SPECIFIC ITEMS
SECTION 3805
investment tax credits

PURPOSE AND SCOPE

.01 This Section establishes standards in respect of recognition of investment tax credits.

DEFINITION

.02 The following term is used in this Section with the meaning specified:

Investment tax credits are a type of government assistance related to specific qualifying expenditures that are prescribed by tax legislation. The credits may be received as a reduction in income taxes otherwise payable or they may be received by other means.

TIMING OF RECOGNITION IN INCOME

.03 Two approaches to the timing of recognition of investment tax credits in income are the cost reduction approach and the flow-through approach.

.04 The cost reduction approach requires that investment tax credits be accounted for in a manner similar to government grants (see GOVERNMENT ASSISTANCE, Section 3800). Thus, investment tax credits would be recognized in income on the same basis as the related expenditures are charged to income. They would either be deducted from the related expenditures or set up as deferred credits and amortized to income on the same basis as the related expenditures.

.05 The flow-through approach requires that investment tax credits be accounted for as a reduction of income tax expense. The investment tax credits would be recognized in income when the enterprise becomes entitled to them.

.06 Those favouring the cost reduction approach argue that investment tax credits are similar, in substance, to government grants. Like grants, investment tax credits encourage specific expenditures by reducing the effective cost of those expenditures to the enterprise. The credits are often taken into account for investment decision purposes and reduce the effective cost of the related assets for income tax purposes.

.07 Those favouring the flow-through approach argue that investment tax credits are regarded as a reduction of income taxes rather than government grants. Generally, the investment tax credits are paid by the government through the income tax system and reduce the tax liability of the enterprise. The availability of the credits does not always influence the investment decision.

.08 Cost reduction proponents maintain that the substance of government assistance and not the form of the specific legislation ought to determine the method of accounting for the assistance. Thus, the method of payment does not affect the economic substance of the assistance and ought not to affect the method of accounting.

.09 Flow-through proponents point out that investment tax credits are usually conditional on income taxes being otherwise payable and on qualifying expenditures being made. It is held that the investment tax credits are earned only when both of these criteria are met and, therefore, ought to be recognized in income only at that time.

.10 Those favouring the cost reduction approach assert that, while the level of taxable income may influence the timing of the actual receipt of the investment tax credit benefits, the primary criterion that must be met is that of incurring qualifying expenditures. To qualify for investment tax credits, an enterprise must make qualifying expenditures for prescribed purposes. Reductions in those expenditures (in the form of investment tax credits) ought to be recognized in income in the same periods as the expenditures are recognized in income. The cost reduction approach precludes the enterprise from taking the full amount of investment tax credits related to the acquisition of assets into income when it claims them for tax purposes and thus precludes the entity from increasing its reported income for a particular period by merely altering the timing of its expenditures on the acquisition of assets.

.11 It has been argued that, under the flow-through approach, the income statement more closely reflects the cash flow implications arising from investment tax credits. Those favouring the cost reduction approach point out that the purpose of the income statement is the disclosure of earnings, not cash flow.

.12 This Section adopts the view that the arguments in support of the cost reduction approach are more persuasive than those in support of the flow-through approach. The cost reduction approach reflects the substance of investment tax credits because it recognizes that they are primarily related to the qualifying expenditures, they effectively reduce the cost of those expenditures to the enterprise and they are similar to government grants.

.13 *Investment tax credits shall be accounted for using the cost reduction approach.*

.14 *Investment tax credits related to the acquisition of assets shall be either:*

(a) deducted from the related assets with any depreciation or amortization calculated on the net amount; or

(b) deferred and amortized to income on the same basis as the related assets.

.15 *Investment tax credits related to current expenses (for example, research expenses) shall be included in the determination of net income for the period.*

ACCRUAL OF INVESTMENT TAX CREDITS

.16 The timing of investment tax credit claims may be influenced by an enterprise's ability to earn a sufficient amount of taxable income. Investment tax credit programs usually provide for carryover periods during which the enterprise can maximize the amount of investment tax credits that it can claim for tax purposes by generating sufficient taxable income. An enterprise can increase the probability of generating sufficient taxable income during a carryover period by taking advantage of the flexibility in not claiming capital cost allowance and other similar tax deductions.

.17 *Investment tax credits shall be accrued when the enterprise has made the qualifying expenditures, provided there is reasonable assurance that the credits will be realized.*

.18 When the investment tax credits are not accrued in the year in which the qualifying expenditures are made because there is no reasonable assurance that the credits will be realized, such credits are accrued in the subsequent year in which reasonable assurance of realization is first obtained. This is accounted for as a change in accounting estimate, as set out in ACCOUNTING CHANGES, Section 1506.

.19 When circumstances arise that indicate that the enterprise will not be able to claim the investment tax credits previously accrued, the effects are accounted for prospectively in a manner similar to the repayment of government assistance (see GOVERNMENT ASSISTANCE, paragraphs 3800.28-.29).

EFFECTIVE DATE

.20 This Section applies to annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier application is permitted.
