Understanding ASPE
Section 3465, Income Taxes
Six questions for private business owners: Income Taxes

A better working world begins with better questions. Asking better questions leads to better answers. To help preparers of financial statements with Canadian accounting standards for private enterprises (“ASPE”) Section 3465, *Income Taxes*, we’ve summarized the key aspects of the Section and offer relevant practical considerations for private mid-market companies through answering six commonly asked questions.

**Question 1: What accounting policy choices are available with respect to accounting for income taxes?**

Section 3465 states that when accounting for income taxes, an entity has the choice to use:
(a) the taxes payable method; or
(b) the future income taxes method.

The *taxes payable* method, as defined in paragraph 3465.02 (l), 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.

The *future income taxes* method, as defined in paragraph 3465.02 (f), 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.

**Question 2: Which method should an entity choose?**

The taxes payable method is easier to apply because it does not require the measurement of future tax assets and liabilities arising from temporary differences. However, future income tax assets, if any, will be left off the balance sheet. On the other hand, the taxes payable method requires a disclosure of a reconciliation of the income tax rate or expenses 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. The choice depends upon the financial reporting needs of the entity. An entity is allowed to change income tax policies without meeting the criterion in paragraph 1506.06(b), *Accounting Changes*. The taxes payable method is not permitted under other financial reporting frameworks, such as International Financial Reporting Standards and Accounting Principles Generally Accepted in the United States of America.
If an entity chooses the taxes payable method, when are income taxes recognized and what tax rate is used to measure income tax assets and liabilities?

Current income taxes, to the extent unpaid or recoverable, shall be recognized as a liability or asset. 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. 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.

The measurement provisions are set forth in paragraphs 3465.51-3465.58. Income tax liabilities/assets, whether current or future, shall be measured using the income tax rates and laws that, at the balance sheet date, are expected to apply when the liability is settled or the asset is realized, which are normally enacted at the balance sheet date. 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 or tax laws.

What are the basic principles of the future income taxes method?

Per paragraph 3465.10, 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.

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. This difference arises when 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 different from the accounting policies followed by an enterprise when determining the income or expense recorded in their financial statements. 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.
Question 5

What are the disclosure requirements of the two methods of accounting for income taxes?

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<tr>
<th>Taxes payable</th>
<th>Future income taxes</th>
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<td>(a) a reconciliation of the income tax rate or expense related to income/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;</td>
<td>(a) current and future income tax expense (benefit) included in the determination of income or loss before discontinued operations;</td>
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<tr>
<td>(b) the amount and timing of capital gain reserves to be included in taxable income within five years;</td>
<td>(b) 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</td>
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<tr>
<td>(c) the amount of unused income tax losses carried forward and unused income tax credits; and</td>
<td>(c) 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.</td>
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<td>(d) the portion of income tax expense (benefit) related to transactions charged (or credited) to equity</td>
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What are refundable taxes and how are they accounted for?

As defined in paragraph 3465.02 (b), refundable taxes are taxes that are based on certain types of income and that are refundable when certain amounts are paid to shareholders. These taxes are applicable to certain investment income earned by Canadian corporations and are refundable when certain distributions are paid to shareholders.

Per paragraphs 3465.67-3465.70, when a payment related to a component of an instrument classified as a liability will give rise to a refund of income taxes previously paid, the refundable amount shall be recognized as a future income tax asset. Refundable taxes that are in nature of advance distributions related to a component of an equity instrument 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.

To learn more about these items or for application guidance, please contact our Private Mid-Market practice at privatecompanyinfo@ca.ey.com.
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