

Ind AS 12 :- Income taxes

EIRC Ind AS Course

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3.	Deferred Tax Liabilities and Deferred Tax Assets
4.	Current Tax
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Objective

To prescribe the accounting treatment for income taxes. The principal issue is how to account for the current and future tax consequences of:

- The future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's balance sheet; and
- Transactions and other events of the current period that are recognised in an entity's financial statements

IND AS 12

vs

AS 22

■ Ind AS 12

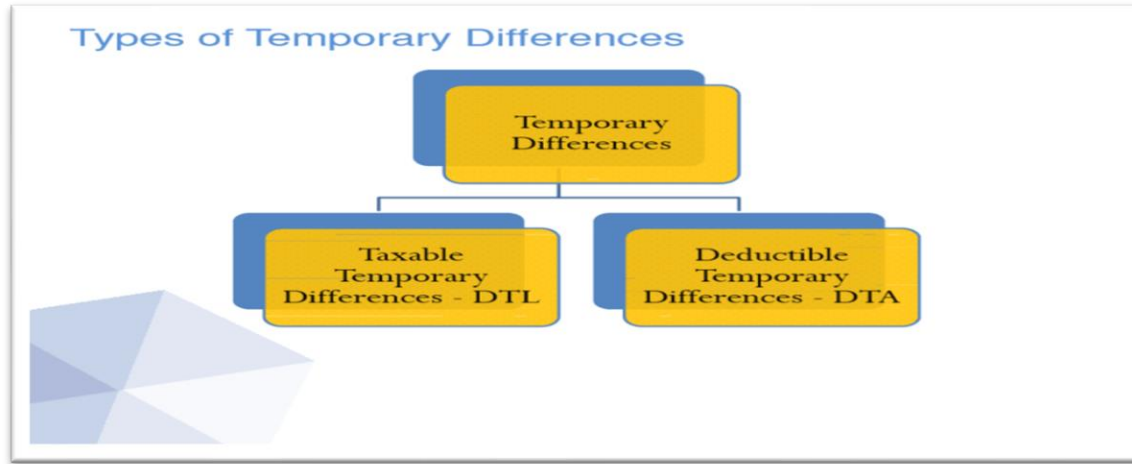
- Balance Sheet Approach
- Comparison of Accounting Base and Tax Base of Assets and Liabilities

■ AS 22

- Income Approach
- Comparison of Accounting Income and Taxable Income

ACCOUNTING BASE & tax base

- Accounting Base is the carrying amount of the assets and liabilities at the Balance Sheet date
- Tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes
- **Temporary differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base.**



Taxable temporary differences will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

Deductible temporary differences will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

Tax base of asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of asset

Particulars	Accounting Base	Tax Base	Temporary Difference	DTL/DTA
PPE	100	70	30	DTL
Interest Receivable (Taxable on cash basis)	100	0	100	DTL
Trade Receivable (Included in computing the taxable income)	100	100	Nil	None
Dividend Receivable (Considered as tax exempt)	100	100	Nil	None
Loan Receivable	100	100	Nil	None
Inventories	100	100	Nil	None
Security Deposits	100	100	Nil	None ⁸

Tax base of a liability is the carrying amount less any amount that will be deductible for tax purpose in respect of that liability in future periods

Particulars (1)	Accounting Base (2)	Amt deduc tible (3)	Tax Base (4)= (2)-(3)	Temporary Difference (5)=(2)-(4)	DTL/DTA
Accrued expenses deductible on cash basis (Sec 43B)	100	100	0	100	DTA
Interest Received in advance (Taxed on cash basis)	100	100	0	100	DTA
Accrued Expenses (already deducted for tax purpose)	100	0	100	Nil	None
Provision for fines and penalties (not deductible for tax purpose)	100	0	100	Nil	None
Loan Payable (Repayment has no tax consequence)	100	0	100	Nil	None
Security Deposits	100	0	100	Nil	None
Sum payable to a National Laboratory or a University or an IIT or a specified person (Sec 35(2AA)	100	150	50	50	DTA/ DTL

Tax base of an amount not appearing in the financial statements to be also considered

Particulars (1)	Accounting Base (2)	Amt deduc tible (3)	Tax Base (4)= (2)-(3)	Temporary Difference (5)=(2)-(4)	DTL/DTA
Preliminary Expenses incurred to be written off in 5 years (Sec 35D)	0	100	100	100	DTA

Summary

Particulars	For Assets	For Liabilities
If Carrying amount > Tax base	Taxable Temporary difference:- Deferred Tax Liability(e.g. WDV as per books > WDV as per Income Tax)	Deductible Temporary Difference:- Deferred Tax Asset(e.g. Provision for Bonus as per books > Provision for Bonus as per Income Tax)
If Carrying amount < Tax base	Deductible Temporary Difference:- Deferred Tax Asset (e.g. WDV as per books < WDV as per Income Tax)	Taxable Temporary difference:- Deferred Tax Liability (e.g. Loan carrying amount as per books and < Loan carrying amount as per Income Tax)
If Carrying amount = Tax Base	No temporary difference	No temporary difference

Taxable temporary difference also arise when:-

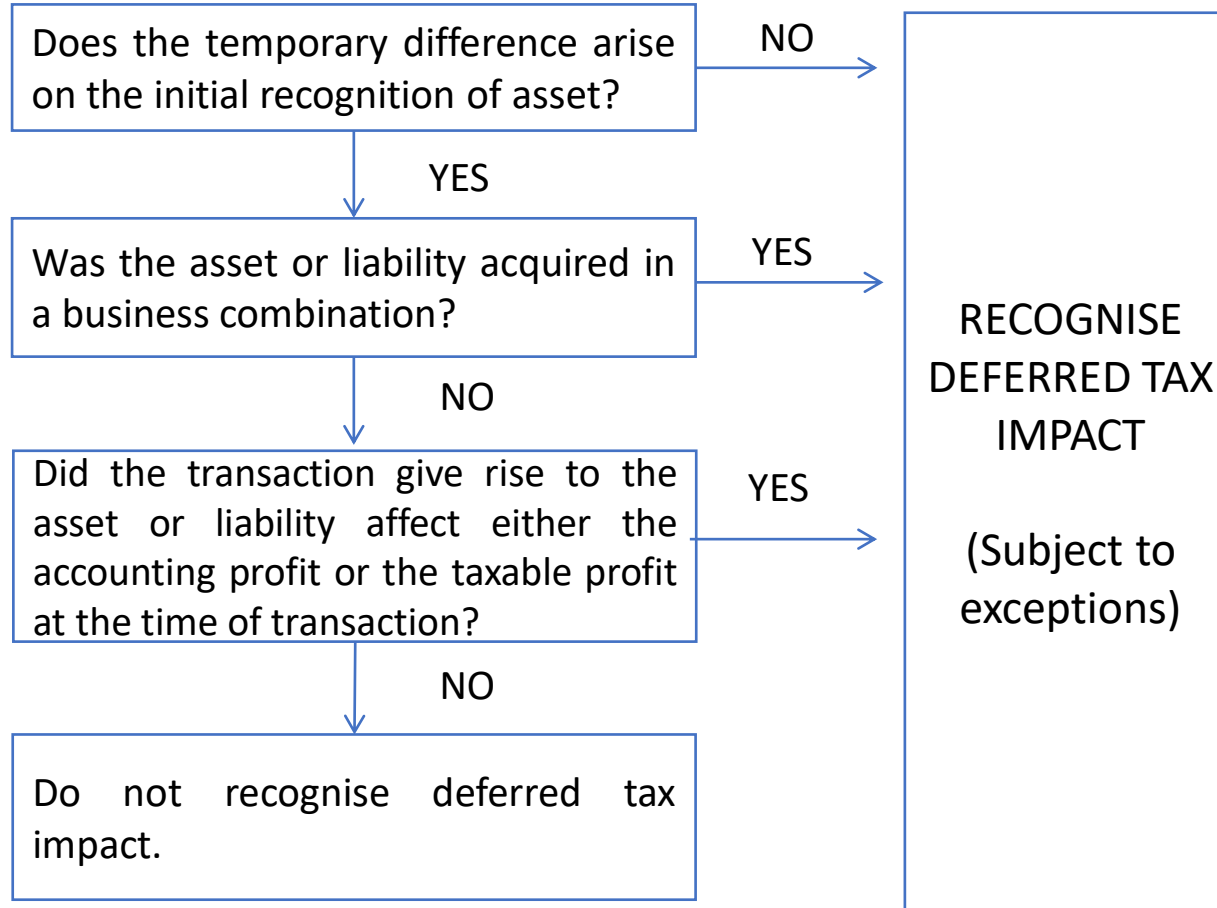
1. Identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values in accordance with Ind AS 103.
2. Assets are revalued and no equivalent adjustment is made for tax purposes.
3. Goodwill arises in a business combination
4. Tax base of an asset or liability on initial recognition differs from its initial carrying amount, for example when an entity benefits from non-taxable government grants related to assets
5. The carrying amount of investments in subsidiaries, branches and associates or interests in joint arrangements becomes different from the tax base of the investment or interest.

Recognition of DTL

Deferred tax liability shall be recognised for all taxable temporary differences, except:-

- the initial recognition of goodwill; or
- the initial recognition of an asset or liability in a transaction which:
 - is not a business combination; and
 - at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).

Recognition Flowchart



Recognition of DTA

DTA shall also be recognised for carry forward of tax losses and tax credits

The carrying amount of DTA should be reviewed at the end of each reporting period.

It should be probable that sufficient taxable profits will be available against which these losses & credits can be used.

DTA can be recognised only to the extent it is probable that taxable profits will be available against which deductible temporary difference can be utilised.

Case Study

Gratuity Provision is deducted in determining accounting profit as service is provided by the employee. But u/s 40A(7) of the IT Act, it is deducted in determining taxable profit either when contributions are paid to an approved fund or when retirement benefits are paid by the entity.

Is there a Temporary difference. If so does it result in DTL or DTA.

Certain assets may be carried at fair value, or may be revalued, without an equivalent adjustment being made for tax purposes

A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.

A Bond of Rs 1000, measured at fair value is quoted at Rs918/-. The Tax Base is Rs 1000/-. The fair values are not tax deductible. The gains or losses on sale of bond will be considered for tax deduction.

Accounting Base of the Bond is Rs 918 as against the tax base of Rs 1000/-. The resultant difference of Rs 82/- will be Deductible Temporary Difference resulting in DTA

Unused tax losses and unused tax credits

A deferred tax asset shall be recognised for the carry forward of *unused tax losses and unused tax credits* to the extent that it is ***probable*** that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised

AS 22 requires virtual certainty with convincing evidence

Current tax

1. To be recognised as liability to the extent unpaid.
2. Asset is recognised on when :
 - ✓ Excess amount already paid exceeds the amount due for those periods.
 - ✓ It is probable that benefit will flow to the enterprise and benefit is reliably measured.

Current tax

Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013

- ❖ Any interest on shortfall in payment of advance income-tax is in the nature of finance cost
- ❖ To be classified as Interest expense under finance costs & to be separately disclosed.
- ❖ Any penalties levied under Income tax laws should not be classified as Current tax. Penalties which are compensatory in nature should be treated as interest and disclosed as Finance Cost.
- ❖ Other tax penalties should be classified under 'Other Expenses'

EXAMPLE

XYZ Ltd intends to use an asset whose cost (carrying amount) is Rs.1,500/- throughout its useful life of five years and then scrap it. The tax rate is 30%. Depreciation of the asset is deductible for tax purposes up to 1,000 (i.e. the tax base of the asset on initial recognition is 1,000).

As XYZ Ltd recovers the carrying amount of the asset, the entity will earn taxable income of 1,500 and pay tax of 450 ($1,500 \times 30\%$) but can recover from depreciation only up to 300 ($1,000 \times 30\%$).

A taxable temporary difference exists of the asset that does not affect accounting profit or taxable profit on initial recognition.

The entity **does not recognise** the resulting deferred tax liability of Rs.150/- **because it results from the initial recognition of the asset**

Business Combination

- ❑ Identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values at the acquisition date.
- ❑ Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the business combination or are affected differently
- ❑ A liability assumed is recognised at the acquisition date but the related costs are not deducted in determining taxable profits until a later period, a deductible temporary difference arises which results in a deferred tax asset.
- ❑ A deferred tax asset also arises when the fair value of an identifiable asset acquired is less than its tax base.
- ❑ The resulting deferred tax liability/ assets affects goodwill

DTL from initial recognition of goodwill is not recognised

Business Combination

- ❑ Probability of realising a pre-acquisition deferred tax asset of the acquirer could change due to business combination
- ❑ Acquirer recognises a change in the DTA/DTL in the period of the business combination, but does not include it as part of the accounting for the business combination; Goodwill/ Bargain Purchase measurement not affected

Business Combination

- ❑ Acquired deferred tax benefits realised after the business combination:
 - ❑ Acquired deferred tax benefits recognised within the measurement period that result from new information about facts and circumstances that existed at the acquisition date shall be applied to reduce the carrying amount of any goodwill related to that acquisition.
 - ❑ If the carrying amount of that goodwill is zero, any remaining deferred tax benefits shall be recognised in other comprehensive income and accumulated in equity as capital reserve or recognised directly in capital reserve, depending on whether paragraph 34 or paragraph 36A of Ind AS 103, would have applied had the measurement period adjustments been known on the date of acquisition itself
- ❑ All other deferred tax benefits to be recognised in P&L

Assets at fair value

- Revaluation is permitted under Ind AS
 - As deemed cost as per para D5 of Ind AS 101
 - As per Ind AS 16 and 38 when Revaluation Model is adopted
- Accounting Base changes without corresponding change in the Tax Base
- Resulting DTL needs to be recognised in Equity/ OCI
- Measured at normal tax rates if the asset is to be used in the business
- DTL in case of Non depreciable asset revalued using Ind AS 16 to be measured using tax rates applicable to sale of asset.

Goodwill

DTL from initial recognition of goodwill is not recognised

Deferred tax liabilities for taxable temporary differences relating to goodwill are, however, *recognised to the extent they do not arise from the initial recognition of goodwill*

Particulars	Amount
Initial Goodwill	100
Dep Rate (upto AY2021-22)	25%
Tax Base at the end of Year 1	75
Accounting Base at the end of year 1	100
Temporary Taxable Difference	25

As per Finance Act 2021, Depreciation on Goodwill Is not allowable

Deferred Tax – Compound Financial Instruments under Ind AS 32

Particulars (1)	Accounting Base (2)	Amt dedu ctibl e (3)	Tax Base (4)= (2)- (3)	Temporary Difference (5)=(2)-(4)	DTL/DTA
Preference Share of Rs 100 Classified as Equity 10 and Debt 90	90	0	90	Nil	None
Bonds of Rs 100 classified as Equity 10 and Debt 90	90	0	100	10	DTL
The DTL arises on account of Equity and will be recognised in Equity & Subsequent changes are recognised in P&L					

Investments in subsidiaries, branches and associates and interests in joint arrangements

Temporary difference arises when the carrying amount of interests in subsidiaries, branches and associates or interests in joint arrangements (i.e. in the consolidated accounts, the net assets including the carrying amount of goodwill) becomes different from the tax base (which is often cost).

Examples

Existence of undistributed profits of subsidiaries, branches and associates or joint ventures

Changes in foreign exchange rates when a parent and its subsidiary are based in different countries having different currencies

Reduction in the carrying amount of an investment in an associate to its recoverable amount (due to impairment)

Recognise all deferred tax liabilities associated with investments in subsidiaries, branches and associates, and interests in joint ventures, **except to the extent** that both of the following conditions are satisfied:

- 1) The parent, investor or venturer is able to **control** the **timing of the reversal** of the temporary difference,
- 2) It is **probable** that the temporary difference **will not reverse** in the foreseeable future

Investments in subsidiaries, branches and associates and interests in joint arrangements

An entity shall recognise a **deferred tax asset** for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint arrangements, to the extent that, and only to the extent that, it is probable that:

- (a) Temporary difference will reverse in the foreseeable future; and
- (b) Taxable profit will be available against which the temporary difference can be utilised.

In consolidated financial statements, the temporary difference may be different from the temporary difference associated with that investment in the parent's separate financial statements if the parent carries the investment in its separate financial statements at cost or revalued amount

Measurement

Rates

- Tax rate – Expected to apply to the period when the asset is realised or liability is settled.
- When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using the average rates that are expected to apply to the taxable profit (tax loss) of the periods in which the temporary differences are expected to reverse.
- Deferred tax assets and liabilities shall not be discounted.

Measurement

Deferred tax is recognised as tax income or expenses and included in P&L for the period, except:-

1. A transaction or the event which is recognised, in the same or different accounting period, directly in equity or within OCI; or
2. A business combination that is an acquisition.

ILLUSTRATION

An item of property, plant and equipment has a carrying amount of Rs. 100 and a tax base of Rs. 60.

A tax rate of 25% would apply if the item were sold and a tax rate of 20% would apply to other income.

The entity recognises a deferred tax liability of Rs. 8 (Rs. 40 at 20%) if it expects to sell the item without further use and a deferred tax liability of Rs. 10 (Rs. 40 at 25%) if it expects to retain the item and recover its carrying amount through use

REVIEW OF DTL & DTA

The carrying amount of deferred tax assets and liabilities may change even though there is no change in the amount of the related temporary differences.

- (a) Change in tax rates or tax laws;
- (b) Reassessment of the recoverability of deferred tax assets; or
- (c) Change in the expected manner of recovery of an asset.

The resulting deferred tax is recognised in profit or loss, except to the extent that it relates to items previously recognised outside profit or loss

Current and deferred tax arising from share-based payment transactions

1. An entity may recognise an expense for the consumption of employee services received as consideration for share options granted, in accordance with Ind AS 102, Share-based Payment, and not receive a tax deduction until the share options are exercised.
2. If the amount of the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item.
3. In this situation, the excess of the associated current or deferred tax should be recognised directly in equity. `

Presentation and Disclosure

Tax asset and liabilities to be presented separately.

Offset if
Legal enforceable right and intends to settle on a net basis.

DTA/DTL should be distinguished from Current tax assets and liabilities

Deferred taxation – Separate disclosure

Major components of tax expenses(income), including;

1. Current tax expense/(income)
2. Adjustment in respect of a prior period
3. Deferred tax expense/(income)
4. Deferred tax expense/(income) arising due to a change in tax rates.
5. Deferred tax consequence of a change in accounting policy or a correction of a fundamental error.

Ind AS 12 vis-à-vis AS 22

Particulars	Ind AS 12	AS 22
Approach for creating Deferred tax	Based on Balance Sheet approach. It requires recognition of tax consequences of differences between the carrying amounts of assets and liabilities and their tax base.	Based on income approach. It requires recognition of tax consequences of differences between taxable income and accounting income.
Recognition for DTA	Only to the extent sufficient taxable temporary difference or other convincing evidence that sufficient taxable profits will be available.	Recognised or carried forward only to the extent of reasonable certainty.

Particulars	Ind AS 12	AS 22
		Where DTA is against the unabsorbed depreciation or carry forward of losses, DTA recognised only when virtual certainty supported by convincing evidence that sufficient future taxable income will be available.
Recognition of Current and Deferred Tax	<ul style="list-style-type: none"> • In profit and Loss • Except to the extent the tax arises from a transaction or event which is recognised outside profit and loss. 	Does not deal with the aspect
DTA/DTL arising out of revaluation of assets.	DTA/DTL on revaluation of non depreciable assets measured on the basis of tax consequence rather than the through use.	AS 22 does not deal with this aspect.

Particulars	Ind AS 12	AS 22
Disclosure of DTA and DTL in Balance Sheet	Income tax relating to each component of other comprehensive income shall be disclosed as current/non current asset or liability in accordance with requirement of Ind AS 1.	Deals with the disclosure requirements.
Virtual Certainty	No such concept exists.	Explains virtual certainty supported by convincing evidence.
Deferred tax in tax holiday period	Does not specifically deals with these situations.	Provides special reference to sections of Income Tax Act, 1961 for treatment of tax holiday.

Summary of ITFG issues on IND AS 12

Bulletin Number	Issue Number	Issue
Bulletin 11	Issue 2	Accounting treatment of Tax Holidays under Ind AS
Bulletin 10	Issue 3	Recognition of deferred tax asset on the tax deductible goodwill in the consolidated financial statements
Bulletin 9	Issue 1	Accounting treatment of dividend distribution tax (DDT) and deferred tax liability (DTL) on the accumulated undistributed profits of the subsidiary company
Bulletin 7	Issue 7	Recognition of deferred tax asset on land sold as slump sale

Summary of ITFG issues on IND AS 12

Bulletin Number	Issue Number	Issue
Bulletin 8	Issue 8	Recognition of the deferred tax on the differences that are arising from adjustment of exchange difference to the cost of the asset
Bulletin 16	Issue 2	Accounting treatment of the interest and penalties related to income taxes
Bulletin 17	Issue 7	Recognition of deferred tax on conversion of capital asset into stock-in-trade

Issue Discussed in ITFG Bulletin

Issue 1:- Recognition of the deferred tax on the differences that are arising from adjustment of exchange difference to the cost of the asset

MNC Ltd. is a first-time adopter of Ind AS. It had taken a foreign currency loan for USD 100 million on March 31, 2013 for construction of its property, plant and equipment (PPE). The company had availed the option given under paragraph 46/46A of AS 11, The Effects of Changes in Foreign Exchange Rates notified under the Companies (Accounting Standards) Rules, 2006 and accordingly, exchange gain/loss on such foreign currency loan had been added to or deducted from the cost of PPE. On the date of transition to Ind AS, the Company has opted for the exemption given under paragraph D13AA of Ind AS 101, First-time Adoption of Indian Accounting Standards. As per section 43A of Income Tax Act, 1961 such exchange differences capitalised are not allowed deduction under the Income Tax. Whether deferred tax is to be recognised on such differences that are arising from adjustment of exchange difference to the cost of the asset or can it be said that these meet the initial recognition exemption under paragraph 15(b) of Ind AS 12, Income Taxes, and hence no deferred tax is required to be created on the same?

Response:-

1. Deferred taxes is required to be recognised for all taxable and deductible temporary differences except in specified situations, e.g. if it arises from initial recognition of an asset or a liability.
2. However, adjustment to the cost of the asset due to exchange difference is a subsequent transaction and does not arise on 'the initial recognition of an asset or liability'.
3. In other words, capitalisation of the exchange differences (including the exchange differences prior to the date of transition) represents subsequent measurement of the liability which has been adjusted to the cost of the asset.
4. Accordingly, in the given case, initial recognition exemption will not be available and deferred tax is required to be recognised on temporary difference arising from capitalised exchange differences.

Thank You

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