Income Taxes, Section 3465 — Background Information and Basis for Conclusions

Foreword

In June 2019, the Accounting Standards Board (AcSB) amended INCOME TAXES, Section 3465 in Part II of the CPA Canada Handbook – Accounting. The AcSB has approved for publication the contents of this document setting out its rationale for the amendments.

Background Information and Basis for Conclusions documents are sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100 in Part II of the Handbook. These documents are intended to help readers understand how the AcSB reached its conclusions, but they do not include explanations of requirements or guidance on the application of the relevant Section or Accounting Guideline.

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INTRODUCTION

1 This document summarizes considerations that were deemed significant by members of the Accounting Standards Board (AcSB) in reaching their conclusions to amend INCOME TAXES, Section 3465 in Part II of the CPA Canada Handbook – Accounting. This document sets out the reasons the AcSB undertook the project to develop the amendments, the process of research and deliberation, the key decisions made and the principal reasons for adopting the positions taken and rejecting others. Individual AcSB members gave greater weight to some factors than to others.

2 Nothing in this document is to be taken as overriding the requirements of the Handbook. However, the discussion may help readers understand how the AcSB reached its conclusions in developing the amendments and the AcSB's intent with respect to its interpretation and application.

BACKGROUND AND EFFECTS ANALYSIS

3 As part of the AcSB's objective to maintain and improve a high-quality set of Part II standards, the AcSB considers improvements needed to current guidance. The AcSB also routinely monitors amendments made to other accounting frameworks for potential improvements to Part II. As a result of these activities, the AcSB identified an example in Section 3465 that is no longer applicable as a result of changes in income tax legislation. The AcSB also identified an amendment to U.S. Generally Accepted Accounting Principles (U.S. GAAP) eliminating the requirement to segregate deferred tax assets and liabilities into current and non-current components. In addition, the AcSB observed that International Accounting Standards Board's (IASB), IAS 1 *Presentation of Financial Statements* does not permit classification of deferred tax assets and liabilities as current and non-current.

4 Consequently, the AcSB decided to amend Section 3465 to remove the outdated example and to require non-current classification of future income tax assets and income tax liabilities rather than require current and non-current classification of these assets and liabilities.

5 In developing these amendments, the AcSB considered the consequences of adopting them relative to the objective of financial statements and the benefit versus cost constraint. As described in FINANCIAL STATEMENT CONCEPTS, paragraph 1000.12, the "objective of financial statements is to communicate information that is useful to investors, creditors and other users ('users') in making their resource allocation decisions and/or assessing management stewardship."

6 A primary effect of the amendments is to provide more useful information to users of the financial statements. This is done by simplifying the classification requirements for future income tax assets and liabilities and requiring additional disclosure relating to the amount of future income tax assets and liabilities for each significant type of temporary difference for each period presented. While the Board recognizes that there will be costs relating to the additional disclosure requirement, the simplified classification will also provide cost savings for preparers.

7 Having considered the effects of the changes to Section 3465 discussed above, the AcSB thinks that the amendments will result in improvements to financial reporting.

DEVELOPMENT OF THE AMENDMENTS

8 Throughout the development of the amendments, the AcSB followed its due process. This process included:

(a) ongoing input from its Private Enterprise Advisory Committee (Advisory Committee);

(b) issuance in September 2018 of the Exposure Draft, "Income Taxes"; and

(c) analysis and consideration of feedback received through written responses to the Exposure Draft (seven comment letters).

9 The AcSB received written responses to the Exposure Draft from six public accounting firms and a joint working group. The AcSB reminds stakeholders that as part of its due process related to Part II of the Handbook, unless confidentiality is requested, it makes available a public file of materials relating to completed projects, which includes response letters received.

10 Respondents supported the underlying principles in the Exposure Draft. However, some respondents provided additional comments suggesting changes to some of the proposals.

11 The specific issues addressed in this project, including the substantive comments received on the Exposure Draft and any changes made in response to those comments, are as follows.

ELIGIBLE CAPITAL PROPERTY

12 The eligible capital property (ECP) rules in Section 14 of the Income Tax Act (the Act) were repealed and replaced by new Class 14.1 of Schedule II to the Income Tax Regulations (the Regulations), effective on January 1, 2017.

13 Paragraph 3465.14(f) provides an example on accounting for ECP using guidance relating to the ECP rules prior to the changes on January 1, 2017. With the introduction of the new Class 14.1, the example in the Handbook is no longer current or valid for new purchases of ECP. Therefore, the AcSB decided that paragraph 3465.14(f) should be removed.

14 Most respondents agreed that the example in paragraph 3465.14(f) be removed. Also, the one respondent that did not agree stated that they would agree if a new example was added in its place. The AcSB has not heard from other stakeholders that a new example is needed. Also, in developing the proposals, the Advisory Committee advised that a new example was not needed since enterprises have been applying the guidance without an updated example. As a result, the AcSB decided to not replace paragraph 3465.14(f) with a new example.

FUTURE INCOME TAX ASSETS AND LIABILITIES

Classification

15 As part of the AcSB's routine monitoring of other Frameworks, the AcSB became aware of a simplification initiative to reduce complexity in U.S. GAAP. This simplification eliminates the requirement to segregate deferred tax assets and liabilities into current and non-current components. Instead, deferred tax assets and liabilities must be classified as non-current. Feedback suggested that the separate classification resulted in little or no benefit to users of financial statements because separate classification did not generally align with the time period in which the recognized deferred tax amounts are expected to be recovered or settled. This amendment to U.S. GAAP is also aligned with the requirements in IAS 1 for classification of deferred income tax assets and liabilities.

16 The AcSB decided to propose that an enterprise that elects to apply the future income taxes method recognize future income tax assets and liabilities and classify them as non-current.

17 The majority of respondents agreed with the proposal. However, two of the firm respondents did not agree and thought the existing classification informed users about the expected timing of when the future income tax assets and liabilities will be settled. These respondents noted the following examples where the existing classification requirements may provide more decision-useful information as to the expected timing of the settlement of future income tax assets and liabilities:

(a) future income tax assets associated with contingent liabilities expected to be settled within one year; and

(b) future income tax liabilities resulting from holdbacks in the construction industry.

To address these concerns, the Advisory Committee advised, and the AcSB agreed, that the additional disclosure requirements to address industry-specific items, which are discussed below, will provide sufficient decision-useful information for users. In particular, the user members on the Advisory Committee advised that the additional disclosures address the concerns raised by these stakeholders.

18 One respondent was also concerned that the classification of the entire balance of future income tax assets and liabilities as non-current may impact an enterprise's financial ratios such that they are not representative of the enterprise's current resources and commitments. This respondent suggested that enterprises should be given an accounting policy choice to select the most appropriate classification to meet the needs of its financial statement users. The Advisory Committee noted, and the AcSB agreed, that providing a policy choice would reduce comparability between private enterprises and introduce unnecessary complexity for financial statement users.

Disclosure

19 The Exposure Draft proposed a requirement be added to disclose the amount of future income tax assets and liabilities for each type of temporary difference for each period presented. The AcSB notes that IAS 12 *Income Taxes* requires disclosure of the amount of deferred tax assets and liabilities for each period presented. However, unlike IAS 12, Section 3465 does not currently include disclosure requirements to identify the types of temporary differences. The Advisory Committee advised, and the AcSB agreed, that the additional disclosure would provide sufficient transparency on what constitutes future income tax assets and liabilities.

20 The majority of respondents agreed with the proposal. However, two respondents thought that the proposed disclosure requirement may discourage enterprises from applying the future income taxes method and instead choose the taxes payable method. Based on the feedback received from the Advisory Committee, the AcSB concluded that the benefits to users of the additional disclosures outweigh the costs of providing that information. Therefore, the AcSB decided to add the disclosure as proposed in the Exposure Draft.

EFFECTIVE DATE

21 The Exposure Draft noted that if no significant changes were required to the proposals after deliberating the comments received, the AcSB planned to issue the amendments in the second quarter of 2019. In that case, the Exposure Draft proposed that the effective date of the amendments would be for fiscal years beginning on or after January 1, 2020. Respondents did not raise any concerns on the timing of the effective date. Accordingly, the amendments are applicable for annual financial statements relating to fiscal years beginning on or after January 1, 2020 with earlier application permitted.

21A In August 2020 the AcSB deferred the effective date of these amendments by one year to alleviate pressure for stakeholders as they navigate challenges and uncertainty created by the COVID-19 pandemic. The amendments are now effective for annual financial statements beginning on or after January 1, 2021. Earlier application is permitted and therefore, the deferral of the effective date does not prohibit stakeholders from applying the amendments in an earlier fiscal year.

TRANSITION

22 In developing the Exposure Draft, the AcSB agreed that since the amendments proposed to Section 3465 remove outdated material and simplify classification requirements, the amendments should be applied retrospectively in accordance with ACCOUNTING CHANGES, Section 1506. All respondents agreed.

CONSEQUENTIAL AMENDMENTS

23 As part of the amendments to Section 3465 discussed above, there were no significant consequential amendments to other Sections in Part II of the Handbook.
