

## SPECIFIC ITEMS

### SECTION 3465

#### income taxes

### Basis for Conclusions

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## PURPOSE AND SCOPE

- .01 This Section establishes standards for the recognition, measurement, presentation and disclosure of income and refundable taxes in an enterprise's financial statements. Special considerations related to the accounting for investment tax credits are dealt with in INVESTMENT TAX CREDITS, Section 3805.

## DEFINITIONS

- .02 The following terms are used in this Section with the meanings specified:
- (a) **Income taxes** include:
    - (i) all domestic and foreign taxes that are based on taxable income;
    - (ii) taxes, such as mining taxes, that are based on a measure of revenue less certain specified expenses;
    - (iii) alternative minimum income taxes, including taxes based on measures other than income and that may be used to reduce income taxes of another period; and
    - (iv) taxes, such as withholding taxes, that are based on amounts paid to the enterprise.
  - (b) **Refundable taxes** are taxes that are based on certain types of income and that are refundable when certain amounts are paid to shareholders.
  - (c) **Temporary differences** are differences between the tax basis of an asset or liability and its carrying amount in the balance sheet. Temporary differences may be either:
    - (i) **Deductible temporary differences**, which are temporary differences that will result in deductible amounts in determining taxable income of future periods when the carrying amount of the asset or liability is recovered or settled; or
    - (ii) **Taxable temporary differences**, which are temporary differences that will result in taxable amounts in determining taxable income of future periods when the carrying amount of the asset or liability is recovered or settled.
  - (d) **Future income tax assets** are the amounts of income tax benefits arising in respect of:
    - (i) deductible temporary differences;
    - (ii) the carryforward of unused tax losses; and
    - (iii) the carryforward of unused income tax reductions, except for investment tax credits.
  - (e) **Future income tax liabilities** are the amounts of income taxes arising from taxable temporary differences.
  - (f) The **future income taxes method** is a method of accounting under which an enterprise reports as an expense (income) of the period the cost (benefit) of current income taxes and the cost (benefit) of future income taxes, determined in accordance with the rules established by taxation authorities.
  - (g) **Taxable income (tax loss)** is the amount for a period, determined in accordance with the rules established by taxation authorities, upon which income taxes are payable (recoverable).
  - (h) The **cost (benefit) of current income taxes** is the amount of income taxes payable (recoverable) in respect of the period.
  - (i) The **cost (benefit) of future income taxes** is the change during the period in future income tax liabilities and future income tax assets.
  - (j) An event is **more likely than not** when the probability that it will occur is greater than 50 percent.
  - (k) A **rate-regulated enterprise** is an enterprise that meets all of the following criteria:
    - (i) the rates for regulated services or products provided to customers are established by or are subject to approval by a regulator or a governing body empowered by statute or contract to establish rates to be charged for services or products;
    - (ii) the regulated rates are designed to recover the cost of providing the services or products; and
    - (iii) it is reasonable to assume that rates set at levels that will recover the cost can be charged to and collected from customers in view of the demand for the services or products and the level of direct and indirect

competition. This criterion requires consideration of expected changes in levels of demand or competition during the recovery period for amounts recorded as recoverable under the rate formula.

- (l) The **taxes payable method** is a method of accounting under which an enterprise reports as an expense (income) of the period only the cost (benefit) of current income taxes for that period, determined in accordance with the rules established by taxation authorities.

#### **ACCOUNTING POLICY**

- .03 *An enterprise shall make an accounting policy choice to account for income taxes using either:*

- (a) *the taxes payable method; or*
- (b) *the future income taxes method.*

*In making this accounting policy choice, the entity need not meet the criterion in ACCOUNTING CHANGES, paragraph 1506.06(b).*

#### **TAXES PAYABLE METHOD**

- .04 Under the taxes payable method, only current income tax assets and liabilities are recognized.

##### **Recognition**

- .05 *Current income taxes, to the extent unpaid or recoverable, shall be recognized as a liability or asset.*
- .06 *The benefit relating to a tax loss arising in the current period that will be carried back to recover income taxes of a previous period shall be recognized as a current asset.*
- .07 The liability for current income taxes included in the balance sheet is the cost (benefit) of current income taxes for current and prior periods less amounts already paid in respect of these income taxes. When the amount already paid in respect of the cost (benefit) of current income taxes for a period exceeds the liability for that period, any excess amount is shown as an asset. When a tax loss is used to recover income taxes previously paid, the benefit is recognized in the period in which the tax loss occurs since the benefit will be realized.

##### **Measurement**

- .08 *Income tax liabilities and income tax assets shall be measured in accordance with paragraphs 3465.51-.58.*

##### **Intraperiod allocation**

- .09 *The relevant intraperiod allocation provisions of paragraphs 3465.59-.79 shall be applied when using the taxes payable method.*

#### **FUTURE INCOME TAXES METHOD**

##### **The basic principles of future income taxes**

- .10 The fundamental principle upon which the future income taxes method is based is that an enterprise recognizes a future income tax liability whenever recovery or settlement of the carrying amount of an asset or liability would result in future income tax outflows. Similarly, an enterprise recognizes a future income tax asset whenever recovery or settlement of the carrying amount of an asset or liability would generate future income tax reductions. An extension of this fundamental principle is that in the case of unused tax losses, income tax reductions, and certain items that have a tax basis but cannot be identified with an asset or liability on the balance sheet, the recognition of future income tax benefits is determined by reference to the likely realization of a future income tax reduction.

##### **Recovery or settlement of the carrying amount of an asset or liability**

- .11 The rules established by the taxation authorities to determine the taxable income that will arise from the recovery or settlement of an asset or liability are often different from the accounting policies followed by an enterprise in the preparation of its financial statements that govern the amounts included in income or expense from the recovery or settlement of an asset or liability. The determination of whether recovery or settlement of an asset or liability will result in future income tax outflows or benefits is determined by reference to the difference between the carrying values and tax basis of assets and liabilities. The tax basis of an asset or liability is the amount, determined with reference to the rules established by the taxation authorities, that could be deducted in the determination of taxable income if the asset were recovered or the liability were settled for its carrying amount. At any point in time, there may be a difference between the tax basis of an asset or liability and its carrying amount. Such differences are temporary differences. Temporary differences may be either taxable or deductible. Taxable temporary differences give rise to future income tax liabilities. Deductible temporary differences give rise to future income tax assets.
- .12 To determine the extent of any temporary differences, it is first necessary to establish the tax basis of the assets and liabilities. The following guidance assists in determining the tax basis of an asset for the purposes of this Section:
- (a) when an amount related to an asset is deductible in determining taxable income over one or more periods, the tax basis at the end of a period is that amount less all amounts already deducted in determining taxable income of the current and prior periods;
  - (b) when an amount related to an asset is deductible in determining taxable income only when the asset is disposed of or permanently withdrawn from use, the tax basis of the asset is that amount;

- (c) when the cost of an asset is not deductible in determining taxable income, but any proceeds of a disposal of the asset would not be included in the determination of taxable income, the tax basis of the asset is equal to the carrying amount; and
- (d) when the amount related to an asset that will be deductible in determining future taxable income depends on whether the asset is utilized or sold, the tax basis of the asset is the greater of those amounts.

**Examples**

- (a) A capital asset was acquired with an original tax basis of \$1,000. Depreciation for income tax purposes ("capital cost allowance") may be deducted at 20 percent per annum declining balance, subject to the "half-year" rule in the year of acquisition. The enterprise takes a full deduction in any given year. At the end of three years \$424 will have been deducted for tax purposes. The tax basis of the asset is its undepreciated capital cost of \$576.
  - (b) A portfolio investment was purchased for \$1,000 cash. This amount is deductible in determining taxable income only on disposition. The tax basis of the investment is \$1,000.
  - (c) An intangible asset is acquired for \$1,000. For accounting purposes, the asset is depreciated over 20 years. None of the cost of the asset is permitted as a deduction from taxable income and any capital gain on disposal will not enter into taxable income. If the asset were sold for its carrying amount there would be no income tax effect. In such a case, the tax basis of the asset is always the same as its carrying amount.
  - (d) An automobile is acquired for \$50,000. If the enterprise uses the automobile in its business it may deduct only \$25,000 against future taxable income. If the enterprise sells the automobile immediately for \$50,000 there will be no income tax consequences. The tax basis of the automobile at the time of purchase is \$50,000. Subsequently, if the automobile can be sold for its carrying amount without income tax consequences, the tax basis is its carrying amount.
  - (e) An enterprise owns a life insurance policy with a cash surrender value of \$100,000. The proceeds related to the policy can be received without tax consequences on the death of the insured. The tax basis of the life insurance policy is the same as its carrying amount.
- .13 The tax basis of a liability is its carrying amount less any amount that will be deductible for income tax purposes in respect of that liability in future periods. In the case of amounts received but not yet recognized as revenue, the tax basis of the resulting liability is its carrying amount less any amount that will not be taxable in future periods. When a liability can be settled for its carrying amount without tax consequences, the tax basis of the liability is considered to be the same as its carrying amount.

**Examples**

- (a) Current liabilities include accrued expenses with a carrying amount of \$1,000. The related expense will be deducted for income tax purposes when paid. The tax basis of the accrued expenses is nil.
  - (b) Current liabilities include interest revenue received in advance, with a carrying amount of \$1,000. The related interest was taxed on a cash basis. The tax basis of the interest received in advance is nil.
  - (c) Current liabilities include accrued expenses with a carrying amount of \$1,000. The related expense has already been deducted for income tax purposes. The tax basis of the accrued expenses is \$1,000.
  - (d) Current liabilities include an accrued fine payable with a carrying amount of \$1,000. Fines are not deductible for income tax purposes. The tax basis of the fine is \$1,000.
  - (e) A loan payable has a carrying amount of \$1,000. The repayment of the loan will have no income tax consequences. The tax basis of the loan is \$1,000.
- .14 The difference between the carrying value of an asset or liability and its tax basis as discussed above will determine the extent of any temporary differences, and these differences will in turn determine the extent of future income tax assets or liabilities. The following guidance assists in determining the nature of any temporary differences for the purposes of this Section:
- (a) When the carrying amount of an asset and its tax basis are the same, the amount included in taxable income on the recovery of the asset is offset by the amount allowed as a deduction in the determination of taxable income. Therefore, there is no temporary difference since the recovery of the carrying amount has no effect on taxable income of the enterprise.
  - (b) When the carrying amount of an asset is greater than its tax basis, the recovery of the carrying amount in a future period will result in a taxable amount in excess of the future amount allowed as a deduction in the determination of taxable income. Therefore, there is a taxable temporary difference that gives rise to a future income tax liability in respect of the income taxes that will be payable in future periods.
  - (c) When the carrying amount of an asset is less than its tax basis, the amount allowed as a deduction in the determination of taxable income in respect of that asset will be greater than the taxable amount arising from the recovery of the carrying amount. Therefore, there is a deductible temporary difference that gives rise to a future income tax asset in respect of the income tax that will be recoverable in future periods.
  - (d) When the carrying amount of a liability is equal to its tax basis, there will be no tax consequences associated with settling the liability. Therefore, there is no temporary difference.

- (e) When an amount related to a liability is deductible for income tax purposes in future periods when the liability is settled, it has a tax basis of nil. The settlement of the liability will result in a deduction for tax purposes. Therefore, the difference between the carrying amount of the liability and its tax basis is a deductible temporary difference that gives rise to a future income tax asset.

### Examples

- (a) A portfolio investment has a carrying amount of \$1,000. Its tax basis is also \$1,000. There is no temporary difference.
- (b) A capital asset was acquired for \$1,000. For income tax purposes, capital cost allowance (CCA) is taken at 40 percent per annum declining balance, subject to the "half-year" rule in the year of acquisition. For financial reporting purposes, depreciation is charged at 20 percent per annum straight line. A full year's depreciation is charged in the year of acquisition. At the end of Year 2, the carrying value of the asset is \$600. The undepreciated capital cost (tax basis) is \$480. There is a taxable temporary difference of \$120.
- (c) A capital asset was acquired for \$1,000. For income tax purposes, capital cost allowance is taken at 10 percent per annum declining balance, subject to the "half-year" rule in the year of acquisition. For financial reporting purposes, depreciation is charged at 25 percent per annum straight line. A full year's depreciation is charged in the year of acquisition. At the end of Year 2, the carrying value of the asset is \$500. The undepreciated capital cost (tax basis) is \$855. There is a deductible temporary difference of \$355.
- (d) Revenue of \$1,000 is recognized as an amount receivable in the financial statements when the goods are sold or the services are rendered but will be included in taxable income only when the cash is received. The tax basis of the receivable recognized in the balance sheet is nil because the revenues do not enter into the determination of taxable income until the cash is collected. There is a taxable temporary difference of \$1,000.
- (e) Development costs of \$1,000 that are recognized as an asset and amortized over future periods in the financial statements might be deducted in determining taxable income in the period in which they are incurred. The development costs have a tax basis of nil as they have already been deducted from taxable income. There is a taxable temporary difference of \$1,000.
- (f) (deleted)
- (g) Product warranty costs of \$1,000 are recognized as a liability and an expense for financial reporting purposes when the related products are sold but are allowed as a deduction in determining taxable income only when paid. The tax basis of the liability for product warranty costs is nil. There is a deductible temporary difference of \$1,000.
- (h) A liability for pension costs of \$1,000 is recognized in the financial statements as the service is provided by the employee. For income tax purposes, the cost is permitted to be deducted in determining taxable income either when contributions are paid to a fund by the enterprise or when retirement benefits are paid by the enterprise. Until the deduction is permitted for income tax purposes, the tax basis of the liability is nil. There is a deductible temporary difference of \$1,000.
- (i) A liability of \$1,000 is recognized for asset retirement obligations. The related costs are not deductible in determining taxable income until a later period. The tax basis of the liability is nil. There is a deductible temporary difference of \$1,000.
- (j) A capital asset is acquired at the beginning of Year 1 for \$1,000 and is eligible for an investment tax credit of 10 percent. Investment tax credits are accounted for using the cost reduction method. For income tax purposes, capital cost allowance is taken at 30 percent per annum declining balance, subject to the "half-year" rule in the year of acquisition; the investment tax credit is deducted from the asset's undepreciated capital cost in the year following acquisition. For financial reporting purposes, the cost of the asset less the amount of investment tax credits is charged at 20 percent per annum straight line. At the end of Year 1, the asset's tax basis is \$750 (i.e., the asset's cost net of the \$100 investment tax credit less CCA of \$150) and its carrying amount is \$720 (i.e., the asset's cost net of the \$100 investment tax credit and less amortization of \$180). There is deductible temporary difference of \$30. At the end of Year 2, the asset's tax basis is \$525 (i.e., opening undepreciated capital cost (UCC) net of the investment tax credit of \$100 less Year 2 CCA amounting to \$225) and its carrying amount is \$540. There is a taxable temporary difference of \$15 at the end of Year 2.
- (k) The facts are the same as for item (j) except that, for accounting purposes, investment tax credits are deferred and amortized at the same rate as the related capital asset. At the end of Year 1, the asset's tax basis is \$750 and its carrying amount is \$800. In addition, there are deferred investment tax credits reported for accounting purposes with a carrying amount of \$80 (i.e., the amount of the investment tax credit less amortization of \$20). The tax basis of these deferred investment tax credits is nil. There is a deductible temporary difference of \$30, consisting of the taxable temporary difference of \$50 related to the asset and the deductible temporary difference of \$80 related to the deferred investment tax credits. At the end of Year 2, the asset has a tax basis of \$525 (i.e., \$850 net of the investment tax credit and less CCA at 30 percent of the net amount) and a carrying amount of \$600. The deferred investment tax credit has a carrying amount of \$60. At the end of Year 2 there is a taxable temporary difference of \$15, consisting of the taxable temporary difference of \$75 related to the asset and the deductible temporary difference of \$60 related to the deferred investment tax credits.

### **Unused tax losses, income tax reductions and certain other items**

- .15 Unused tax losses, and income tax reductions that are not related to particular assets or liabilities in the balance sheet, may generate benefits that meet the conceptual definition of assets, and would be recognized if appropriate criteria are met. In addition, some items have a tax basis but cannot be identified with a particular asset or liability in the balance sheet, such as the following:
- (a) Research costs are recognized as an expense in the financial statements in the period in which they are incurred but might not be deducted in determining taxable income until a later period. The difference between the tax basis of the research costs (i.e., the amount the taxation authorities will permit as a deduction in the future) and the carrying amount of nil is a deductible temporary difference that gives rise to a future income tax asset.
  - (b) For financial statement purposes, an enterprise might recognize profits on a long-term contract using the percentage of completion method but use the completed contract method when determining taxable income. Income is deferred for tax purposes, with no corresponding amount being deferred for accounting purposes. The income deferred for tax purposes represents a taxable temporary difference.

### **Business combinations**

- .16 In consolidated financial statements, temporary differences are the differences between the carrying amounts, in the consolidated financial statements, of assets and liabilities of each enterprise and the appropriate tax basis. The tax bases of the assets and liabilities are determined by reference to the individual enterprises in the group.
- .17 In a business combination, the cost of the acquisition is allocated to the assets and liabilities acquired by reference to their fair values at the date of the exchange transaction. Temporary differences might exist between the assigned values and the tax bases of the related assets and liabilities. Such temporary differences can be either taxable temporary differences or deductible temporary differences and, therefore, result in either future income tax liabilities or assets. For example, when the carrying amount of an asset is increased to fair value but the tax basis of the asset is not adjusted, a taxable temporary difference arises, resulting in a future income tax liability. When a liability is recognized on the acquisition but the related costs are not deductible in determining taxable income until a later period, a deductible temporary difference arises resulting in a future income tax asset. These future income tax assets and liabilities are treated as identifiable assets and liabilities when allocating the cost of the purchase.

### **Example**

As a result of a business combination, the carrying amount of an asset is stated at its fair value of \$1,000. In the financial statements of the acquired company, the asset had a carrying value of \$750 and a tax basis of \$700. The acquisition did not affect the tax basis, which remains at \$700. There is a taxable temporary difference in the consolidated financial statements of \$300.

### **Compound financial instruments**

- .18 If an entity allocates a portion of the initial carrying amount of a compound financial instrument to the equity component (and does not measure that component at zero, see FINANCIAL INSTRUMENTS, paragraph 3856.22), the carrying amount of the component of the financial instrument classified as a liability will normally be different from the tax basis of the instrument. If the liability component were to be settled for its carrying amount, this would otherwise give rise to taxable or deductible amounts that would be included in the determination of taxable income. However, settlement of the instrument in accordance with its terms, either through settlement on maturity or conversion, might not result in the incidence of tax to the issuer. When the enterprise is able to settle the instrument without the incidence of tax, the tax basis of the liability component is considered to be the same as its carrying amount and there is no temporary difference.

### **Recognition**

#### **Current income tax liabilities and current income tax assets**

- .19 *Current income tax liabilities and current income tax assets are recognized in accordance with paragraphs 3465.05-.07, and shall not be included in future income tax assets and future income tax liabilities.*

#### **Future income tax liabilities and future income tax assets**

Taxable temporary differences

- .20 *At each balance sheet date, except as provided in paragraphs 3465.31, 3465.33 and 3465.35, a future income tax liability shall be recognized for all taxable temporary differences other than those arising from any portion of goodwill that is not deductible for tax purposes.*
- .21 Any difference between the carrying amount of goodwill and its tax basis is a taxable temporary difference that would usually result in a future income tax liability. This Section does not permit the recognition of such a future income tax liability because goodwill itself is a residual and the recognition of the future income tax liability would merely increase the carrying amount of that residual.

Deductible temporary differences, unused tax losses and income tax reductions

- .22 *At each balance sheet date, except as provided in paragraphs 3465.31, 3465.33 and 3465.35, a future income tax asset shall be recognized for all deductible temporary differences, unused tax losses and income tax reductions. The amount recognized shall be limited to the amount that is more likely than not to be realized.*

- .23 Future realization of the tax benefit of an existing deductible temporary difference, unused tax loss or unused income tax reduction ultimately depends on the existence of sufficient taxable income of an appropriate nature, relating to the same taxable entity and the same taxation authority, within the carryback / carryforward periods available under the tax law. The following sources of taxable income may be available under the tax law to realize a tax benefit for deductible temporary differences, unused tax losses or income tax reductions:
- (a) future reversals of existing taxable temporary differences;
  - (b) future taxable income before the effects of reversing temporary differences, unused tax losses and income tax reductions;
  - (c) taxable income in prior year(s) if carryback is permitted under the tax law; and
  - (d) tax-planning strategies that, if necessary, would be implemented to realize a future income tax asset.
- .24 An enterprise would consider tax-planning strategies in determining the extent to which it is more likely than not that a future income tax asset will be realized. Tax planning strategies are actions that:
- (a) are prudent and feasible;
  - (b) an enterprise ordinarily might not take, but would take to prevent a tax loss or income tax reduction from expiring unused; and
  - (c) would result in realization of future income tax assets.
- The carrying amount of any future income tax asset recognized as a result of a tax planning strategy would reflect the cost of implementing that strategy.
- .25 Forming a conclusion that it is appropriate to recognize a future income tax asset is difficult when there is unfavourable evidence such as cumulative losses in recent years. Other examples of unfavourable evidence include:
- (a) a history of tax losses or income tax reductions expiring unused;
  - (b) losses expected in early future years (by a currently profitable enterprise);
  - (c) unsettled circumstances that, if unfavourably resolved, would adversely affect future operations and profit levels on a continuing basis in future years; and
  - (d) a carryback or carryforward period that is so brief that it would limit realization of tax benefits, particularly if the enterprise operates in a traditionally cyclical business.
- .26 Examples of favourable evidence that might support a conclusion that recognition of a future income tax asset is appropriate despite the existence of unfavourable evidence include:
- (a) existing sufficient taxable temporary differences relating to the same taxable entity and the same taxation authority that result in taxable amounts against which the unused tax losses or income tax reductions can be utilized;
  - (b) existing contracts or firm sales backlog that will produce more than enough taxable income to realize the future income tax asset based on existing sales prices and cost structures;
  - (c) an excess of fair value over the tax basis of the enterprise's net assets in an amount sufficient to realize the future income tax asset; or
  - (d) a strong earnings history exclusive of the loss that created the future deductible amount (unused tax loss carryforward or deductible temporary difference) together with evidence indicating that the loss is an aberration rather than a continuing condition.
- .27 An enterprise must use judgment in considering the relative impact of unfavourable and favourable evidence on the recognition of a future income tax asset. The weight given to the potential effect of unfavourable and favourable evidence is commensurate with the extent to which it can be verified objectively. The more unfavourable evidence that exists, the more favourable evidence is necessary and the more difficult it is to support a conclusion that recognition of some portion or all of the future income tax asset is appropriate.
- .28 An enterprise could recognize a future income tax asset for all deductible temporary differences, unused tax losses and income tax reductions, reduced by a valuation allowance to the extent that it is more likely than not that some portion or all of the assets will not be realized. The valuation allowance reduces the future income tax asset to the amount that is more likely than not to be realized. This results in the same net asset as that determined in accordance with paragraph 3465.22 and after applying the considerations described in paragraphs 3465.23-.27 in determining the amount of the valuation allowance.
- Reassessment of future income tax assets
- .29 *At each balance sheet date:*
- (a) *to the extent that it is no longer more likely than not that a recognized future income tax asset will be realized, the carrying amount of the asset shall be reduced; or*
  - (b) *to the extent that it is more likely than not that an unrecognized future income tax asset will be realized, a future income tax asset shall be recognized.*
- .30 At each balance sheet date, an enterprise reassesses recognized and unrecognized future income tax assets. When it is more likely than not that sufficient future taxable income will be available to allow a previously unrecognized future

income tax asset to be realized, the future income tax asset is recognized to the extent of that taxable income. For example, an improvement in existing contracts or firm sales backlog may increase the probability of the enterprise's ability to generate future taxable income such that the future income tax asset meets the recognition criteria in paragraphs 3465.22-.27. Conversely, a significant weakening of an enterprise's financial position may indicate that the enterprise will not be able to generate sufficient taxable income to allow recognized future income tax assets to be realized, in which case the future income tax asset is reduced to the amount that is considered more likely than not to be realized.

#### Integrated foreign operations

- .31 *A future income tax asset or liability shall not be recognized for a temporary difference arising from the difference between the historical exchange rate and the current exchange rate translations of the cost of non-monetary assets or liabilities of integrated foreign operations.*
- .32 FOREIGN CURRENCY TRANSLATION, Section 1651, requires the use of historical exchange rates to measure the cost of non-monetary assets of an integrated foreign operation such as inventory, property, plant and equipment. Assuming that the Canadian dollar is the currency of measurement, when exchange rates change, the amount of foreign currency revenues needed to recover the Canadian dollar cost of those assets also changes but the foreign currency tax basis of those assets does not change. After a change in exchange rates, there will be a difference between:
- (a) the amount of foreign currency needed to recover the Canadian dollar cost of those assets; and
  - (b) the foreign currency tax basis of those assets.

Although that difference technically meets the definition of a temporary difference, the substance of accounting for it as such would be to recognize future income taxes on exchange gains and losses that are not recognized in accordance with Section 1651. In order to resolve that conflict and to reduce complexity by eliminating cross-currency (Canadian dollar cost versus foreign tax basis) computations of future income taxes, recognition of future income tax assets and future income tax liabilities for those differences is prohibited.

#### Example

On January 1, 20X1, Company P made an investment of \$1,000,000 in Company S, an integrated foreign operation that has a manufacturing plant with a fair value (and tax basis) of FC 1,000,000 when the exchange rate is \$1 = FC 1.

At December 31, 20X2, the exchange rate is \$1 = FC 1.5.

At December 31, 20X2, the financial statements of Company S will reflect the plant at FC 1,000,000. The consolidated financial statements of Company P will reflect the plant at \$1,000,000, based on the historic exchange rate.

In order to recover the carrying value in the consolidated financial statements, Company P must realize \$1,000,000 or FC 1,500,000. Realization of FC 1,500,000 would lead to a future income tax liability since the tax basis of the asset is FC 1,000,000. The temporary difference of FC 500,000 would otherwise give rise to a future income tax liability. The liability is not recognized because it relates to a foreign exchange gain that itself is not recognized in accordance with FOREIGN CURRENCY TRANSLATION, Section 1651.

#### Intra-group transfers

- .33 *When an asset is transferred between enterprises within a consolidated group, a future income tax liability or asset shall not be recognized in the consolidated financial statements for a temporary difference arising between the tax basis of the asset in the buyer's tax jurisdiction and its cost as reported in the consolidated financial statements. Any taxes paid or recovered by the transferor as a result of the transfer shall be recorded as an asset or liability in the consolidated financial statements until the gain or loss is recognized by the consolidated entity.*
- .34 A transfer of assets such as the sale of inventory or depreciable assets between enterprises within a consolidated group is a taxable event that might establish a new tax basis for those assets in the buyer's tax jurisdiction. The new tax basis of those assets is deductible on the buyer's income tax return when the cost of those assets as reported in the consolidated financial statements is recovered. However, from the point of view of the consolidated financial statements, no profit or loss has been realized and there will be no change in net assets until such time as that asset is transferred, by sale or otherwise, outside the consolidated group. Although the difference between the buyer's tax basis and the cost of transferred assets as reported in the consolidated financial statements technically meets the definition of a temporary difference, the substance of accounting for it as such would be to recognize income taxes related to intercompany gains or losses that are not recognized in accordance with CONSOLIDATED FINANCIAL STATEMENTS, Section 1601. Similar principles apply to investments subject to significant influence and interests in joint arrangements.

#### Investments in subsidiaries and interests in joint arrangements

- .35 *At each balance sheet date, a future income tax liability or future income tax asset shall be recognized for all temporary differences arising from investments in subsidiaries and interests in joint arrangements, except with respect to the difference between the carrying amount of the investment and the tax basis of the investment when it is apparent that this difference will not reverse in the foreseeable future. Any future income tax asset shall be recognized only to the extent that it is more likely than not that the benefit will be realized.*
- .36 Temporary differences may arise from investments in subsidiaries and interests in joint arrangements in a number of different circumstances. Examples include:



- (a) differences between the carrying amounts (in the consolidated financial statements) of individual assets and liabilities of subsidiaries and joint arrangements and their tax basis ("inside basis differences"); or
- (b) differences between the carrying amount of an investment in a subsidiary or an interest in a joint arrangement and its tax basis ("outside basis differences") because of items such as:
  - (i) the existence of undistributed income of subsidiaries and joint arrangements; or
  - (ii) changes in foreign exchange rates when a parent and its subsidiary are based in different countries.

Such temporary differences are differences between the carrying amounts of assets and liabilities of each enterprise in the financial statements of the investor and the appropriate tax basis even when they are eliminated on consolidation. The tax basis of the assets and liabilities is determined by reference to the individual enterprises in the group.

- .37 In consolidated financial statements, the taxable temporary difference arising from an investment in a subsidiary reflects the parent's share of the undistributed income of the subsidiary and differences arising from other transactions and events that affect the carrying amount of the parent's investment. The taxable temporary difference may be different from the taxable temporary difference in the separate financial statements of the parent if the parent carries its investment in its separate financial statements at cost.
- .38 As a parent controls the dividend policy of its subsidiary, it is able to control the timing of the reversal of temporary differences associated with its investment. When the parent considers the reinvestment of a subsidiary's profits as part of its permanent investment in the subsidiary, and it has determined that those profits will not be distributed for the foreseeable future, a future income tax liability is not recognized. When it is apparent that all or part of the temporary difference will reverse in the foreseeable future, a future income tax liability is recognized.
- .39 An investor in a joint arrangement generally has joint control over that joint arrangement. Joint control is the contractually agreed sharing of the continuing power to determine the strategic, operating, investing and financing policies of the joint arrangement. Decisions relating to distributions from the joint arrangement usually require the consent of the investors in such a manner as defined in the terms of the contractual arrangement. Therefore, when the investor can exercise joint control over distributions and it is apparent that distributions will not be made for the foreseeable future, a future income tax liability is not recognized.
- .40 The temporary differences described in paragraph 3465.36 might also exist for investments subject to significant influence accounted for by the equity method. A future income tax liability or asset is recorded for such temporary differences since the investor is not normally able to control the timing of their reversal.

**Assets acquired other than in a business combination**

- .41 *When an asset is acquired other than in a business combination and the tax basis of that asset is less than its cost, the cost of future income taxes recognized at the time of acquisition shall be added to the cost of the asset. When an asset is acquired other than in a business combination and the tax basis of that asset is greater than its cost, the benefit related to future income taxes recognized at the time of acquisition shall be deducted from the cost of the asset.*
- .42 In some circumstances, an asset acquired, other than an asset acquired in a business combination, has a tax basis that is less than its cost. This gives rise to a taxable temporary difference that results in the recognition of a future income tax liability. Adding the cost of future income taxes to the cost of the asset reflects the following:
  - (a) the carrying amount of the asset will include the cost to acquire the asset and the unavoidable income tax consequences of utilizing the asset; and
  - (b) the carrying amount will represent the minimum future cash flows necessary to recover the investment in the asset including any tax consequences associated with the asset.

**Example**

An enterprise buys an asset for \$8,000 cash. The maximum tax basis of the asset on initial recognition is \$2,000. The tax rate is 40 percent. In accordance with paragraph 3465.41, the enterprise recognizes the asset at an initial carrying amount of \$12,000 and recognizes a future income tax liability of \$4,000. The initial carrying amount is determined using the formula set out below:

$$\text{Carrying value} = \text{Cost of the asset} + \frac{([\text{Cost} - \text{Tax basis}] \times \text{tax rate})}{(1 - \text{tax rate})}$$

that is:

$$\text{Carrying value} = \$8,000 + \frac{([\$8,000 - \$2,000] \times .40)}{(1 - .40)} = \$12,000$$

The journal entry on initial recognition is:

Dr. Asset	12,000	
Cr. Cash		8,000
Cr. Future income tax liability		4,000

- .43 There may be circumstances in which an asset acquired, other than an asset acquired in a business combination, has a tax basis in excess of its cost. This Section requires the recognition of a future income tax asset in respect of the origination or reversal of the resulting temporary difference. The most appropriate manner of recognizing this future income tax asset is to reduce the cost of the asset by the future income tax benefit in order to reflect the consideration paid for the asset and take into account the effect of the tax treatment applied by the taxation authorities to the difference between the cost of the asset and its tax basis. This treatment is consistent with accounting for government assistance (see GOVERNMENT ASSISTANCE, Section 3800) and with accounting for investment tax credits (see INVESTMENT TAX CREDITS, Section 3805).

**Example**

As an inducement to enterprises to invest in a particular area, tax laws permit enterprises making eligible investments a tax basis for qualifying assets of 120 percent of cost.

An enterprise acquires a qualifying asset for \$6,000. Its tax basis as a result of the incentive program is \$7,200. The tax rate is 40 percent. In accordance with paragraph 3465.41, the enterprise recognizes the asset at an initial carrying amount of \$5,200 and recognizes a future income tax asset of \$800. The initial carrying value of the asset is determined as follows:

$$\text{Carrying value} = \$6,000 + \frac{[(\$6,000 - \$7,200) \times .40]}{(1 - .40)} = \$5,200$$

The journal entry on initial recognition is:

Dr. Asset	5,200	
Dr. Future income tax asset	800	
Cr. Cash		6,000

**Business combinations**

- .44 *When, at the time of a business combination, the acquirer considers it more likely than not that it will realize a future income tax asset of its own that was previously unrecognized, it shall recognize a change in the future income tax asset in the period of the business combination, but shall not include it as part of the accounting for the business combination.*
- .45 In certain circumstances, an acquirer may consider it more likely than not that, as a result of a business combination, it will be able to realize a future income tax asset of its own or its subsidiaries that was unrecognized immediately before the acquisition. For example, the acquirer may be able to utilize the benefits of its unused tax losses against the future taxable income of the acquiree or through the use of tax planning strategies. Alternatively, as a result of the business combination, it might no longer be more likely than not that future taxable profit will allow the future income tax asset to be recovered. In such cases, the acquirer recognizes a change in the future income tax asset in the period of the business combination, but does not include it as part of the accounting for the business combination. Therefore, the acquirer does not take the future income tax asset into account in measuring the goodwill or bargain purchase gain it recognizes in the business combination.
- .46 *When a future income tax asset acquired in a business combination that was not recognized as an identifiable asset by the acquirer at the date of the acquisition is subsequently recognized by the acquirer within the measurement period, the benefit shall be applied:*
- first to reduce to zero any unamortized goodwill related to the acquisition; and*
  - then to reduce income tax expense.*
- .47 The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognized for a business combination (see BUSINESS COMBINATIONS, Section 1582).
- .48 *When a future income tax asset acquired in a business combination that was not recognized as an identifiable asset by the acquirer at the date of the acquisition is recognized by the acquirer after the measurement period, the benefit shall be recognized in income tax expense.*
- .49 *The principles in paragraphs 3465.44, 3465.46 and 3465.48 shall be applied:*
- when accounting for an investment subject to significant influence or an interest in a joint arrangement; and*
  - when recognizing future income tax assets in periods subsequent to the application of push-down accounting (see COMPREHENSIVE REVALUATION OF ASSETS AND LIABILITIES, Section 1625).*
- .50 *When a future income tax asset that was not recognized at the date of a comprehensive revaluation as a result of a financial reorganization (see COMPREHENSIVE REVALUATION OF ASSETS AND LIABILITIES, Section 1625) is subsequently recognized, the benefit shall be applied:*
- first to reduce to zero any unamortized intangible assets (see GOODWILL AND INTANGIBLE ASSETS, Section 3064) that were recorded at the date of the comprehensive revaluation; and*

- (b) *then in a manner consistent with the revaluation adjustment recorded at the date of the comprehensive revaluation.*

#### **Measurement**

- .51 *Income tax liabilities and income tax assets shall be measured using the income tax rates and income tax laws that, at the balance sheet date, are expected to apply when the liability is settled or the asset is realized, which are normally those enacted at the balance sheet date.*
- .52 *Future income tax liabilities and future income tax assets shall not be discounted.*
- .53 Whether current or future, income tax liabilities and income tax assets are normally measured using the income tax rates and tax laws that have been enacted at the balance sheet date. However, there may be circumstances in which the use of a substantively enacted income tax rate or income tax law is more appropriate. In some jurisdictions, such as Canada, announcements of changes to income tax rates and tax laws by the government may have the substantive effect of actual enactment, which may follow the announcement by a significant period of time. It is appropriate to use a substantively enacted income tax rate or income tax law only when there is persuasive evidence that:
- (a) the government is able and committed to enacting the proposed change in the foreseeable future; and
  - (b) when the change relates to the current year, the enterprise expects to be assessed based on the announced tax rates or tax laws.
- Persuasive evidence that a change in tax law or tax rates is substantively enacted usually exists only when the proposed change is specified in sufficient detail to be understood and applied in practice, has been drafted in legislative or regulatory form and has been tabled in Parliament or presented in Council.
- .54 When a change in income tax rates or income tax laws is substantively enacted before the balance sheet date, income tax liabilities and income tax assets are measured using the announced tax rates and tax laws. When changes to tax rates and tax laws are not substantively enacted, income tax assets and income tax liabilities are measured using the enacted rate.
- .55 For changes in income tax rates and tax laws enacted or substantively enacted after the date of the financial statements but before the date of their completion, disclosure as a subsequent event may be appropriate in accordance with SUBSEQUENT EVENTS, Section 3820.
- .56 When the effective tax rate that applies to capital gains and losses differs from that which applies to other taxable income, the rate used to measure future income tax assets and liabilities reflects the expected manner of recovery of the asset.
- .57 Income tax legislation provides economic incentives by various means. Such means include actual or effective reductions in the income tax rate applied on taxable income. Three such incentives in Canada are the small business deduction, the manufacturing and processing profits deduction and the resource allowance deduction. An enterprise measures future income tax liabilities and future income tax assets using income tax rates that reflect enacted or substantively enacted income tax rate reductions provided that it is more likely than not that the enterprise will be eligible for such rate reductions in the period(s) of reversal. Provincial income tax rates expected to be in effect and the expected allocation of taxable income earned in each province are used in determining the income tax rates. Income tax reductions that are based on a measure of revenue, rather than on a measure of income or costs incurred, are recognized when such revenue is recognized, and not as a rate reduction.
- .58 When different income tax rates apply to different levels of taxable income, future income tax assets and liabilities are measured using the rates that are expected to apply to the taxable income of the periods in which the temporary differences are expected to reverse. When income tax rate reductions must be allocated among companies in a related group, future income tax liabilities and future income tax assets are measured in the financial statements of the individual companies based on the allocations of these reductions expected to occur in the future, regardless of the actual allocations in the current year.

#### **Intraperiod allocation**

##### **Income tax expense**

- .59 *The cost (benefit) of current and future income taxes shall be recognized as income tax expense included in the determination of net income or loss for the period before discontinued operations, except that:*
- (a) *any portion of the cost (benefit) of current and future income taxes related to discontinued operations of the current period shall be included in the income statement with the results of discontinued operations;*
  - (b) *any portion of the cost (benefit) of current and future income taxes relating to capital transactions in the current period, or relating to items that are credited or charged directly to equity in the current period, shall be charged or credited directly to equity;*
  - (c) *any portion of the cost (benefit) of current and future income taxes arising at the time of changes in shareholder status shall be treated as a capital transaction (see CAPITAL TRANSACTIONS, Section 3610);*
  - (d) *any portion of the cost of future income taxes arising at the time an enterprise renounces the deductibility of expenditures to an investor shall be treated as a cost of issuing the security to the investor;*
  - (e) *any portion of the cost (benefit) of future income taxes arising at the time of acquisition of an asset, other than an asset acquired in a business combination, shall be recognized in accordance with paragraph 3465.41;*

- (f) *any portion of the cost (benefit) of future income taxes recognized at the time of a business combination shall be included in the allocation of the cost of the purchase (see paragraph 3465.17);*
  - (g) *any other portion of the cost (benefit) of future income taxes related to a business combination, investment in a significantly influenced investee, interest in a joint arrangement or comprehensive revaluation of assets and liabilities shall be recognized in accordance with paragraphs 3465.46 and 3465.48-.50;*
  - (h) *any refundable taxes shall be recognized in accordance with paragraphs 3465.67-.69; and*
  - (i) *any portion of the cost (benefit) of current and future income taxes relating to the correction of an error or a change in accounting policy shall be recognized in a manner consistent with the underlying item (see ACCOUNTING CHANGES, Section 1506).*
- .60 *Changes in future income tax balances recognized in accordance with paragraph 3465.51 as a result of changes in tax laws or rates shall be included in future income tax expense reported in income before discontinued operations.*
- .61 *The cost (benefit) of current income taxes represents the amount of income taxes payable or recoverable in respect of the period. The cost (benefit) of future income taxes represents the amount of future income tax liabilities and future income tax assets recognized in the period. The cost (benefit) of current and future income taxes is recognized in a manner consistent with the transaction or event that gave rise to the current or future income tax liability or asset. Therefore, the cost (benefit) of current and future income taxes is recognized as income tax expense except for any portions allocated elsewhere in accordance with paragraph 3465.59.*
- .62 *The tax benefit of an unused tax loss or income tax reduction, to the extent recognized in the year of the loss, is reported in the same manner as the related loss. When included in net income, the tax benefit of a loss carryforward recognized in a period after the period of the loss is reported in income before discontinued operations regardless of the classification of the loss in the prior period.*
- .63 *When an item is treated as a capital transaction, or is otherwise credited or charged to equity rather than included in the determination of the net income or loss for the period, the cost (benefit) of current and future income taxes relating to that item is also charged or credited directly to equity. Examples of such items are:*
- (a) *the amount of the correction of an error that relates to prior periods that is reported by adjusting the opening balance of retained earnings (see ACCOUNTING CHANGES, Section 1506);*
  - (b) *the amount of an adjustment resulting from a change in accounting policy that is applied retroactively and that is reported as an adjustment to the opening balance of retained earnings (see ACCOUNTING CHANGES, Section 1506);*
  - (c) *exchange gains and losses arising from the translation of the financial statements of a foreign enterprise that are included in equity (see FOREIGN CURRENCY TRANSLATION, Section 1651); and*
  - (d) *the costs related to the issue, redemption or cancellation of share capital (see CAPITAL TRANSACTIONS, Section 3610).*
- .64 *Future income tax liabilities and assets may change because of changes in shareholder status or share capital transactions that affect the enterprise's tax status (for example, changes in the residence of shareholders and changes in control). The changes in future income tax assets and liabilities related to the shareholders' action or to the injection of new equity are recorded as capital transactions. The effects of changes in tax status related to the enterprise's actions or decisions, such as a change in the enterprise's residency, are included in income tax expense included in the determination of net income before discontinued operations.*
- .65 *Tax legislation may permit an enterprise to issue securities to investors whereby the deductions for tax purposes related to expenditures made previously or in the future may be claimed by the investors and not by the enterprise (commonly referred to as flow-through securities). When the expenditures are recorded as assets, the carrying value may exceed the tax basis as a result of the enterprise renouncing the deductions to the investors. The cost of future income taxes related to the resulting temporary difference is recorded as a cost of issuing the securities to the investors when the expenditures are renounced. Consequently, the future income tax liability is recognized, and the shareholder's equity reduced, on the date that the company files the documents with the tax authorities to renounce the tax credits associated with the expenditures, provided there is reasonable assurance that the expenditures will be made. The date of this filing by the company may differ from the effective date of the renouncement that allows an investor to claim the tax deduction.*
- .66 *Changes in future income tax balances recognized as a result of changes in tax laws or rates in accordance with paragraph 3465.51 are included in income before discontinued operations because such changes are considered to be a result of normal business activities.*
- Refundable taxes**
- .67 *When a payment related to a component of an instrument classified as a liability in accordance with FINANCIAL INSTRUMENTS, Section 3856, will give rise to a refund of income taxes previously paid, the refundable amount shall be recognized as a future income tax asset.*
- .68 *Refundable taxes that are in the nature of advance distributions related to a component of an instrument classified as equity in accordance with FINANCIAL INSTRUMENTS, Section 3856, shall be charged to retained earnings when it is more likely than not that such taxes will be recovered in the foreseeable future. The recovery of such refundable taxes*

*shall be credited to retained earnings. When it is not more likely than not that the taxes will be recovered in the foreseeable future, the taxes shall be charged to income.*

- .69 *Refundable taxes shall be accrued with respect to all related elements of income recognized in the period, whether the taxes with respect to such amounts are payable currently or in the future.*
- .70 Refundable taxes are applicable to certain investment income earned by Canadian corporations. The taxes are refundable when certain distributions are paid to shareholders. From the enterprise's perspective, such taxes represent an advance distribution on behalf of the shareholders.
- .71 Any taxes refundable on payment of an amount related to an item classified as equity are not recognized as an asset since they do not represent a potential economic benefit — the benefit could only be realized by a decrease in net assets.
- .72 Any taxes refundable on payment of amounts related to an item classified as a liability represent an advance payment in respect of an expense and are recorded as an asset.

#### **Examples**

- (a) An enterprise pays refundable tax of \$100 related to investment income earned. The tax will be refundable at a rate of \$1 for every \$3 of dividends paid on instruments that are shares under corporate law.
- When preferred shares are included in liabilities on the basis of a mandatory dividend requirement, it is presumed that dividends will be paid in future. When such dividends would give rise to a recovery of all or part of the refundable taxes paid, the refundable portion is recorded as an asset.
- When the only way to recover the tax is by payment of a dividend on an amount included in equity, the tax is charged to retained earnings unless there is no expectation of paying dividends in the future.
- When there is no reasonable expectation of paying dividends in the foreseeable future, the amount of the tax paid is included in income tax expense in the income statement.
- (b) For retractable preferred shares or retractable or mandatorily redeemable shares issued in a tax planning arrangement classified as a financial liability in accordance with FINANCIAL INSTRUMENTS, Section 3856, payment of the amount of the liability might give rise to a deemed dividend for tax purposes. When such a deemed dividend will give rise to a refund of taxes previously paid, the amount of the refundable taxes is included in future income tax assets.
- .73 It is appropriate to accrue refundable dividend tax at the time the related investment income is recorded, whether or not it is currently taxable. Similarly, the recovery of refundable taxes charged to equity is recorded in the financial statements when the conditions prerequisite to a refund have been met (i.e., such amount is recorded when it is known that the amount of the tax is recoverable). For example, the declaration of a qualifying dividend (whether paid or unpaid) may establish the recoverability of amounts of refundable taxes. Such recoverable amounts are an asset to be recorded at the date of declaration of the dividend.
- .74 When it is not more likely than not that such taxes will be recovered in the foreseeable future, they cannot be considered to be in the nature of advance distributions to shareholders. In such cases, the tax payments are appropriate charges to income.
- .75 If it is more likely than not that a particular temporary difference will attract a refundable tax when the difference reverses, the refundable tax is included in the tax rate at which the future income tax liability related to such temporary difference is calculated.

#### **Alternative minimum tax**

- .76 *Any amounts of income tax payable currently that may reduce income taxes of a future period shall be recorded as a future income tax asset if it is more likely than not that income taxes will be sufficient to recover the amounts payable currently. Any amounts not more likely than not to be recovered shall be included in current income tax expense.*
- .77 Certain jurisdictions levy a minimum tax with reference to income for financial statement purposes, or to certain elements of capital. Such amounts are creditable against future income taxes payable in certain circumstances. When it is more likely than not that future income tax liabilities will be sufficient to recover the minimum tax, the minimum tax recoverable is recorded as an asset.

#### **Taxes related to distributions**

- .78 *Taxes related to distributions or future distributions shall be given the same accounting treatment as the distributions.*
- .79 Taxes paid on certain dividends are a form of advance corporation tax and are given the same accounting treatment as the dividends on the shares. For example, an enterprise that issues taxable preferred shares may be subject to an advance corporation tax on certain dividends paid. If the preferred shares are shown as debt on the balance sheet and the dividends are shown on the income statement, then the advance corporation tax is also shown on the income statement as an adjustment of the financing cost. If the preferred shares are classified as equity and dividends on preferred shares are charged to retained earnings, the advance corporation tax is charged to retained earnings. Income tax reductions or recoveries as a result of the tax are also accounted for in the same manner as the advance corporation tax that led to the reduction and receive the same accounting treatment as the dividends.

#### **PRESENTATION**

##### **Income tax expense**

- .80 *Income tax expense included in the determination of net income or loss before discontinued operations shall be presented on the face of the income statement.*

**Income tax liabilities and income tax assets**

- .81 *Income tax liabilities and income tax assets shall be presented separately from other liabilities and assets. Current income tax liabilities and current income tax assets shall be presented separately from future income tax liabilities and future income tax assets.*
- .82 *When an enterprise segregates assets and liabilities between current and non-current assets and liabilities, it shall classify future income tax assets and future income tax liabilities as non-current.*
- .83 *Current income tax liabilities and current income tax assets shall be offset if they relate to the same taxable entity and the same taxation authority. Future income tax liabilities and future income tax assets shall be offset if they relate to the same taxable entity and the same taxation authority.*
- .84 *When enterprises in a group are taxed separately by the same taxation authority, a future income tax asset recognized by one enterprise in the group shall not be offset against a future income tax liability of another enterprise in the group unless tax planning strategies could be implemented to satisfy the requirements of paragraph 3465.83 when the future income tax liability becomes payable.*
- .85 *Although current income tax assets and current income tax liabilities are separately recognized and measured, they may be offset in the balance sheet to the extent that they relate to income taxes levied on the same taxable entity by the same taxation authority. Similarly, future income tax assets and future income tax liabilities are offset to the extent that they relate to income taxes levied on the same taxable entity by the same taxation authority. However, current and non-current income tax balances are not offset by an enterprise that makes a distinction between current and non-current assets and liabilities, irrespective of whether the balances relate to income taxes levied by the same taxation authorities. In addition, current income tax liabilities and current income tax assets are not offset with future income tax liabilities and future income tax assets, irrespective of whether the balances relate to income taxes levied by the same taxation authorities. However, it is appropriate to consider available tax planning strategies that can be implemented. A tax planning strategy is assumed only when it is practical and when management has both the ability and the intent to employ the strategy, if necessary, to offset tax balances. An example of a tax planning strategy that might result in an offset of future income tax assets and liabilities in a consolidated group is an amalgamation of companies in the group.*

**RATE-REGULATED ENTERPRISES**

- .86 *Rate-regulated enterprises shall recognize income taxes in accordance with this Section.*
- .87 *If a rate-regulated enterprise adopts the future income taxes method and, as a result of an action by a regulator, future income taxes are expected to be included in approved rates charged to customers in the future and to be recovered from or returned to future customers, the enterprise recognizes an asset or liability for that expected future revenue or reduction in future revenue. Such an asset or liability is:*
- (a) *a temporary difference for which a future income tax liability or asset is recognized; and*
  - (b) *presented separately from future income tax liabilities and future income tax assets, in accordance with paragraph 3465.81.*

**DISCLOSURE**

- .88 *When an enterprise applies the taxes payable method of accounting for income taxes, the financial statements shall disclose the following:*
- (a) *(deleted)*
  - (b) *a reconciliation of the income tax rate or expense related to income or loss for the period before discontinued operations to the statutory income tax rate or the dollar amount that would result from its application, including the nature and amount of each significant reconciling item;*
  - (c) *the amount and timing of capital gain reserves and similar reserves to be included in taxable income within five years;*
  - (d) *the amount of unused income tax losses carried forward and unused income tax credits; and*
  - (e) *the portion of income tax expense (benefit) related to transactions charged (or credited) to equity (see paragraphs 3465.68 and 3465.78).*
- .89 *When an enterprise applies the future income taxes method of accounting for income taxes, the following shall be disclosed separately:*
- (a) *current income tax expense (benefit) included in the determination of income or loss before discontinued operations;*
  - (b) *future income tax expense (benefit) included in the determination of income or loss before discontinued operations;*
  - (c) *the portion of the cost (benefit) of current and future income taxes related to capital transactions or other items that are charged or credited to equity (see paragraphs 3465.68 and 3465.78);*

- (d) the total amount of unused tax losses and income tax reductions, and the amount of deductible temporary differences, for which no future income tax asset has been recognized; and
- (e) the amount of future income tax assets and future income tax liabilities in respect of each type of temporary difference for each period presented.
- .90 The net charge or recovery of refundable dividend taxes shall be disclosed separately.
- .91 An enterprise that is not subject to income taxes because its income is taxed directly to its owners shall disclose that fact.

#### **EFFECTIVE DATE AND TRANSITION**

- .92 Except as specified in paragraphs 3465.93-.96, this Section applies to annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier application is permitted.
- .93 Amendments to paragraph 3465.88, issued in October 2012, apply to annual financial statements relating to fiscal years beginning on or after January 1, 2013. Earlier application is permitted.
- .94 Amendments to paragraphs 3465.34-.36(b)(i), 3465.39, 3465.49(a) and 3465.59(g), issued in September 2014, apply to annual financial statements relating to fiscal years beginning on or after January 1, 2016. Earlier application is permitted.
- .95 Amendments to paragraph 3465.72(b), issued in December 2018, apply to annual financial statements related to fiscal years beginning on or after January 1, 2021. Earlier application is permitted.
- .96 Amendments to paragraphs 3465.14(f), 3465.82-.83 and 3465.89, issued in June 2019, apply to annual financial statements relating to fiscal years beginning on or after January 1, 2021. An enterprise applies these amendments retrospectively, as defined in ACCOUNTING CHANGES, paragraph 1506.05(d). Earlier application is permitted.

#### **ILLUSTRATIVE EXAMPLES**

This material is illustrative only.

These examples illustrate how the accounting treatment specified in this Section might be applied in particular situations. Matters of principle relating to particular situations should be decided in the context of this Section.

Example 1 — Capital assets

Example 2 — Future income tax assets and liabilities

Example 3 — Business combinations

Example 4 — Disclosure requirements for the taxes payable method

##### **Example 1 — Capital assets**

An enterprise buys equipment for \$10,000 and depreciates it on a straight-line basis over its expected useful life of five years. For tax purposes, capital cost allowance (CCA) on the equipment is claimed at 25 percent per annum on a declining balance basis, subject to the "half-year" rule in the year of acquisition. The tax basis of the equipment is calculated as follows:

	<u>20X1</u>	<u>20X2</u>	<u>20X3</u>	<u>20X4</u>	<u>20X5</u>
Tax basis — beginning of year	\$10,000	\$8,750	\$6,562	\$4,921	\$3,691
CCA (@25% declining balance)	(1,250)	(2,188)	(1,641)	(1,230)	( 923)
<b>Tax basis — end of year</b>	<b>\$ 8,750</b>	<b>\$6,562</b>	<b>\$4,921</b>	<b>\$3,691</b>	<b>\$2,768</b>
	=====	=====	=====	=====	=====

Tax losses may be carried back and applied against taxable income of the previous three years. The combined federal and provincial tax rate is 40 percent. The enterprise's current tax computation is as follows:

	<u>20X1</u>	<u>20X2</u>	<u>20X3</u>	<u>20X4</u>	<u>20X5</u>
Taxable income before CCA	\$2,000	\$2,000	\$3,000	\$4,000	\$5,000
Capital cost allowance	(1,250)	(2,188)	(1,641)	(1,230)	( 923)
<b>Taxable income (tax loss)</b>	<b>\$ 750</b>	<b>\$ (188)</b>	<b>\$1,360</b>	<b>\$2,770</b>	<b>\$4,077</b>
	=====	=====	=====	=====	=====
<b>Cost (benefit) of current income taxes at 40%</b>	<b>\$ 300</b>	<b>\$ (75)</b>	<b>\$ 544</b>	<b>\$1,108</b>	<b>\$1,631</b>
	=====	=====	=====	=====	=====

In accordance with paragraph 3465.06, the enterprise recognizes a current tax asset at the end of 20X2 since the benefit will be realized by carrying the loss back to recover income taxes previously paid.

The temporary differences associated with the equipment and the resulting future income tax asset and liability and cost (benefit) of future income taxes are as follows:

	<u>20X1</u>	<u>20X2</u>	<u>20X3</u>	<u>20X4</u>	<u>20X5</u>
Carrying amount	\$8,000	\$6,000	\$4,000	\$2,000	\$ —
Tax basis	<u>(8,750)</u>	<u>(6,562)</u>	<u>(4,921)</u>	<u>(3,691)</u>	<u>(2,768)</u>
<b>Deductible temporary difference</b>	<b>\$(750)</b>	<b>\$(562)</b>	<b>\$(921)</b>	<b>\$(1,691)</b>	<b>\$(2,768)</b>
	=====	=====	=====	=====	=====
Opening future income tax liability (asset)	\$ —	\$(300)	\$(225)	\$(368)	\$(676)
Closing future income tax liability (asset)	<u>(300)</u>	<u>(225)</u>	<u>(368)</u>	<u>(676)</u>	<u>(1,107)</u>
<b>Cost (benefit) of future income taxes</b>	<b>\$(300)</b>	<b>\$ 75</b>	<b>\$(144)</b>	<b>\$(308)</b>	<b>\$ (431)</b>
	=====	=====	=====	=====	=====

The enterprise's income statement is as follows:

	<u>20X1</u>	<u>20X2</u>	<u>20X3</u>	<u>20X4</u>	<u>20X5</u>
Income before depreciation	\$2,000	\$2,000	\$3,000	\$4,000	\$5,000
Depreciation	<u>(2,000)</u>	<u>(2,000)</u>	<u>(2,000)</u>	<u>(2,000)</u>	<u>(2,000)</u>
<b>Income before income tax</b>	<b>—</b>	<b>—</b>	<b>1,000</b>	<b>2,000</b>	<b>3,000</b>
Current income tax expense (benefit)	300	(75)	544	1,108	1,631
Future income tax expense (benefit)	<u>(300)</u>	<u>75</u>	<u>(144)</u>	<u>(308)</u>	<u>(431)</u>
<b>Total income tax expense</b>	<b>—</b>	<b>—</b>	<b>400</b>	<b>\$ 800</b>	<b>1,200</b>
<b>Net income for the period</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 600</b>	<b>\$1,200</b>	<b>\$1,800</b>
	=====	=====	=====	=====	=====

The enterprise recognizes a future income tax asset in all years because it is more likely than not that there will be sufficient taxable income in subsequent years.

#### **Example 2 — Future income tax assets and liabilities**

The example deals with an enterprise over the two-year period, 20X5 and 20X6. In 20X5 the enacted combined federal and provincial income tax rate was 45 percent of taxable income. In June 20X6, the federal government enacted a reduction in the federal income tax rate such that the combined enacted income tax rate was 40 percent of taxable income, effective January 1, 20X6.

Repairs under warranty are recognized on the accrual basis for financial statement purposes. For income tax purposes, repairs under warranty are deductible as an expense only in the period in which they are paid.

Buildings are depreciated for accounting purposes at 5 percent a year on a straight-line basis and at 10 percent a year on a declining balance basis for tax purposes subject to the "half-year" rule in the year of acquisition. Motor vehicles are depreciated for accounting purposes at 20 percent a year on a straight-line basis, and at 30 percent a year on a declining balance line basis for tax purposes subject to the "half-year" rule in the year of acquisition. A full year's depreciation is charged for accounting purposes in the year that an asset is acquired.

In 20X2, the enterprise incurred \$1,250 of costs in relation to the development of a new product. These costs were deducted for tax purposes in 20X2. For accounting purposes, the enterprise capitalized this expenditure and is amortizing it on the straight-line basis over five years. At December 31, 20X4, the unamortized balance of these product development costs was \$500.

In 20X5, the enterprise was notified by the relevant authorities that they intend to pursue an action against the enterprise with respect to sulphur emissions. Although at December 31, 20X5 the action had not yet come to court, the enterprise recognized a liability of \$700 at that date being its best estimate of the fine arising from the action. Fines are not deductible for tax purposes.

In 20X5, the enterprise entered into an agreement with its existing employees to provide health care benefits to retirees. The enterprise recognizes the cost of this plan as an expense as employees provide service. No payments to retirees were made for such benefits in 20X5 and 20X6. Health care costs are deductible for tax purposes only when payments are made to retirees.

The enterprise has determined that it is more likely than not that taxable income will be available against which any resulting deductible temporary difference can be utilized.

#### **Current income taxes**

20X6

20X5



Net income before income taxes	\$9,190	\$8,775
Add:		
Depreciation for accounting purposes	7,800	4,800
Change in provision for repairs under warranty	350	500
Fine for environmental pollution	—	700
Amortization — product development costs	250	250
Accrual of health care benefits	<u>1,000</u>	<u>2,000</u>
	18,590	17,025
Deduct:		
Capital cost allowance for income tax purposes	<u>(6,115)</u>	<u>(4,357)</u>
<b>Taxable income</b>	\$12,475	\$12,668
	=====	=====
Current income taxes at 45%		\$ 5,701
		=====
Current income taxes at 40%	\$4,990	
	=====	

#### Carrying amounts of property, plant and equipment

	<u>Building</u>	<u>Motor vehicles</u>	<u>Total</u>
Depreciation rate	5%	20%	—
Carrying amount at December 31, 20X4	\$30,000	\$ 6,000	\$36,000
Additions — 20X5	6,000	—	6,000
Depreciation — 20X5	<u>(2,800)</u>	<u>(2,000)</u>	<u>(4,800)</u>
Carrying amount at December 31, 20X5	33,200	4,000	37,200
Additions — 20X6	—	15,000	15,000
Depreciation — 20X6	<u>(2,800)</u>	<u>(5,000)</u>	<u>(7,800)</u>
<b>Carrying amount at December 31, 20X6</b>	\$30,400	\$14,000	\$44,400
	=====	=====	=====

#### Tax basis of property, plant and equipment

	<u>Building</u>	<u>Motor vehicles</u>	<u>Total</u>
Capital cost allowance rate	10%	30%	—
Tax basis at December 31, 20X4	\$22,719	\$ 5,950	\$28,669
Additions — 20X5	6,000	—	6,000
CCA claimed — 20X5	<u>(2,572)</u>	<u>(1,785)</u>	<u>(4,357)</u>
Tax basis at December 31, 20X5	26,147	4,165	30,312
Additions — 20X6	—	15,000	15,000
CCA claimed — 20X6	<u>(2,615)</u>	<u>(3,500)</u>	<u>(6,115)</u>
<b>Tax basis at December 31, 20X6</b>	\$23,532	\$15,665	\$39,197
	=====	=====	=====

### Future income taxes at December 31, 20X4

	Carrying amount	Tax basis	Taxable (deductible) temporary differences
Accounts receivable	\$ 500	\$ 500	\$ —
Inventory	2,000	2,000	—
Product development costs	500	—	500
Investments	33,000	33,000	—
Property, plant and equipment	<u>36,000</u>	<u>28,669</u>	<u>7,331</u>
	\$72,000	\$64,169	\$7,831
	=====	=====	=====
Current income taxes payable	\$ 3,000	\$ 3,000	\$ —
Accounts payable	500	500	—
Provision for repairs under warranty	—	—	—
Fines payable	—	—	—
Liability for health care benefits	—	—	—
Long-term debt	20,000	20,000	—
Future income taxes	<u>3,524</u>	<u>—</u>	<u>—</u>
	27,024	\$23,500	\$ —
		=====	=====
Share capital	5,000		
Retained earnings	<u>39,976</u>		
	\$72,000		
	=====		

### Calculation of future income taxes

Future income tax liability (related to taxable temporary differences)	\$7,831	45%	\$3,524
Future income tax asset (related to deductible temporary differences)	<u>—</u>		<u>—</u>
Net future income tax liability	\$7,831		\$3,524
	=====		=====

### Future income taxes at December 31, 20X5

	Carrying amount	Tax basis	Taxable (deductible) temporary differences
Accounts receivable	\$ 500	\$ 500	\$ —
Inventory	2,000	2,000	—
Product development costs	250	—	250
Investments	33,000	33,000	—

Property, plant and equipment	<u>37,200</u>	<u>30,312</u>	<u>6,888</u>
	\$72,950	\$65,812	\$7,138
	=====	=====	=====
Current income taxes payable	\$ 3,570	\$ 3,570	\$ —
Accounts payable	500	500	—
Provision for repairs under warranty	500	—	(500)
Fines payable	700	700	—
Liability for health care benefits	2,000	—	(2,000)
Long-term debt	12,475	12,475	—
Future income taxes	<u>2,087</u>	<u>—</u>	<u>—</u>
	21,832	\$17,245	\$(2,500)
		=====	=====
Share capital	5,000		
Retained earnings	<u>46,118</u>		
	\$72,950		
	=====		

**Calculation of future income taxes**

Future income tax liability (related to taxable temporary differences)	\$7,138	45%	\$3,212
Future income tax asset (related to deductible temporary differences)	<u>(2,500)</u>	45%	<u>(1,125)</u>
Net future income tax liability (a)	\$4,638		2,087
	=====		
Opening future income tax liability			<u>(3,524)</u>
Cost (benefit) of future income taxes related to the origination and reversal of temporary differences			\$(1,437)
			=====

(a) This calculation is done for the purpose of calculating the cost of future income taxes.

**Future income taxes at December 31, 20X6**

	<u>Carrying amount</u>	<u>Tax basis</u>	<u>Taxable (deductible) temporary differences</u>
Accounts receivable	\$ 500	\$ 500	\$ —
Inventory	2,000	2,000	—
Product development costs	—	—	—
Investments	33,000	33,000	—
Property, plant and equipment	<u>44,400</u>	<u>39,197</u>	<u>5,203</u>
	\$79,900	\$74,697	\$5,203
	=====	=====	=====
Current income taxes payable	\$2,359	\$2,359	\$ —

Accounts payable	500	500	—
Provision for repairs under warranty	850	—	(850)
Fines payable	700	700	—
Liability for health care benefits	3,000	—	(3,000)
Long-term debt	12,805	12,805	—
Future income taxes	<u>541</u>	<u>—</u>	<u>—</u>
	\$20,755	\$16,364	\$(3,850)
		=====	=====
Share capital	5,000		
Retained earnings	<u>54,145</u>		
	\$79,900		
	=====		

#### Calculation of future income taxes

Future income tax liability (related to taxable temporary differences)	\$5,203	40%	\$2,081
Future income tax asset (related to deductible temporary differences)	<u>(3,850)</u>	40%	<u>(1,540)</u>
Net future income tax liability (a)	\$1,353		\$ 541
	=====		
Opening future income tax liability			<u>(2,087)</u>
Cost (benefit) of future income taxes			\$(1,546)
			=====
Components of the cost (benefit) of future income taxes):			
Cost (benefit) of future income taxes related to the origination and reversal of temporary differences	[4,638 – 1,353]	40%	\$(1,314)
Adjustment to opening future income tax liability resulting from reduction in tax rate	4,638	5%	<u>(232)</u>
			\$(1,546)
			=====

(a) This calculation is done for the purpose of calculating the cost of future income taxes. [Former paragraph (a) retained in Archived Pronouncements]

#### Example 3 — Business combinations

On January 1, 20X5, Company A acquired 100 percent of the shares of Company B at a cost of \$600. The tax rate in Company A's tax jurisdiction is 45 percent and the tax rate in Company B's tax jurisdiction (a foreign country) is 40 percent.

The fair value of the identifiable assets and liabilities (excluding future income tax assets and future income tax liabilities) acquired by Company A, together with their tax basis in Company B's tax jurisdiction and the resulting temporary differences is as follows:

	<u>Fair value</u>	<u>Tax basis</u>	<u>Temporary differences</u>
Property, plant and equipment	\$270	\$155	\$115
Accounts receivable	210	210	—
Inventory	174	124	50

Retirement benefit obligations	(30)	—	(30)
Accounts payable	<u>(120)</u>	<u>(120)</u>	<u>—</u>
	\$504	\$369	\$135
	=====	=====	=====
Fair value of identifiable assets and liabilities acquired, excluding future income tax			\$504
Future income tax liability (\$135 at 40%)			<u>(54)</u>
Amount of net identifiable assets and liabilities acquired			\$450
Goodwill			<u>150</u>
Cost of investment			\$600
			=====

In accordance with paragraph 3465.20, Company A does not recognize a future income tax liability for the taxable temporary difference related to the goodwill.

At the date of acquisition, the tax basis, in Company A's tax jurisdiction, of Company A's investment in Company B is \$600. In Company A's jurisdiction, there is no temporary difference associated with the investment.

During 20X5, Company B's equity (incorporating the effects of amortizing fair value adjustments made on acquisition) changed as follows:

At January 1, 20X5	\$450
Net income for 20X5	<u>150</u>
At December 31, 20X5	\$600
	=====

At December 31, 20X5, the carrying amount of Company A's underlying investment in Company B is as follows:

Net assets of B in the consolidated financial statements	\$600
Goodwill	<u>150</u>
Carrying amount	\$750
	=====

The temporary difference associated with Company A's underlying investment is \$150, being the carrying amount of \$750 less its tax basis of \$600. It represents the cumulative income since the acquisition.

If Company A has determined that the investment is essentially permanent in nature, no future income tax liability is recognized for the \$150 temporary difference related to Company A's investment in Company B (paragraph 3465.35).

If Company A expects to sell the investments in Company B, or if Company B will make a distribution in the foreseeable future, Company A recognizes a future income tax liability to the extent that the temporary difference is expected to reverse.

#### **Example 4 — Disclosure requirement for the taxes payable method**

This example illustrates how the reconciliation requirement in paragraph 3465.88(b) might be applied in a particular situation. Situation I illustrates the reconciliation using income tax expense; Situation II illustrates the reconciliation using income tax rates.

#### **Note X: Income taxes**

The Company accounts for income taxes using the taxes payable method. As a result, the company's income tax expense varies from the amount that would otherwise result from the application of the statutory income tax rates as set out below:

#### **Situation I Income Tax Expense**

	<u>20X1</u>	<u>20X0</u>
Net income before income taxes	\$107,000	\$84,000
	=====	=====
Expected income tax expense at the combined tax rate of 42% (20X0 — 44%)	\$45,000	\$37,000

Increase (decrease) in income tax expense resulting from:		
Non-taxable income or non-deductible expense	3,000	1,000
Income or expenses claimed in different periods for income tax purposes		
Capital cost allowance in excess of amortization	(2,000)	(2,500)
Interest in net earnings of affiliate	<u>(1,000)</u>	<u>(1,000)</u>
	45,000	34,500
Rate adjustments		
Small business deduction	(22,000)	(18,000)
Manufacturing rate deduction	<u>(5,000)</u>	<u>(3,500)</u>
Income tax expense	\$ 18,000	\$13,000
	=====	=====

**Situation II**  
**Income Tax Rate**

	<u>20X1</u>	<u>20X0</u>
Net income before income taxes	\$107,000	\$84,000
	=====	=====
Combined basic federal and provincial tax rates	42%	44%
Increase (decrease) in income tax expense resulting from:		
Non-taxable income or non-deductible expense	3%	1%
Income or expenses claimed in different periods for income tax purposes		
Capital cost allowance in excess of amortization	(2%)	(3%)
Interest in net earnings of affiliate	<u>(1%)</u>	<u>(1%)</u>
	42%	41%
Rate adjustments		
Small business deduction	(21%)	(21%)
Manufacturing rate deduction	<u>(4%)</u>	<u>(5%)</u>
Effective income tax rate (Income tax expense \$18,000 (20X0 — \$13,000).)	17%	15%
	=====	=====

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