

IFRIC 21: Levies – Property Taxes in Canada

Extract, IFRS Discussion Group Report on Meeting – February 26, 2014

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.