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GAAP for Private Enterprises – How Can It Affect Your Tax Reporting?

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Canada's private enterprises have the option to convert from existing Canadian generally accepted accounting principles (GAAP) to the new Accounting Standards for Private Enterprises (ASPE). These changes could significantly affect the tax accounts of private enterprises. Therefore, we felt it important to inform you what the impacts may be, should you adopt ASPE.

The Accounting Standards Board (AcSB) has approved the final Accounting Standards for Private Enterprises (ASPE) in Canada. These accounting standards form Part II of the *CICA Accounting Handbook* and take effect for fiscal years starting on or after January 1, 2011. Early adoption is permitted.

ASPE can be adopted by any Canadian enterprise that does not have equity or debt that trades in a public market and does not act in a fiduciary capacity for the general public. Private enterprises that choose not to adopt ASPE must adopt International Financing Reporting Standards (IFRS) by their first fiscal year starting in 2011.

Accounting Standard for Income Taxes

The ASPE standard for income taxes, CICA HB II 3465 – *Income Taxes*, is similar to its predecessor. Under ASPE, however, you can make an accounting policy choice to account for income taxes using one of two methods:

- **Taxes payable method** – Under this method, the enterprise reports only the cost (benefit) of current income taxes for the period. While this concept is not new, an enterprise previously had to qualify under differential reporting in order to elect to account for income taxes on this basis and thereby not report future income taxes.
- **Future income taxes method** – Under this method, the enterprise reports the cost (benefit) of current and future income taxes, consistent with previous GAAP.

Applying the taxes payable method is the simpler approach, as it will not reflect future tax obligations arising from temporary differences. However, under the taxes payable method, certain tax benefits, such as tax loss carryforwards, are left off the balance sheet.

Impact on Tax Reporting

In developing the ASPE standard for income taxes, the AcSB made a number of other changes to certain existing sections and guidelines. Tax return preparers will need to understand the differences between reported balances for their company under Canadian GAAP and ASPE—both on adopting ASPE and in the future—in order to determine the proper treatment on the company's tax returns and compute the company's tax provision.

Below we describe examples of some of the more significant differences your company may encounter on adopting ASPE and how they may affect your tax reporting.

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Financial Instruments

ASPE's new financial instruments standard sets out all aspects for financial instruments in one standard. All financial instruments are measured at amortized cost under the new standard, with two exceptions:

- Equity securities quoted in an active market and free-standing derivatives that are not part of a hedging relationship are measured at fair value. Later changes in measurement are reported as net income (i.e., and not as other comprehensive income).
- Companies can opt to record any financial instrument at fair value. You must select this option on the instrument’s initial recognition, and you cannot later revoke this choice.

For tax purposes, fair value movements are generally not included in income until they are realized. As a result, corporations must determine how these fair value adjustments will affect their tax return and tax provision reporting, and whether an adjustment is needed to reconcile net income for accounting and tax purposes.

The new financial instruments standard also provides that the transaction costs for acquiring financial instruments carried at fair value must be expensed. For tax purposes, certain transaction costs are deductible over 5 years, while others are added to the cost of the shares or assets acquired, and so corporations must determine the appropriate tax treatment for these costs. If the tax and accounting treatments differ, an adjustment to reconcile net income for accounting and tax purposes is necessary.

In both cases, corporations using the future income taxes method must also determine whether a temporary difference has been created.

Employee Future Benefits

ASPE simplifies the accounting treatment for defined benefit plans. Businesses can use the actuarial valuation prepared for funding purposes to measure the plan’s obligations, and recognize actuarial gains and losses in income when they occur. Because these actuarial gains and losses are not included in income for Canadian tax purposes, despite the simplified approach, taxable income should not change, as only contributions made to the plan are deductible for tax purposes. Corporations will continue to determine the adjustment needed to reconcile net income for accounting and tax purposes. Corporations using the future income taxes method will also need to consider the effect on the temporary difference for employee future benefits.

Internally Developed Intangible Assets

ASPE allows an enterprise to adopt an accounting policy of either capitalizing qualifying development costs incurred on eligible internally developed intangible assets or expensing them as incurred. Depending on your choice, your company will need to analyze these costs to determine whether they should be currently deducted or added to the asset’s cost for tax purposes. Corporations should also consider whether their development costs qualify for tax incentives under Canada’s Scientific Research and Experimental Development (SR&ED) program.

In addition to these differences, there are other less common ASPE accounting standard differences that may arise where the impact on tax reporting needs to be considered. While they are rare and unique to each business, it is highly advised that owners and leaders of Canadian private companies connect with their business advisers for a conversation to better understand the differences.

Change is coming, and KPMG Enterprise business advisers are committed to helping Canadian private companies ensure a successful transition to the accounting framework that is best suited to their business needs and objectives.

To learn more about how ASPE can affect your company’s tax reporting, please contact your local KPMG Enterprise adviser.

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