

# Tax Implications of IFRS

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## Background

In a previous article “Converting to IFRS”; we outlined the steps required for creating a robust IFRS conversion plan in order to meet the January 1, 2011 deadline. It is important to note that a revised IFRS for income taxes is expected to be released in 2009 and it is the revised standard that will likely be adopted for the January 1, 2011 deadline. In this article, we look at the impact IFRS will have on the treatment of income taxes using the differences expected to remain after its revision.

## Current Status

International Accounting Standard (IAS) 12 addresses both current and deferred taxes and covers both domestic and foreign taxes based on taxable income as well as other taxes based on payment (i.e. withholding taxes). IAS 12 does not stipulate how current taxes should be calculated as that is driven by domestic tax law but does require that a tax liability (or asset) is recorded where a corporation has unpaid taxes (or recoverable taxes). The Canada Revenue Agency has not indicated that it has any issues with the adoption of IFRS.

IAS 12 requires deferred taxes to be calculated using the balance sheet liability method based on temporary differences arising between an item’s accounting and tax base. Furthermore, the IASB has (at least for now) accepted that the Canadian “more likely than not” threshold equates the IFRS threshold of “probable” for recognition of deferred taxes. IAS 12 requires the deferred taxes be established using the tax rates expected for the period in which the temporary difference reverses based on rates and laws that have been enacted or substantively enacted. This is virtually the same as the use of “substantively enacted” rates currently used in Canadian GAAP. Looking at the surface, IAS 12 appears to be very similar to current Canadian GAAP but a corporation must look further into the details.

## Area for Potential Differences

- The revaluation of non-depreciable assets may create a deferred tax asset or liability as current Canadian GAAP does not permit this type of revaluation.
- IAS 21<sup>1</sup> requires that where a gain or loss on a non-monetary item is recognised into equity, any corresponding foreign exchange gain or loss also be recorded in equity. This will typically occur on translation of non-current assets such as foreign operations. Any change in the deferred tax related to the foreign exchange must also be recorded in equity, rather than the income statement.
- Two scenarios may exist if a corporation has a stock-based compensation plan<sup>2</sup> as the unit of measurement is an individual award: (i) the deferred taxes relating to a temporary

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<sup>1</sup> IAS 21 *The Effects of Foreign Exchange*

<sup>2</sup> IFRS 2 requires that corporations reflect the substance of giving employees and third parties stock-based payments by recording them in the income statement and are recognised at the time when either the goods or services are provided.

difference would be reflected in equity if the tax deduction exceeds the cumulative stock-based compensation amount expensed, or (ii) if the tax deduction is less than the cumulative stock-based compensation amount expensed, deferred taxes relating to a temporary difference would be reflected in income.

- To the extent that certain current income tax calculations rely on balance sheet amounts, the adoption of IFRS could impact the figures. This may occur for items such as SR&ED credits and rates as well as small business deductions for some provinces. Capital tax calculations may be impacted for financial institutions federally and for some remaining provinces as inputs include debt, equity and its retained earnings. Provincial capital taxes for other corporations will have been phased out by the IFRS adoption date<sup>3</sup>.

The potential differences noted above have been generalised and the impact of converting to IFRS will naturally differ for each corporation according to its specific accounting and tax situation. Furthermore, the differences discussed may change as the International Accounting Standards Board (the "IASB") has not yet issued an exposure draft on its revisions to IAS 12.

### **The Claret Partners Limited**

The conversion to IFRS is a large project for any entity; we can assist you in the following ways.

- Preparation of the comparison of existing GAAP to IFRS for your entity and in particular IAS 12 as it exists and its future revisions,
- Assessing the entity's options under IFRS 1 and its impacts on income taxes balances,
- Assisting in defining the scope, time table and resources required for implementation,
- Preparing the implementation plan,
- Revision of policies, procedures and processes due to the adoption of IFRS, and
- Implementing the conversion.

*The Claret Partners Limited is a consulting firm dedicated to providing the best in regulatory compliance, tax, risk and governance services as consultants and project managers creating workable and practical solutions. **For more information please contact us at [contact@theclaretpartners.com](mailto:contact@theclaretpartners.com).***

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<sup>3</sup> Except for Nova Scotia which will be phased out in 2012.