IFRIC 21: Levies

Extract, IFRS Discussion Group Report on Meeting – December 2, 2013

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 defines a levy as an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation (i.e., laws and/or regulations).

A payment made for the acquisition of an asset, or rendering of services under a contractual agreement with a government, is not a levy. Outflows of resources that are within the scope of other standards (for example, taxes that are within the scope of IAS 12 *Income Taxes*), fines and penalties, and liabilities arising from emission trading schemes are explicitly excluded from the scope of the Interpretation.

IFRIC 21 confirms that an entity recognizes a liability for a levy when, and only when, the triggering event[1] specified in the legislation occurs. An entity does not recognize a liability at an earlier date, even if it has no realistic opportunity to avoid the triggering event.

The Group considered whether certain payments, such as premiums payable under the Workplace Safety and Insurance Board of Ontario (WSIB) plan and property taxes, are within the scope of IFRIC 21.

The Group's Discussion

Group members noted that the scope of IFRIC 21 is potentially quite broad and careful consideration of all types of payments imposed by governments is necessary. One approach is to consider what kind of payments are imposed on an entity by governments and work through a complete list of such payments to identify why each type of payment might not be in the scope of IFRIC 21.

Group members noted that the premiums payable under the WSIB plan may be considered to fall outside the scope of IFRIC 21 because these payments fall within the scope of IAS 19 Employee Benefits. However, Group members observed that property taxes appear to fall within the scope of IFRIC 21, in accordance with the criteria in paragraph 4 of the Interpretation, and the application of IFRIC 21 may result in a change in the timing of the liability and expense recognition. Further details about the Group's discussions of these two examples are included in the accompanying Appendix.

Group members observed that many may overlook the potential applicability of IFRIC 21 to these types of payments or prematurely assume that there would be no effect on the accounting treatment. Although property taxes may not be material for some entities, they could be quite significant for certain entities with significant real estate assets.

[1] Triggering event is the obligating event that gives rise to a liability to pay a levy (i.e., the activity that triggers the payment of the levy, as identified by legislation).

Group members observed that the discussion has highlighted the potentially broad scope of IFRIC 21. The Group only discussed two of the many possible payments to government that may be within the scope of IFRIC 21. Group members expressed concern that there are many more payments made to governments that need to be assessed under IFRIC 21 and the effective date of January 1, 2014 does not provide much time to do so. Group members encouraged preparers and auditors to focus on IFRIC 21 and spend the necessary time to analyze the various payments made to government under this Interpretation.

Group members considered whether a formal recommendation should be made to the AcSB to refer this issue to the IASB or the IFRS Interpretations Committee. Group members observed that it seems likely there will be significant diversity in practice. Although the Group's discussion has demonstrated the practical difficulties in applying IFRIC 21, it is unclear what part of IFRIC 21 could be clarified. Some Group members suggested that, if such a broad scope was intended, perhaps a deferral in the effective date could be pursued.

The Group decided that no formal action should be taken at this time but supported the AcSB Chair's suggestion to discuss the issue with the AcSB as well as the IASB staff in December. Subsequent to the Group's meeting, the AcSB discussed this issue in its December and January meetings and directed staff to take further steps to raise awareness, including another public discussion of this issue by the IFRS Discussion Group in the first quarter of 2014.

Appendix to the discussion of IFRIC 21: Levies

Example 1: Premiums payable under the WSIB plan

In Ontario, most employers are required to register with the WSIB. The WSIB is legislated by the Ontario government and is responsible for administration of the Workplace Safety and Insurance Act. The payment of premiums to the WSIB will result in an outflow of resources embodying economic benefits (for example, payment of cash) to the WSIB, which is legislated by the Ontario government.

The Ontario WSIB plan is understood to be relatively consistent with similar plans across the other provinces.

The premiums are based on payroll costs and injury experience and not taxable profit. The WSIB premiums are based on the premium rates set by the WSIB and employers are required to pay premiums up to a maximum amount of insurable earnings per employee. Payments are due as long as the eligible employee is employed and is on the payroll. Currently, employers pay the WSIB premiums on a monthly basis and recognize the related cost as salaries and wages are earned.

Do the premiums payable under the WSIB plan fall within the scope of IFRIC 21?

The Group's Discussion

Payments within the scope of any IFRS other than IAS 37 are not within the scope of IFRIC 21. Group members observed that the premiums paid to the WSIB do not fall within the scope of IAS 12 as specified in paragraph 2 because they are based on payroll costs and injury experience rather than taxable profit. However, the premiums may be considered to fall within the scope of IAS 19 *Employee Benefits* (Amended 2011). Group members noted that, under paragraphs 4 and 44-45 of IAS 19, the WSIB plan could be considered to be a "state plan" in the scope of IAS 19 because:

- it is established by legislation to cover all entities or all entities in a particular category given the WSIB plan is established by the Workplace Safety and Insurance Act legislation;
- it is operated by local government given the WSIB is legislated by the Ontario government; and
- it is not subject to the control or influence by a reporting entity.

As a result, the premiums payable under the WSIB plan appear to be outside the scope of IFRIC 21 because these payments fall within the scope of IAS 19. Additionally, Group members noted that even if the WSIB were not considered to be a state plan under IAS 19 and is in the scope of IFRIC 21, there would be no change to the current practice of recognizing the liability because the payments are due over time as long as an employee is on the payroll. As a result, the triggering event occurs progressively over time.

The Group did not recommend any further action be taken regarding this example.

Example 2: Property taxes

In Canada, municipalities have the power to levy property taxes. Property taxes are levied on a property situated within the boundaries of a municipality. Taxes are generally calculated based on an annual period and are billed at varying times throughout the year. The amount of tax paid depends on the value of the property on the assessment date and the rate applicable to the nature of the property, such as residential or commercial. Municipalities charge property taxes for an annual period and stipulate the timing for payment of taxes.

The Group considered whether property taxes fall within the scope of IFRIC 21 and, if so, whether the triggering event is ownership of the property at the specific date (View A) or ownership of the property over the period to which the tax relates (View B).

Is there an outflow of resources embodying economic benefits to the government(s)?

The payment of property taxes will result in an outflow of resources embodying benefits (for example, a payment of cash) to the municipal governments and could potentially be within the scope of IFRIC 21.

Is the payment within the scope of other standards or a fine/penalty imposed for breach of legislation?

Payments made for property taxes are within the scope of IAS 37 and do not fall within the scope of any other standard. Property tax is not a fine or penalty imposed for breaches of legislation.

Is payment imposed in accordance with legislation?

The payment of property taxes is imposed in accordance with legislation by each municipality (for example, in the City of Toronto Act (2006)).

Is payment for acquisition of an asset, or for the rendering of services under a contractual agreement with a government?

The question arises whether the property taxes are effectively paid to the government for the rendering of services. The payment is made so that the levying municipality has funds to be able to render basic city services (for example, local road maintenance, signage, lighting, local first-responder services). However, property taxes are not paid "under a contractual agreement" between the specific property owner and the municipal government as required by paragraph 5 of IFRIC 21.

While additional factors should be considered prior to concluding that property taxes are within the scope of IFRIC 21, any conclusion may be irrelevant if the timing of the recognition of the liability to pay the property taxes does not change. Therefore, one approach is to consider whether IFRIC 21, if applicable, would affect current accounting practice and only if current practice would change once IFRIC 21 becomes effective, consider further whether the liability is in the scope of IFRIC 21.

Is the current practice of recognizing the liability consistent with the triggering event?

What is the triggering event under IFRIC 21?

View A: The triggering event is ownership of the property at a specific date.

Under this view, the obligation for payment of the property taxes to the municipal government is not triggered until a specified date. Paragraph 8 of IFRIC 21 states that:

> "The obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation."

Accordingly, an obligation for property tax would only be recognized upon ownership of the property on a specified date. That specific date may vary by municipality in accordance with the legislation. Possible dates might be the assessment date, the beginning of the property tax year, the billing date (interim or final) or the due date (as each instalment, interim or final, is due). The determination of the appropriate date would require careful review of the applicable legislation.

Pre-payment or a pro-rata amount is not required to be submitted to the government if the property owner sells or transfers ownership of the property to another party prior to the due date. If a property is sold and property taxes remain unpaid, the municipality may be entitled to continue to seek payment from the previous owner but generally the municipality's more practical recourse is to put a lien on the property. Similarly, if a property is sold and the previous owner (i.e., the seller) has already paid the property taxes for the year, that previous owner is not entitled to a refund of taxes paid from the municipality.

In practice, an adjustment may be made to the consideration to be exchanged between the buyer and the seller for any property taxes paid in advance or due in arrears. However, such a payment or adjustment is not required by the legislation and, therefore, should not be considered under IFRIC 21.

View B: The triggering event is ownership of the property over the period to which the tax relates.

Under this view, the activity that gives rise to the payment of the levy is ownership of the property, which occurs over the period in which the property is held, rather than at a specific date. While payment may be deferred until a future date, under the legislation, property taxes are determined and payable based on the assessed value of the property during the tax period. The fact that upon the sale of a property an adjustment in the consideration to be exchanged is made between the buyer and the seller for any property taxes due in arrears or paid in advance indicates that the obligation for payment of the taxes occurs over time. Under this view, the property taxes should be recognized progressively in accordance with paragraph 11 of IFRIC 21 because municipalities charge property taxes for an annual period and stipulate the timing for payment of taxes.

What is the current accounting practice under IAS 37?

In practice, entities generally recognize property taxes on a monthly basis. The amount is estimated based on the instalments due (for example, an interim bill), if the final bill is not yet available.

Is the current practice of recognizing the liability consistent with the triggering event?

If the triggering event is ownership of the property at a specific date (*View A*) rather than over time (*View B*), the application of IFRIC 21 will result in a change in the accounting.

If View A is the appropriate application of IFRIC 21 and it is determined that recognition of the liability for the levy gives rise to an expense rather than an asset, the effect on the statement of comprehensive income for a quarterly interim period reporting entity will create significant differences in the timing of recognition of the expense. Comparisons of different interim periods of a single entity and comparisons between entities will be affected. The differences in timing of recognition will be pervasive because property taxes are levied universally across all municipalities and across all industries as a significant routine form of revenue generation for local governments in order to provide basic services to local residents.

The Group's Discussion

The Group's Chair asked whether any Group members thought there was a basis to argue that property taxes are outside the scope of IFRIC 21 based on paragraph 5. Many Group members indicated that to argue that a contractual arrangement exists is difficult to support because the tax payer has no ability to negotiate a contract and the payment is a non-reciprocal and non-exchange transaction. Further, the perceived link between services received in exchange for the levy appears to be indirect at best.

Group members noted that it is not clear under View A whether the triggering event is the assessment date, beginning of the property tax year, billing date or the due date. Group members observed that the details might vary by municipality because the legislation is specific to each municipality. Also, the legislation may not be clear because it is not written with the objective of clearly identifying the activity that triggers the obligating event. Group members also noted that it may be difficult to justify the current accounting practice of accruing the liability evenly over the year under IFRIC 21 because upon sale, any property taxes paid or owed follow the property rather than the owner.

One Group member suggested looking at whether a change in the use of the property, such as demolishing the building, would cause the municipality to reassess the property value for the period. However, other Group members noted that this argument may not support View B because the reassessment following a change in use will benefit the current property owner rather than the property owner when the use of the property changed.

Some Group members observed that any instalment payment options available to the property owner may be viewed as a financing arrangement or a convenience to the municipality and should not affect the timing of the recognition of the liability for property taxes. Further, it does not make sense to arrive at different accounting results depending on the instalment plan elected by the tax payer.

Group members observed that IFRIC 21 solely focuses on the recognition of the liability and does not deal with the asset or expense recognition. Group members noted that the discomfort with View A is primarily due to the "lumpiness" of expense recognition that may result. Although paragraph 14 of IFRIC 21 notes that an asset should be recognized for any payments made before the obligating event, Group members were not clear on whether an asset could be recognized after the obligating event has occurred.

As noted above, Group members had not yet fully formulated their views on many of the issues discussed with respect to property taxes. Accordingly, the Group will discuss this example further in an additional public meeting expected to be held in the first quarter of 2014.