IFRS Discussion Group

Report on the Public Meeting

February 26, 2014

The IFRS Discussion Group is a discussion forum only. The Group's purpose is to assist the Accounting Standards Board (AcSB) regarding issues arising on the application of International Financial Reporting Standards (IFRSs) in Canada. The Group comprises members with various backgrounds who participate as individuals in the discussion. Any views expressed in the public meeting do not necessarily represent the views of the organization to which a member belongs or the views of the AcSB. The discussions of the Group do not constitute official pronouncements or authoritative guidance.

This document has been prepared by the staff of the AcSB and is based on discussions during the Group's meeting.

Comments made in relation to the application of IFRSs do not purport to be conclusions about acceptable or unacceptable application of IFRSs. Only the IFRS Interpretations Committee or the International Accounting Standards Board can make such a determination.

(For a full understanding of the discussions and views expressed at the public meeting, listen to the audio clips).

Items Presented and Discussed at the February 26, 2014 Meeting

IFRIC 21: Levies – Property Taxes in Canada

IFRIC 21: Levies – Consideration of Levies Other than Property Taxes

ITEMS PRESENTED AND DISCUSSED AT THE FEBRUARY MEETING

IFRIC 21: Levies – Property Taxes in Canada

IFRIC 21 *Levies* provides guidance on accounting for levies in accordance with the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This Interpretation is effective for annual periods commencing on or after January 1, 2014 and is applied retrospectively.

IFRIC 21 requires that an entity recognizes a liability for a levy when the triggering event as specified in the legislation occurs. An entity does not recognize a liability at an earlier date, even if it has no realistic alternative to avoid the triggering event. Consequently, the potential impact of IFRIC 21 is one of timing of recognition of the liability.

In Canada, municipalities have the power through legislation to levy property taxes. Property taxes are generally levied on a property situated within the boundaries of a municipality and are determined with reference to the underlying property's value. Given that property taxes are non-reciprocal charges imposed by a government, in accordance with legislation, and are based on property value (and as such are not within the scope of IAS 12 *Income Taxes* — or any other standard), property taxes appear to be within the scope of IFRIC 21.

The Group considered when a liability to pay property taxes should be recognized in accordance with IFRIC 21 based on some of the typical features found in Canadian municipal tax legislation. The Group also considered the accounting for the debit side of the entry in relation to Canadian property taxes.

Issue 1: Timing of recognition of a liability to pay property taxes

Two alternatives have been identified with regard to the appropriate timing of recognition of a liability for property tax under IFRIC 21 in Canada. The different alternatives are a result of the fact that the relevant Canadian municipal legislation is often somewhat ambiguous as to what the triggering event is for property taxes and at what point they become unavoidable. The legislation also varies from place to place within Canada.

View 1A – The liability to pay property taxes should generally be recognized at a point in time.

Under this view, the obligating event is the ownership of the property on a specific date. Canadian municipal legislation may have clauses that impose property taxes on the owner of a property on, or as of, a specific date (or dates) in the year. Some general clauses that have been seen in Canadian municipal legislation note that property taxes are deemed to be imposed on January 1st of each year. Additionally, the municipality may be able to recover those taxes from either the current owner of the property or the original owner who owned the property at the time the property taxes were imposed.

Under this view, when a property is owned throughout the year, a liability for annual property taxes should be recognized on the later of January 1st (the "imposition date") and the date of the assessment. In this scenario, one would need to determine what is meant by "assessed" and the timing of the assessment in order to determine the specific date on which the liability to pay the property tax levy should be recognized.

Once recognized, the liability would be based on the property owner's estimate of the property tax for the year and would be adjusted once the amount of the levy is finalized.

View 1B – The liability to pay property taxes should generally be recognized ratably throughout the year.

Under this view, the obligating event occurs ratably throughout the year. Property tax legislation in various jurisdictions in Canada does not clearly define a single obligating event that gives rise to a liability to pay the annual levy. The relevant municipal legislation may not specify a single date at which one is obligated for an entire year's property taxes and, as such, at any date within the year, the only amount of property taxes that an owner can reasonably estimate they are liable for is a pro rata estimate of annual property taxes based on the number of days of ownership. Under this view, wider consideration of the assessment and taxation processes that comprise the typical Canadian property tax system is required, including, for example, the relevant municipal Assessment Act and the associated appeals process for refunds in certain circumstances, such as a change in the condition or use of the property, as well as the mechanisms available in the municipal legislation itself relating to refunds, adjustments and relief from property taxes. Such collective consideration of the property tax system would also support that there is not a single date at which the obligation is unavoidable.

The Group's Discussion

Based on the facts and circumstances described above, a majority of the Group members supported View 1B, which represented some of the requirements that may be found in Canadian municipal property tax mechanics. However, some members did see merit in the arguments supporting View 1A, particularly when other facts and circumstances exist.

Group members noted that it is difficult to apply IFRIC 21 to Canadian property tax legislation. Members observed that the determination of the appropriate view should not be an accounting policy choice but rather should be based on an interpretation of the specific facts and circumstances relating to the relevant Canadian property tax legislation. Group members noted that it is the varying degrees of ambiguity across multiple aspects of the pieces of legislation underlying the Canadian property tax system that makes it difficult to justify one view as more appropriate than the other.

Group members commented that it appears that diversity in practice is unlikely to occur at this point because many preparers and auditors seem to support View 1B, based on their understanding of the context in which property taxes are levied across Canada.

Group members noted that foreign jurisdictions have different legislation, which may specify that property tax obligations arise at a specific point in time, or specify that the tax obligation arises rateably over the period. Detailed analysis of the specific pieces of legislation by preparers and auditors will be necessary. Group members reminded preparers and auditors that it is important to keep up to date on this issue as other jurisdictions begin to apply IFRIC 21. Preparers will have to identify, and perform an analysis of, the applicable legislation in the relevant Canadian and foreign jurisdictions to fully assess the impact of IFRIC 21.

One Group member commented that it is important that Crown corporations take into account the specific terms of the Payments in Lieu of Taxes Act and any related Orders in Council applicable to the

Crown corporation to determine if the analysis of these payments would align with the discussion above. Group members also commented that the real estate industry should consider the effect of the relevant view (or views) applicable to their organization regarding the timing of recognition of the property tax liability on the determination of fair value if they are applying the fair value model. Group members also noted that under View 1A in the real estate industry, there could be a disconnect in the recognition of the property tax liability in relation to the timing of recognizing property tax recoveries from tenants under the terms of commercial leases.

Issue 2: Accounting for the debit side of the entry

IFRIC 21 only provides guidance on when to recognize a liability — it does not address whether the debit side is an asset or an expense. However, paragraph 14 of IFRIC 21 requires that an entity recognize an asset if it has prepaid a levy but does not yet have a present obligation to pay that levy. As such, under View 1B above, one would record a prepaid asset only when property taxes have been paid to the municipality in excess of the amount of the obligation based on the pro rated number of days of ownership during the year.

Under View 1A above, when a liability for a full annual property tax levy is triggered on a specific date, the issue arises as to where the debit side of the entry would be recorded at the time the liability is recorded. Two potential views have been expressed:

View 2A – Property taxes should generally be expensed (unless recognized as an asset in accordance with another standard, such as property plant and equipment under construction).

Under this view, property taxes should be expensed because there is no clear future economic benefit to be received by an owner as a result of paying the property taxes. Therefore, the recognition of an asset would be inappropriate because the definition of an asset has not been met.

View 2B – Recognize a “right to use” asset.

Under this view, one would record a liability for property tax on a specific date but also record an asset in relation to the right to use the property for the remainder of the year.

Under this view, the payment of property taxes is considered to provide the owner with the continuing right to use the property over the year. As such, an intangible asset would be recorded when the liability to pay property taxes is recorded and amortized over the remainder of the year.

Group Discussion

The majority of Group members supported View 2A and concluded that it is difficult to support the view that the payment of property taxes generates an asset because it is a non-reciprocal transaction.

Group members considered whether a formal recommendation should be made to the AcSB to refer these issues to the IASB or the IFRS Interpretations Committee. Although the Group’s discussion demonstrated the practical difficulties in applying IFRIC 21 to property taxes, members could not identify what part of IFRIC 21 could be clarified and, considering the discussions as a whole, did not believe the general criteria for a submission to IFRIC was met.

The Group decided that no formal action should be taken at this time.

IFRIC 21: Levies – Consideration of Levies Other than Property Taxes

IFRIC 21 *Levies* provides guidance on accounting for levies in accordance with the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This Interpretation is effective for annual periods commencing on or after January 1, 2014 and is applied retrospectively.

The Group discussed levies, other than property taxes, which are paid by Canadian companies to local and foreign governments that may be within the scope of IFRIC 21 and considerations that Canadian entities should apply in analyzing the potential effect of IFRIC 21. The analysis under IFRIC 21 of Canadian property taxes, a specific type of levy, is addressed in a separate paper.

An issue with IFRIC 21 is that its scope is potentially broader than many preparers might expect. The term “levies” is not one that is widely used in Canada but it is important to remember that it is not what an item is called that determines whether or not it falls within the scope of IFRIC 21. Rather, the key issue is whether or not the item, whatever it may be called, meets the definition of a “levy” under IFRIC 21. As such, Canadian companies should consider all payments imposed by, and/or paid to, government pursuant to legislation or regulation, rather than by contract, to determine if they are within the scope of IFRIC 21. Items that are considered to be levies within the scope of IFRIC 21 may be referred to as a levy or as some other term in the underlying legislation. Examples of items that may be levies under IFRIC 21 include rents, royalties, taxes, contributions and fees.

The first question that Canadian companies should consider, once they have identified all such payments imposed by government, is whether they are within the scope of IFRIC 21:

- Is the payment imposed by a government in accordance with legislation?
- Is the payment non-reciprocal? (That is, a payment made for the acquisition of an asset, or for the rendering of services under a contractual agreement with a government, does not meet the definition of a levy.)
- Is the payment not within the scope of another standard (for example, IAS 12 *Income Taxes*, IAS 19 *Employee Benefits, etc.*)?
- Is the payment not a fine or penalty imposed for breach of the legislation?

If the answer is “yes” to all four questions, the payment is a levy within the scope of IFRIC 21.

When determining whether payments are imposed by a government, payments made to all levels and types of government should be considered — municipal, provincial, federal, First Nations and organizations controlled by government (such as Crown corporations and government agencies). Levies are also not confined to Canada — an entity must consider payments imposed by governments in all foreign jurisdictions as well. For this purpose, the definition of “government” in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and IAS 24 *Related Party Disclosures* is applicable.

When assessing whether payments are non-reciprocal, judgment may be required to determine if the payment of a levy results in the acquisition of an asset, depending on the nature of the levy and the activity that gives rise to the obligation.

Once a levy has been identified as being within the scope of IFRIC 21, the next consideration is whether the guidance in IFRIC 21 would significantly change the current accounting for the levy.

This step may require Canadian companies to consider the following:

- What is the activity that triggers the payment of the levy as identified in the legislation?
  - The activity which triggers payment in the legislation is the obligating event*,* which determines the point at which the liability for payment of the levy is recognized.
- For example, a levy may be a:
  - Progressive levy – an entity may be obligated under the legislation to pay a levy calculated as a percentage of revenues in the current year. Under IFRIC 21, the obligation to pay that levy would generally be recognized progressively as the revenues are earned.
  - Point in time levy – an entity may be obligated under the legislation to pay a levy in full on a particular date (for example, if the entity is operating in a specified industry or in a specified manner at the end of the annual reporting period). Under IFRIC 21, the obligation to pay the levy would generally be recognized in full on the particular date identified.
- Even if the liability is recognized progressively, there may be some features of the levy that may change the timing of recognition of the liability. For example:
  - Minimums –If the legislation prescribes that no levy is triggered until revenues reach a certain threshold (such as a zero per cent tax rate on revenues until revenues reach $50 million, and then the payment is two per cent of revenues after that point).
  - Progressive tax rates – If the legislation prescribes that the tax rate is escalating (such as two per cent on the first $x million in revenues, three per cent for revenues in excess of $x million).
  - Specified formula –If the legislation prescribes that the levy is calculated based on a specified formula that does not match the actual activity for the period. Certain levies may be calculated as a fixed percentage times a twelve-month rolling average of a specified performance measure (such as gross profit).
- The current method of accounting for the levy, both annually and for interim periods, should be considered to determine whether the guidance in IFRIC 21 would change the timing of the liability and, therefore, possibly affect the timing or amount of recognition of the expense. For example, IFRIC 21 addresses the following questions:
  - Does economic compulsion to continue to operate in a future period create a constructive obligation to pay a levy that will be triggered by operating in that future period?

    Paragraph 9 of IFRIC 21 states: “An entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period as a result of the entity being economically compelled to continue to operate in that future period.”
  - Does the going concern assumption imply that an entity has a present obligation to pay a levy that will be triggered by operating in a future period?

> Paragraph 10 of IFRIC 21 states: “The preparation of financial statements under the going concern assumption does not imply that an entity has a present obligation to pay a levy that will be triggered by operating in a future period.”

There are many types of legislation or regulation that result in payments to which IFRIC 21 may apply. Canadian companies are subject to a range of government-imposed regulations and legislation. Major industries that are affected include, but are not limited to, financial services (banking, insurance, etc.), broadcast/telecom/wireless spectrum, transportation, environment, food and agriculture, health, energy and natural resources.

The Group’s Discussion

Group members noted the complexity of applying the guidance in IFRIC 21. Group members observed that the term “levy” in IFRIC 21 is causing confusion because there are numerous items within its scope that are not called a levy (for example, royalties, taxes, etc.). Group members observed that this confusion may lead preparers to conclude prematurely that IFRIC 21 does not apply to their circumstances.

Group members emphasized the importance for preparers to review all clauses in the relevant legislation when applying IFRIC 21 to avoid missing vital pieces of information that could affect the ultimate analysis. Group members commented that the considerations and steps described in the summary above provide a roadmap for applying IFRIC 21.

Group members had previously discussed the alternate views about the timing of recognition of the debit side of the entry when the liability is recognized for the obligating event in the discussion of: Levies – Property Taxes in Canada.

Group members suggested that preparers and auditors stay up to date on this topic since additional interpretive guidance and clarifications may become available.

Group members noted that this item was intended to raise awareness of IFRIC 21 and how Canadian entities may be impacted by this Interpretation.

The Group decided that no other formal action should be taken at this time.