IFRS 1 and IAS 12: Initial Recognition Exemption on First-time Adoption of IFRSs

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The tax effects of acquiring assets outside a business combination are treated differently under Section 3465, *Income Taxes*, than under IAS *12 Income Taxes*. Section 3465 requires the recognition of a deferred tax liability and a corresponding increase in the carrying value of the related assets on the initial recognition of an asset in a transaction that is not a business combination and for which the tax basis is less than its cost. IAS 12 has an initial recognition exemption in respect of such a deferred tax liability. Generally, IFRS 1 *First-time Adoption of International Financial Reporting Standards* requires full retrospective application of IFRSs unless specifically exempted. The issue for consideration is whether a request should be made to the IFRS Interpretations Committee for clarification on whether an entity that has acquired assets for which the tax value is different to the cost is required to retrospectively apply the initial recognition exemption in IAS 12 on transition to IFRSs and adjust the carrying amount of the assets and the deferred tax liability in the opening balance sheet.

Members discussed three related scenarios:

Scenario 1 involved assets acquired in a transaction that was not considered a business combination under Section 1581, *Business Combinations*, or under IFRS 3. Full retrospective application of IAS 12 requires the assets and deferred taxes to be restated to reflect the initial recognition exemption. Members recommended that this issue not be brought to the attention of the IFRS Interpretations Committee because members were not aware of any diversity in practice on this issue.

Scenario 2 involved assets acquired in a transaction that was not considered a business combination under Section 1581, but did qualify as a business combination under IFRS 3. The members discussed whether the transaction should be accounted for as a business combination on adoption of IFRSs and, if so, whether the option available in IFRS 1 to not apply IFRS 3 retrospectively could be used. There are a number of issues if an entity applies the IFRS 3 exemption, including whether any asset that has been grossed up under Section 1581 would be required to be restated at the acquisition date, and/or whether any related deferred tax has to be restated at the acquisition or transition date to IFRSs. Members recommended that the issues arising under Scenario 2 not be brought to the attention of the IFRS Interpretations Committee because the issue arises from the specifics of Canada's pre-changeover GAAP and any solution would not be timely for Canada's changeover.

Scenario 3 involved oil and gas assets acquired in a transaction that did not constitute a business combination under either Section 1581 or IFRS 3. On transition to IFRSs, the entity elected to use the exemption in paragraph D8A of IFRS 1 that allowed the assets' previous GAAP carrying amount at the date of transition to be the entity's deemed cost of the assets under IFRS. Although there was diversity in views on whether IAS 12 should be retrospectively applied on transition to IFRSs, members recommended that the issue not be brought to the attention of the IFRS Interpretations Committee because it is a transition issue and the Interpretations Committee would not be able to address the issue in time for Canada's transition to IFRSs.