior to the first IFRS financial statements being prepared. Under the proposals first-time adopters with a transition date prior to the date the new standard is finalized and issued (which is likely to be all Canadian entities required to adopt IFRS) have the option to apply the new standard to all periods that will be presented or of applying the current IAS 12 requirements for any periods commencing before the new standard is finalized and issued (e.g. the comparative period(s)). The entity could then choose to adopt the new standard for the following year. If the second option is taken, the entity would follow the transition provisions (which are applicable to entities already applying IFRS) of the new standard, instead of the special transition provisions for first-time adopters.

Another proposed exemption is in relation to the initial recognition difference mentioned above. An exemption is proposed such that full retrospective application of the initial recognition will not be required. Therefore, when determining the new carrying amount for assets formerly covered by the initial recognition exemption, entities treat such assets and liabilities as if they had been acquired outside of a business combination for their carrying amount (i.e. use the existing, which may be the previous Canadian GAAP, carrying amount as the IFRS carrying amount).

## Conclusion

In general, the principles relating to accounting for income taxes under Canadian GAAP and IFRS have a lot of similarities. However, when looking at the details of each standard there are some significant differences which an entity needs to be aware of and needs to evaluate the impact of moving to IFRS on the amount of income taxes presented. The move to accounting for income taxes in accordance with IFRS is also complicated by the desire of the IASB to issue a new income tax standard. The impact of this on an entity can not really be determined until the standard is actually issued as any proposals made to date may change prior to finalization of the new standard.

If you require further guidance on income taxes under IFRS or any other IFRS information or reference sources, please contact your local BDO Dunwoody LLP office or visit [www.bdo.ca/ifrs](http://www.bdo.ca/ifrs).

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