

IAS 19: Refundable Tax Accounts in Retirement Compensation Arrangements

Extract, IFRS Discussion Group Report on Meeting – September 11, 2014

Under a retirement compensation arrangement (referred to as “RCA”), an employer makes contributions to a custodian. The funds are held in trust and invested with the proceeds ultimately to be distributed to the employee upon retirement. The contributions to the retirement compensation arrangement trust are subject to a refundable tax – for every dollar to be invested, a dollar must be remitted to the Canada Revenue Agency (CRA). The funds remitted to the CRA are held in deposit in a refundable tax account (referred to as “RTA”) that is non-interest bearing. The funds are paid on the same basis as they are remitted – for every \$2 in benefit payments made from the trust, \$1 is refunded to the trust from the refundable tax account.

If the trust is wound up while a balance still exists in the refundable tax account, and the employer is entitled to the surplus on wind-up, the CRA will remit the final payment directly to the employer. For example:

- An employer contributes \$50 to the retirement compensation arrangement trust, which triggers a requirement to remit \$50 to the CRA.
- The first \$50 is invested in interest-bearing assets; the CRA remittance is deposited in the refundable tax account at a zero percent of return.
- Upon payment of retirement benefits to the plan member, the trustee is entitled to claim a refund from the refundable tax account. The trustee receives \$1 from the refundable tax account for every \$2 paid to a plan member.

Plan assets are assets that are held by an entity that is legally separate from the reporting entity and exists solely to pay or fund employee benefits. The retirement compensation arrangement is considered a retirement arrangement under IAS 19 *Employee Benefits*. Therefore, plan assets are measured at fair value. The plan sponsor recognizes an expense equal to net interest on the net defined benefit liability. Net interest is the sum of interest income on the plan assets, interest cost on the plan obligation and the interest effect of any asset ceiling. Interest income on the plan assets is determined for these purposes by multiplying the fair value of the plan assets by the discount rate. Any difference between interest income and the actual return on plan assets is a remeasurement to be recognized in other comprehensive income.

Issue: How should the amounts held by the refundable tax account be accounted for?

View A – The refundable tax account is a plan asset and should be measured at face value. Interest income is recognized at the discount rate and the remeasurement loss is recognized in other comprehensive income.

The refundable tax account meets the definition of a plan asset since it exists solely to pay employee benefits. The face value represents the amount that will be paid to the trust and, hence, to the employee any time that benefits are paid or repaid to the entity in the event of plan wind-up. The requirements relating to net interest mean that interest income must be calculated on the face value of the refundable tax account. This is the case even though the refundable tax account does not bear interest. Thus, a remeasurement loss equal to the interest income computed will be recognized in other comprehensive income in each period.

View B – The refundable tax account is a plan asset and should be measured at face value. As the asset does not bear interest, no interest income should be recognized.

The view is consistent with View A other than the calculation of interest income. Proponents of this view argue that the net interest requirements of IAS 19 do not contemplate this type of arrangement and that the discount rate should only be applied to interest-bearing plan assets. Neither interest income nor a remeasurement loss should be recognized for the refundable tax account.

View C – The refundable tax account is a plan asset and should be measured at its discounted value. An entry will be recorded on initial recognition as part of net income. Interest income is recognized at the discount rate.

Proponents of this view argue that the fair value of refundable tax account assets should be determined by considering the limitations on their use. Fair value should be initially estimated through discounting the expected cash flows for the effects of the time value of money between the contribution date and the date the money is expected to be paid to the beneficiaries. The fair value would then be adjusted with the passage of time. This approach is consistent with the measurement of the corresponding defined benefit obligation. It is also consistent with the measurement of reimbursement rights, qualifying insurance policies and interest-free loans receivable.

Under this approach, the initial entry would be to recognize in net income the difference between the discounted amount and the face value of the contribution to the refundable tax account. Net interest will include interest income determined by applying the discount rate to the refundable tax account. Actual interest is equal to the periodic unwinding of the discount rate through the adjustment of the refundable tax account to its new fair value each period. The difference between these amounts is recognized in remeasurements and will be nil if the discount rate used for the refundable tax account and the defined benefit obligation are the same.

View D – The refundable tax account is a plan asset and should be measured at its discounted value. An entry will be recorded in either net income or other comprehensive income. Interest income is recognized at the discount rate.

The approach is the same as View C except for the initial recognition entry, for which a policy choice is permitted.

The Group's Discussion

Group members observed that this issue has arisen as a result of the revision to IAS 19 that was effective for annual periods beginning on or after January 1, 2013. Previously under IAS 19, entities were able to specify the assumption on asset return. Now, investment income on plan assets is calculated based on the discount rate.

The majority of Group members supported a discounting approach to measuring the refundable tax account at fair value. The standard requires that plan assets be measured at fair value. This fair value approach is consistent with the economics of the decision to invest cash into a refundable tax account that is non-interest bearing and is subject to transfer limitations. Therefore, discounting the face value to arrive at a fair value reflects the economics of a refundable tax account. Group members had varying views on whether the initial entry to recognize the difference between the discounted amount and the face value of the contribution amount should be recorded in net income or other comprehensive income.

A smaller number of Group members thought the refundable tax account could be recognized at face value if the difference between the face value and discounted value is not material. While it was noted there may be complexity in measuring the discounted value (i.e. estimating maturity), stakeholders should consider if an entity is able to reclaim the refundable tax account in a short period of time to determine if the difference is material.

The Group discussed this topic to raise awareness and recommended that the AcSB consider if this is a common issue among Canadian private enterprises.