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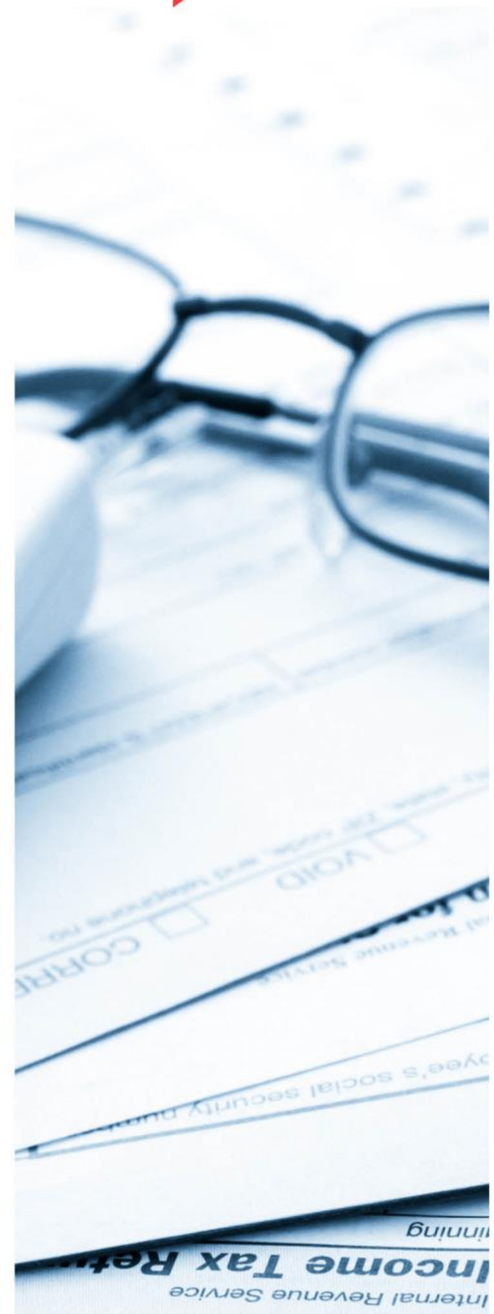
ASSURANCE AND ACCOUNTING

ASPE - IFRS: A Comparison

Income Taxes

In this publication we will examine the key differences between Accounting Standards for Private Enterprises (ASPE) and International Financial Reporting Standards (IFRS) related to accounting for income taxes with a focus on:

- Exceptions to the recognition and measurement of temporary differences;
- Recognition of deferred/future tax assets;
- Measurement of deferred/future tax assets and liabilities;
- Allocation of tax to components of comprehensive income or equity; and
- Balance sheet classification.



ASPE-IFRS differential rating scale

References

ASPE	IFRS
• Section 3465 – *Income Taxes*	• IAS 12 – *Income Taxes* • IFRIC 23 – *Uncertainty Over Income Tax Treatments* • SIC 25 – *Income taxes: Changes in the Tax Status of an Entity or its Shareholders*

Overview of Major Differences

The most significant difference between ASPE and IFRS in terms of accounting for income taxes is that ASPE allows an entity to apply one of two methods in accounting for income taxes:

- The taxes payable method; or
- The future income taxes method.

Under the taxes payable method, only current income tax assets and liabilities are recognized. Temporary differences giving rise to future income tax balances are ignored.

IFRS does not contain such an accounting policy choice. The remainder of this publication will focus on the differences between the future income taxes method under ASPE and the requirements of IFRS.

In accounting for income taxes under the deferred/future income taxes method, ASPE and IFRS are similar in that they generally require deferred/future tax balances to be recognized for temporary timing differences arising from differences in the carrying amount and tax bases of assets and liabilities, but it is the detailed requirements or the 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 ASPE or IFRS.

Definitions and Scope

ASPE 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 ASPE and IFRS determine the temporary difference of an asset or liability using the difference between the asset or liability's carrying amount on the balance sheet and the amount attributed for tax purposes.

There are also differences in the scope of each standard and there is a difference in when each standard is applicable.

ASPE	IFRS
Section 3465 provides specific guidance on alternative minimum taxes and the treatment of regulated entities within its scope.	The scope of IAS 12 includes all domestic and foreign taxes which are based on taxable profits. No guidance is specifically provided for alternative taxes and the treatment of regulated entities is not specifically covered by IAS 12.
Investment tax credits are not within the scope of Section 3465. As a result the definition of future income tax assets specifically excludes investment tax credits. These are covered in Section 3805, *Investment Tax Credits*, which requires the use of the cost reduction approach (similar to accounting for government grants).	Accounting for government grants and investment tax credits are excluded from the scope of IAS 12. However, items described as investment tax credits that are linked to net or taxable income are not considered investment tax credits for the purposes of the scope exclusion and are covered by IAS 12. The standard also addresses temporary differences that arise from these credits.

Recognition

The recognition of current income taxes under ASPE 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 ASPE 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 as deferred/future taxes.

Guidance within IFRS relating to refundable taxes differs significantly from ASPE. In the case of refundable taxes, ASPE generally requires them to be recorded directly through retained earnings, whereas IFRS would record them through profit or loss in the period to which they relate.

The following differences exist between the future income taxes method in ASPE and the overall requirements of IFRS:

ASPE	IFRS
ASPE refers to future income tax assets and / or future income tax liabilities being recognized.	IAS 12 refers to deferred tax assets and / or deferred tax liabilities being recognized.

<table>
<tr><th>ASPE</th><th>IFRS</th></tr>
<tr><td>Generally, future income taxes are recognized for all temporary differences. Exceptions to this rule are for temporary differences arising from:
• Any portion of goodwill that is not deductible for tax purposes;
• The difference between the historical exchange rate and the current exchange rate translation of the cost of non-monetary assets or liabilities of integrated foreign operations;
• Intra-group transfer of assets between enterprises in a consolidated group;
• The difference between the carrying amount of investments in subsidiaries and / or interests in joint ventures and the tax basis of those investments; or
• Deductible temporary differences and loss carry forwards (i.e. future tax assets) that are not more likely than not to be realized.

An event is more likely than not when the probability that it will occur is greater than 50 percent.</td><td>Generally, deferred income taxes are recognized for all temporary differences, except to the extent that the deferred tax arises from:
• The initial recognition of goodwill (effectively the same as ASPE);
• Investments in all subsidiaries, associates, branches and interests in joint ventures;
• 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
• Deductible temporary differences to the extent that it is not probable that taxable profit will be available against which the deductible temporary difference can be utilized.

Probable is interpreted as being the same as more likely than not.</td></tr>
<tr><td>Certain jurisdictions levy a minimum tax with reference to income for financial statement purposes, or to certain elements of capital.

Any amounts of minimum tax payable currently that may reduce income taxes of a future period are recorded as a future income tax asset if it is more likely than not that income taxes will be sufficient to recover the amounts payable currently. Any amounts that are not more likely than not to be recovered are included in current income tax expense.</td><td>IAS 12 contains no specific guidance on alternative minimum taxes. The criteria to recognize deferred tax assets apply, and since alternative minimum taxes do not arise from deductible temporary differences or unused tax losses and tax credits, an entity would generally be precluded from recognizing deferred tax assets relating to alternative minimum taxes.</td></tr>
<tr><td>Refundable taxes are taxes that are based on certain types of income and that are refundable when certain amounts are paid to shareholders. In Canada, this is common in the form of refundable dividend tax on hand (RDTOH) and the dividend refund system relating to taxes levied on investment income of certain corporations.

Instruments Classified as Equity
Refundable taxes related to instruments classified as equity are charged to retained earnings when it is more likely than not that such taxes will be recovered in the foreseeable future. The recovery of such refundable taxes is credited to retained earnings. When it is not more likely than not that the taxes will be recovered in the foreseeable future, the taxes are charged to income.

Instruments Classified as Liabilities
When the taxes relate to an instrument classified as a liability, the refundable taxes are recognized as a future</td><td>When different rates of tax apply to an entity on undistributed profits compared to profits that have been distributed via dividend or other mechanism, current and deferred taxes are measured at the rate applicable to undistributed profits.

An entity shall recognize the income tax consequences of dividends as defined in IFRS 9 when it recognizes a liability to pay a dividend. The income tax consequences of dividends are linked more directly to past transactions or events that generated distributable profits than to distributions to owners. Therefore, an entity shall recognize the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognized those past transactions or events.</td></tr>
</table>

income tax asset. For example, this may occur when retractable preferred share are classified as liabilities under Section 3856, *Financial Instruments,* and the payment of the liability triggers a deemed dividend for tax purposes. When such a deemed dividend will give rise to a refund of taxes previously paid, the amount of the refundable taxes is included in future income tax assets.	

Recognition: Temporary Difference Exceptions

As discussed above, deferred taxes are generally recognized for all temporary differences for entities following the future income taxes method. However, both ASPE and IFRS include exceptions to this general rule. In certain cases the exceptions under ASPE are different than the exceptions under IFRS:

ASPE	IFRS
Translation of foreign non-monetary assets and liabilities from local currency to functional currency	
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.	An entity must recognize a deferred tax asset or deferred tax liability for the temporary differences arising from foreign non-monetary assets and liabilities that are remeasured from the local currency into the functional currency using historical exchange rates.
Intra-group transfer of assets between enterprises in a consolidated group[1]	
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 of assets between entities are required to be recognized with the deferred tax being determined based on the buyer's tax basis and buyer's tax rate. Taxes paid on intercompany profits are recognized as incurred.

[1] When preparing consolidated financial statements under ASPE and / or IFRS, inter-company transactions, including the seller's gain or loss, are eliminated with the asset being recorded at the seller's 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 seller's position) and the new tax basis (the buyer's position).

<table>
<tr><td colspan="2">Investment in subsidiaries and related entities (outside basis differences)</td></tr>
<tr>
<td>Temporary differences may arise from investments in subsidiaries and interests in joint arrangements due to “inside basis differences” (i.e. differences in the carrying amount and tax basis of assets and liabilities of subsidiaries and joint arrangements) and “outside basis differences” (i.e. differences in the carrying amount and tax basis of the investor’s investment in subsidiaries or joint arrangements due to undistributed profits or foreign exchange rates).

A future income tax liability or future income tax asset is recognized for all temporary differences arising from investments in subsidiaries and interests in joint arrangements, except outside basis difference when it is apparent that this difference will not reverse in the foreseeable future.

Any future income tax asset related to outside basis differences shall be recognized only to the extent that it is more likely than not that the benefit will be realized.</td>
<td>A deferred tax liability or deferred tax asset is recognized for outside basis temporary differences arising from investments in <u>all</u> subsidiaries, associates, branches and interests in joint ventures, except to the extent that both of the following conditions are satisfied:
• The parent, investor or venturer is able to control the timing of the reversal of the temporary difference; and
• It is probable that the temporary difference will not reverse in the foreseeable future.
A deferred tax asset is 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:
• The temporary difference will reverse in the foreseeable future; and
• Taxable profit will be available against which the temporary difference can be utilized.</td>
</tr>
<tr><td colspan="2">Initial recognition of an asset outside of a business combination</td></tr>
<tr>
<td>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.</td>
<td>No deferred tax liability or deferred tax asset is recognized on temporary differences arising for asset acquisitions that are not business combinations.

If the temporary differences increase in subsequent periods (e.g. due to different accounting and tax depreciation rates), the change in the temporary differences from initial recognition <u>do</u> give rise to deferred tax liabilities and assets, subject to the other recognition criteria.

<u>Example</u>
A piece of equipment is acquired for $100, but its tax base is limited to $75. The initial timing difference of $25 does not give rise to deferred tax as it is included in the initial recognition exemption, discussed above.

For accounting purposes, the asset is amortized over 10 years, and for tax purposes, it is amortized over 3 years. At the end of year 1:

Carrying value 90
Tax base <u>50</u>
Temporary difference 40
Less: initial difference <u>25</u>
Net temporary difference 15

The remaining temporary difference of $15 gives rise to deferred tax as it is a result of different amortization rates between IFRS and the tax authorities, and is therefore not part of the initial recognition exemption.</td>
</tr>
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ASPE	IFRS
Recognition: Business Combinations	
Differences between ASPE and IFRS exist in accounting for income taxes related to a business combination. These differences are addressed in our IFRS-ASPE Comparison series publication on business combinations.	

Allocation of Taxes

Generally, ASPE 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.

ASPE	IFRS
Generally, when the income taxes are being recognized in a subsequent period, they are required to be charged to the income statement and presented 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).

To illustrate the difference in allocation of taxes between ASPE and IFRS, the following example will be used:

Facts

On January 1, 20x2, ABC Company issues shares for $100,000. In the process, they incur $10,000 of issuance costs. These are deductible over 5 years for income tax purposes. The tax rate is 40%, and is not expected to change.

Solution

The tax impact of the share issuance at the time of issuance and over subsequent periods is as follows:

ASPE	IFRS
January 1, 20x2: DR share capital (costs) 6,000 DR future tax asset 4,000 CR cash 10,000 *The share issuance costs are shown as $6,000, net of the associated tax benefit they will provide in the future.* December 31, 20x2: DR future tax expense 800 CR future tax asset 800 *As the timing difference reverses as the issuance costs are deducted over 5 years, the effect of the reversal is recognized in profit or loss. The same entry would be booked for the remaining 4 fiscal periods.*	January 1, 20x2: DR share capital (costs) 6,000 DR deferred tax asset 4,000 CR cash 10,000 *The share issuance costs are shown as $6,000, net of the associated tax benefit they will provide in the future. This is the same treatment as ASPE.* December 31, 20x2: DR share capital (tax) 800 CR deferred tax asset 800 *As the timing difference reverses as the issuance costs are deducted over 5 years, the effect of the reversal is recognized in the same manner as the related item (i.e. the tax effect is “backwards traced” to the component of equity it relates to). The same entry would be booked for the remaining 4 fiscal periods.*

As of December 31, 20x6, when all the tax effect had been utilized, the net result of the share issuance would be: Share capital (gross) 100,000 Cost of issuance 6,000 Net 94,000	*As of December 31, 20x6, when all the tax effect had been utilized, the net result of the share issuance would be:* Share capital (gross) 100,000 Cost of issuance 6,000 Tax effect of costs 4,000 Net 90,000 In the end, share capital under IFRS is lower since the effect of tax is ultimately recorded in the same place as the issued share capital.

Measurement

The measurement of future income tax liabilities and future income tax assets is similar under ASPE and IFRS. Differences relating to measurement include:

ASPE	IFRS
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. It is appropriate to use a substantively enacted income tax rate or income tax law only when there is persuasive evidence that: • The government is able and committed to enacting the proposed change in the foreseeable future; and • When the change relates to the current year, the enterprise expects to be assessed based on the announced tax rates or tax laws. Persuasive evidence that a change in tax law or tax rates is substantively enacted usually exists only when the proposed change is specified in sufficient detail to be understood and applied in practice, has been drafted in legislative or regulatory form and has been tabled in Parliament or presented in Council.	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, based on tax rates/laws that have been enacted or substantively enacted at the end of the reporting period.
When the effective tax rate that applies to capital gains and losses differs from that which applies to other taxable income, the rate used to measure future income tax assets and liabilities reflects the expected manner of recovery of the asset.	An entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.
ASPE does not include specific guidance on recognition and measurement for any uncertain tax position adjustment.	IFRIC 23 - *Uncertainty Over Income Tax Treatments*[1] clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments. In such a circumstance, an entity shall recognize and measure its current or deferred tax asset or liability applying the requirements in IAS 12

[1] An entity shall apply this Interpretation for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted.

	based on taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates determined applying IFRIC 23. Refer to BDO's IFRS at A Glance: *IFRIC 23 - Uncertainty over Income Tax Treatments* for a summary of the guidance.

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 ASPE and IFRS. ASPE 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. The difference is as follows:

ASPE	IFRS
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. However, Section 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.	IAS 12 does not contain any special exemption relating to the recognition of deferred taxes arising on compound financial instruments. 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.

Interpretation and Guidance for Special Taxes and Tax Entities

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

Classification

ASPE and IFRS require deferred/future assets and liabilities to be classified differently on the balance sheet:

ASPE	IFRS
The current and non-current portions of future income tax liabilities and future income tax assets must 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. 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.	Deferred tax assets or deferred tax liabilities are <u>never</u> classified as current assets (liabilities).

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.	

Conclusion

In general, the principles relating to accounting for income taxes under ASPE and IFRS have a lot of similarities for those entities following the future income tax method under ASPE. However, when looking at the details of each standard there are some significant differences which an entity needs to be aware of. If you require further guidance on accounting for income taxes under ASPE or IFRS please contact your local BDO Canada LLP office. If you are considering the adoption of a new standard, learn how our BDO Integrated Advisory Services Team can help you with the transition.

To learn more about the differences between standards, view our ASPE-IFRS: A Comparison Series.

The information in this publication is current as May 31st, 2018.

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