

## IFRS in Canada

### Potential IFRS liability treatment for REIT units

March 2009

Under International Financial Reporting Standards (IFRS), there is the potential that units of open-ended Canadian real estate investment trusts (REITs) may be required to be classified as a liability rather than equity. **While a REIT will not have to present its first IFRS financial statements until 2011, action may be required before the upcoming Annual General Meetings for the current 2008 year ends to avoid potentially undesirable accounting results for 2011 and 2010 comparative IFRS figures.**

#### Will REIT units be classified as equity or a liability?

A REIT's declaration of trust may permit the REIT's unit holders to redeem their REIT units and may require the REIT to distribute a minimum amount to its unit holders annually. More specifically, a REIT's declaration of trust may provide for the following:

- Typically a REIT is required to declare a distribution each year at least equal to the REIT's net income and net realized capital gains for the year computed in accordance with the *Income Tax Act* (Canada) and the REIT's unit holders would have a legal obligation to enforce the payment of such a distribution on December 31<sup>st</sup> of that year. This requirement is intended to ensure that the REIT is not subject to income tax. The REIT's distributions may be paid in cash or, in certain circumstances, by the issuance of additional units. Alternatively, in other cases, the REIT's trustees may only

express an intention to declare sufficient distributions to ensure that the REIT is not subject to income tax and therefore have full discretion as to the amount of any REIT distributions.

- In the case of an open-ended REIT, its unit holders would typically have the right to require the REIT to redeem their units at any time. The redemption price may be determined based upon the trading value of the REIT's units, such as the 20-day weighted average unit price less a specified discount such as 5%. For many REITs, the amount of the redemptions settled in cash may be limited (e.g., \$50,000 per month), with any amounts in excess of the limited settled by the issuance by the REIT of promissory notes, other financial instruments or other non-financial assets with a fair value equal to the remaining redemption amount.

While the facts and circumstances relevant for each REIT need to be considered carefully, including consideration of any other features of the units and terms of the REIT's declaration of trust that may result in liability treatment, mandatory distribution requirements and redemption features may result in liability treatment for the units rather than equity.

If it is determined that the REIT units meet the definition of a liability under current IFRS, then all such units would be recorded by default as "other liabilities" at amortized cost. However, the application of the effective interest rate

method to these liabilities would make their amortized cost approximate measurement at fair value on the balance sheet, with changes in fair value each reporting period recorded through profit and loss. Distributions on such units would be treated as interest expense and recorded in the income statement. This could have a significant impact on debt covenants and other ratios.

### Action may be needed soon.

To avoid the potentially significant issues noted above, action is required immediately. For REITs that will adopt IFRS in 2011 (assuming a calendar year-end), the transition date is January 1, 2010. If amendments to the declaration of trust are required to address the potential liability accounting treatment under IFRS on transition on January 1, 2010 (i.e., by making distributions discretionary), such amendments will need to be presented to and approved by the unit holders in the upcoming Annual General Meetings for the 2008 year-ends unless a special meeting is called (i.e., before December 31, 2009).

The tax implications of any amendment to a REIT's declaration of trust must be carefully reviewed. Any amendment to a REIT's distribution policy may also have important commercial, legal or other implications related to such things as market reaction, unit holder relations and analyst perspectives as such a change may introduce an element of uncertainty relating to the declaration of future distributions, especially in the current economic environment. REIT trustees and management will need to address any proposed changes carefully.

PricewaterhouseCoopers LLP can help you in the consideration of the specific facts and circumstances, including your declaration of trust, your determination of how its units will be classified under IFRS and, in a case where the units will be treated as liabilities, to help you develop specific actions for obtaining equity treatment

instead. Accounting and tax considerations must be carefully considered in developing any recommendations, including any implications for Canadian GAAP reporting prior to 2011.

### Other PwC information on REITs and IFRS

A PricewaterhouseCoopers real estate professional can help you better understand the implication of the choices to your organization.

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A number of PricewaterhouseCoopers publications are available at [www.pwcifrs.ca/realestate](http://www.pwcifrs.ca/realestate). They provide more information on IFRS and their application to Canadian real estate entities.