TOPIC - 4

INDAS - 12
INCOME TAXES

(No. of Questions Covered – 13)

IMP. QUESTIONS FOR PRACTICE

(ICAI MODULE)

Q1:

An entity has a deductible temporary difference of Rs. 50,000. It has no taxable temporary differences against which it can be offset. The entity is also not anticipating any future profits. However, it can implement a tax planning strategy which can generate profits up to Rs60,000. The cost of implementing this tax planning strategy is Rs12,000. The tax rate is 30%. Compute the deferred tax asset that should be recognised.

Suggested Answer:

The entity should recognise a deferred tax asset of Rs14,400 @ 30% of Rs48,000 (Rs60,000 – Rs12,000).

The balance deferred tax asset of Rs. 600 @ 30% on Rs2,000 (Rs50,000 – Rs48,000) shall remain un-recognised.

Q2:

A Limited recognises interest income in its books on accrual basis. However, for income tax purposes the method is 'cash basis'. On December 31, 20X1, it has interest receivable of Rs 10,000 and the tax rate was 25%. On February 28, 20X2, the finance bill is introduced in the legislation that changes the tax rate to 30%. The finance bill is enacted as Act on May 21, 20X2. Discuss the treatment of deferred tax in case the reporting date of A Limited's financial statement is December 31, 20X1 and these are approved for issued on May 31, 20X2.

Suggested Answer:

The difference of Rs 10,000 between the carrying value of interest receivable of Rs 10,000 and its tax base of NIL is a taxable temporary difference.

A Limited has to recognise a deferred tax liability of Rs 2,500 (Rs 10,000 x 25%) in its financial statements for the reporting period ended on December 31, 20X1.

It will not recognise the deferred tax liability @ 30% because as on December 31, 20X1, this tax rate was neither substantively enacted or enacted on the reporting date. However, if the effect of this change is material, A Limited should disclose this difference in its financial statements.

Q3:

On 1st April 20X1, ABC Ltd acquired 100% shares of XYZ Ltd for INR 4,373 crores. By 31st March, 20X5, XYZ Ltd had made profits of INR 5 crores, which remain undistributed. Based on the tax legislation in India, the tax base investment in XYZ Ltd is its original cost. Assume the dividend distribution tax rate applicable is 15%.

Suggested Answer:

A taxable temporary difference of INR 5 therefore exists between the carrying value of the investment in XYZ at the reporting date of INR 4,378 (INR 4,373 + INR 5) and its tax base of INR 4,373. Since a parent, by definition, controls a subsidiary, it will be able to control the reversal of this temporary difference, for example - through control of the dividend policy of the subsidiary. Therefore, deferred tax on such temporary difference is generally not provided unless it is probable that the temporary difference will reverse in the foreseeable future

Q4:

ABC Ltd. acquired 50% of the shares in PQR Ltd. on 1st January 20X1 for INR 1000 crores. By 31st March, 20X5 PQR Ltd. had made profits of INR 50 crores (ABC Ltd.'s share), which remained undistributed. Based on the tax legislation in India, the tax base of the investment in PQR Ltd. is its original cost. Assume the dividend distribution tax rate applicable is 15%.

Suggested Answer:

A taxable temporary difference of INR 50 therefore exists between the carrying value of the investment in PQR at the reporting date of INR 1,050 (INR 1,000 + INR 50) and its tax base of INR 1,000. As ABC Ltd. does not completely control PQR Ltd. it is not in a position to control the dividend policy of PQR Ltd. As a result, it cannot control the reversal of this temporary difference and deferred tax is provided on temporary differences arising on investments in joint venture. (50 x 15%).

Q5:

A Ltd. Acquired B Ltd. The following assets and liabilities are acquired in a business combination:

Rs 000's

	Fair Value	Carrying amount	Temporary Difference
Plant and Equipment	250	260	(10)
Inventory	120	125	(5)
Debtors	200	210	(10)
	570	595	(25)
9% Debentures	(100)	(100)	
	470	495	
Consideration paid	500	500	
Goodwill	30	5	(25)

Calculate Deferred Tax Asset.

Suggested Answer:

In this case there is a Deferred Tax Asset as the Tax base of assets acquired is higher by 25,000. DTA would be Rs 7,500 (25,000 x 30%)

Journal entry:

Plant and equipment	Dr	250	
Inventory	Dr	120	
Debtors	Dr	200	
Goodwill	Dr	22.5 (30- 7.5)	
DTA	Dr	7.5	
To 9% Debentures			100
To Bank			500

Q6:

B Limited is a newly incorporated entity. Its first financial period ends on March 31, 20X1. As on the said date, the following temporary differences exist:

(a) Taxable temporary differences relating to accelerated depreciation of Rs9,000. These are expected to reverse equally over next 3 years.

(b) Deductible temporary differences of Rs4,000 expected to reverse equally over next 4 years.

It is expected that B Limited will continue to make losses for next 5 years. Tax rate is 30%. Losses can be carried forward but not backwards.

Discuss the treatment of deferred tax as on March 31, 20X1.

Suggested Answer:

As per IndAS 12, DTA shall be recognised to the extent it is probable that the entity **will have taxable profits** against which deductible temp. diff. shall be reversed; or the entity has **sufficient taxable temporary differences** relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;

In the given situation, sufficient Taxable Income is not available, however entity has some taxable temporary differences. Therefore deductible temporary differences to be extent of Rs. 3000 (1000 each year) shall be considered for recognising DTA.

Balance Rs. 1000 is to be ignored since it is revseable in the year 20x5 where entity does not have any Anticipated Taxable Temporary Differences.

The year-wise anticipated reversal of temporary differences is as under:

Particulars	Year ending on March 31, 20X2	Year ending on March 31, 20X3	Year ending on March 31, 20X4	Year ending on March 31, 20X5
Reversal of taxable temporary difference relating to accelerated depreciation over next 3 years (Rs9,000/3)	3,000	3,000	3,000	Nil

Reversal of deductible temporary difference relating to preliminary expenses over next 4 years (Rs4,000/4)	1,000	1,000	1,000	1,000

B Limited will recognise a deferred tax liability of Rs2,700 on taxable temporary difference relating to accelerated depreciation of Rs9,000 @ 30%.
However, it will limit and recognise a deferred tax asset on reversal of deductible temporary difference relating to preliminary expenses reversing up to year ending March 31, 20X4 amounting to Rs900 (Rs3,000 @ 30%). No deferred tax asset shall be recognized for the reversal of deductible temporary difference for the year ending on March 31, 20X5 as there are no taxable temporary differences. Further, the outlook is also a loss. However, if there are tax planning opportunities that could be identified for the year ending on March 31, 20X5 deferred tax asset on the remainder of Rs1,000 (Rs4,000 – Rs3,000) of deductible temporary difference could be recognised at the 30% tax rate.

Q7:

An asset with a cost of Rs. 100 and a carrying amount of Rs. 80 is revalued to Rs. 150. No equivalent adjustment is made for tax purposes. Cumulative depreciation for tax purposes is Rs. 30 and the tax rate is 30%. If the asset is sold for more than cost, the cumulative tax depreciation of Rs. 30 will be included in taxable income but sale proceeds in excess of cost will not be taxable.

Required:

State the deferred tax consequences of the above if the company:

(a) Expects to recover its carrying amount through use

(b) Expects to sell the asset without further use

Suggested Answer:

The tax base of the asset is Rs. 70 and there is a taxable temporary difference of Rs. 80 (Rs. 150 the revalued amount is the carrying amount).

(a) If the entity expects to recover the carrying amount by using the asset, it must generate taxable income of Rs. 150, but will only be able to deduct depreciation of Rs. 70. On this basis, there is a deferred tax liability of Rs. 24 (Rs. 80 at 30%).

(b) If the entity expects to recover the carrying amount by selling the asset immediately for proceeds of Rs. 150, the deferred tax liability is computed as follows:

Sale Proceeds	Rs. 150
Sale Proceeds in excess of Cost (Rs. 100)	Rs. 50
Taxable Proceeds	Rs. 100
Tax Base	Rs. 70
Taxable Temporary Differences	Rs. 30
Tax Rate	30%
Deferred Tax liability	Rs. 9

Q8:

On 1st April 20X1, S Ltd. leased a machine over a 5 year period. The present value of lease liability is ₹ 120 Cr (discount rate of 8%) and is recognized as lease liability and corresponding Right of Use (RoU) Asset on the same date. The RoU Asset is depreciated under straight line method over the 5 years. The annual lease rentals are ₹ 30 Cr payable starting 31st March 20X2. The tax law permits tax deduction on the basis of payment of rent. Assuming tax rate of 30%, you are required to explain the deferred tax consequences for the above transaction for the year ended 31st March 20X2.

Solution:

A temporary difference effectively arises between the value of the machine for accounting purposes and the amount of lease liability, since the rent payment is eligible for tax deduction.

Tax base of the machine is nil as the amount is not eligible for deduction for tax purposes. Tax base of the lease liability is nil as it is measured at carrying amount less any future tax deductible amount

Recognition of deferred tax on 31st March 20X2:

Carrying amount in balance sheet	
RoU Asset (120 Cr – 24 Cr (Depreciation))	₹ 96.00 Dr
Lease Liability (120 Cr + 9.60 Cr (120 Cr x 8%) - 30 Cr)	₹ 99.60 Cr
Net Amount	**₹ 3.60 Cr**
Tax Base	₹ 0.00 Cr
Temporary Difference (deductible)	₹ 3.60 Cr
Deferred Tax asset to be recognized (₹ 3.60 Cr x 30%)	₹ 1.08 Cr

Q9:

On 1st April 20X1, P Ltd. had granted 1 Cr share options worth ₹ 4 Cr subject to a two-year vesting period. The income tax law permits a tax deduction at the exercise date of the intrinsic value of the options. The intrinsic value of the options at 31st March 20X2 was ₹ 1.60 Cr and at 31st March 20X3 was ₹ 4.60 Cr. The increase in the fair value of the options on 31st March 20X3 was not foreseeable at 31st March 20X2. The options were exercised at 31st March 20X3. Give the accounting for the above transaction for deferred tax for period ending 31st March, 20X2 and 31st March, 20X3. Assume that there are sufficient taxable profits available in future against any deferred tax assets. Tax rate of 30% is applicable to P Ltd.

Solution:

On 31st March 20X2:

The tax benefit is calculated as under:

Carrying amount of Share based payment	₹ 0.00 Cr
Tax Base of Share based payment (₹ 1.60 Cr x ½)	₹ 0.80 Cr
Temporary Difference (Carrying amount – tax base)	₹ 0.80 Cr

Deferred Tax Asset recognized (Temporary Difference x Tax rate)

(0.80 Cr x 30%) ₹ 0.24 Cr

Journal Entry for above:

Deferred Tax Asset	Dr.	₹ 0.24 Cr	
To Tax Expense			₹ 0.24 Cr

(Being DTA recognized on equity option)

On 31st March 20X3:

The options have been exercised and a current tax benefit will be available to the entity on the basis of intrinsic value of ₹ 4.60 Cr. Initially recognized deferred tax asset will no longer be required.

The accounting entry will be done as under:

Tax Expense	Dr	₹ 0.24 Cr	
To Deferred Tax Asset			₹ 0.24 Cr

(Being DTA reversed on the exercise of the option)

Q10:

On 1 April 20X1, A Ltd. acquired 12 Cr shares (representing 80% stake) in B Ltd. by means of a cash payment of ₹ 25 Cr. It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in B Ltd. at 1 April 20X1 can be used for this purpose. On 1 April 20X1, the market value of a B Ltd. share was ₹ 2.00

On 1 April 20X1, the individual financial statements of B Ltd. showed the net assets at ₹ 23 Cr.

The directors of A Ltd. carried out a fair value exercise to measure the identifiable assets and liabilities of B Ltd. at 1 April 20X1. The following matters emerged:

- ***Property having a carrying value of ₹ 15 Cr at 1 April 20X1 had an estimated market value of ₹ 18 Cr at that date.***
- ***Plant and equipment having a carrying value of ₹ 1 Cr at 1 April 20X1 had an estimated market value of ₹ 13 Cr at that date.***
- ***Inventory in the books of B Ltd. is shown at a cost of ₹ 2.50 Cr. The fair value of the inventory on the acquisition date is ₹ 3 Cr.***

The fair value adjustments have not been reflected in the individual financial statements of B Ltd. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

Calculate the deferred tax impact on above and calculate the goodwill arising on acquisition of B Ltd.

Solution:

Purchase Consideration:	₹ 25 Cr
Non-Controlling Interest [{(12 Cr x (20% / 80%)} x ₹ 2 per share]	₹ 6 Cr

Computation of Net Assets of B Ltd.

As per books	₹ 23.00 Cr
Add: Fair value differences not recognized in books of B Ltd.:	
Property (18 Cr – 15 Cr)	₹ 3.00 Cr
Plant and Equipment (13 Cr – 11 Cr)	₹ 2.00 Cr
Inventory (3 Cr – 2.5 Cr)	₹ 0.50 Cr
	₹ 28.5 Cr
Less: Deferred tax liability on fair value difference @ 20% [(3 Cr + 2 Cr + 0.50 Cr) x 20%]	(₹ 1.10 Cr)
Total Net Assets at Fair Value	**₹ 27.40 Cr**

Computation of Goodwill:

Purchase Consideration	₹ 25.00 Cr
Add: Non-Controlling Interest	₹ 6.00 Cr
	₹ 31.00 Cr
Less: Net Assets at Fair Value	(₹ 27.40 Cr)
Goodwill on acquisition date	**₹ 3.60 Cr**

Q11.

A Ltd prepares financial statements to 31 March each year. The rate of income tax applicable to A Ltd is 20%. The following information relates to transactions, assets and liabilities of A Ltd during the year ended 31 March 20X2:

i) A Ltd has a 40% shareholding in L Ltd. A Ltd purchased this shareholding for ₹ 45 Cr. The shareholding gives A Ltd significant influence over L Ltd but not control and therefore A Ltd. accounts for its interest in L Ltd using the equity method. The equity method carrying value of A Ltd's investment in L Ltd was ₹ 70 Cr on 31 March 20X1 and ₹ 75 Cr on 31 March 20X2. In the tax jurisdiction in which A Ltd operates, profits recognised under the equity method are taxed if and when they are distributed as a dividend or the relevant investment is disposed of.

ii) A Ltd. measures its head office building using the revaluation model. The building is revalued every year on 31 March. On 31 March 20X1, carrying value of the building (after revaluation) was ₹ 40 Cr and its tax base was ₹ 22 Cr. During the year ended 31 March 20X2, A Ltd charged depreciation in its statement of profit or loss of ₹ 2 Cr and claimed a tax deduction for tax depreciation of ₹ 1.25 Cr. On 31 March 20X2, the building was revalued to ₹ 45 Cr. In the tax jurisdiction in which A Ltd operates, revaluation of property, plant and equipment does not affect taxable income at the time of revaluation.

Basis the above information, you are required to compute:

a) The deferred tax liability of A Ltd at 31 March 20X2

b) The charge or credit to both profit or loss and other comprehensive income relating to deferred tax for the year ended 31 March 20X2

Solution:

A) Deferred Tax Liability as at 31st March 20X2

Investment in L Ltd:

Carrying Amount = ₹ 75 Cr

Tax base = ₹ 45 Cr (Purchase cost)

Temporary Difference = ₹ 30 Cr

Since carrying amount is higher than the tax base, the temporary difference is recognized as a taxable temporary difference. Using the tax rate of 20%, a deferred tax liability of ₹ 6 Cr is recognized:

Head office building

Carrying Amount = ₹45 Cr (Revalued amount on 31st of March 20X2)

Tax base = ₹20.75 Cr (22 Cr – 1.25 Cr)

Temporary Difference = ₹24.25 Cr

Since carrying amount is higher than the tax base, the temporary difference is recognized as a taxable temporary difference. Using the tax rate of 20%, a deferred tax liability of ₹ 4.85 Cr is created.

Total Deferred Tax Liability ₹ 6 Cr + ₹ 4.85 Cr = ₹ 10.85 Cr

B) Charge to Statement of Profit or Loss for the year ended 31st March 20X2:

Investment in L Ltd.

Particulars	Carrying Amount	Tax Base	Temp. Difference
Opening Balance (1st April 20X1)	**70**	**45**	**25**
Closing Balance (31st March 20X2)	**75**	**45**	**30**
Net Change			**5**
Increase in Deferred Tax Liability (20% tax rate)			**1**

Considering the increase in the value of investment arising through Statement of Profit or Loss, the accounting for the increase in deferred tax liability is made as under:

Tax expense (Profit or Loss Statement)	Dr	₹ 1 Cr	
To Deferred Tax Liability		₹ 1 Cr	
(Being increase in deferred tax liability recognized)			

Head Office Building:

The deferred tax liability at 31 March 20X1 is ₹ 3.6 Cr (20% x {₹ 40 Cr – ₹ 22 Cr}). At 31 March 20X2, prior to revaluation, the carrying amount of the property is ₹ 38 Cr and its tax base is ₹ 20.75 Cr (₹ 22 Cr – ₹ 1.25 Cr). The deferred tax liability at this point is ₹ 3.45 Cr (20% x {₹ 38 Cr – ₹ 20.75 Cr}).

The reduction in this liability is ₹ 0.15 Cr (₹ 3.6 Cr – ₹ 3.45 Cr). This would be credited to income tax expense in arriving at profit or loss.

Post revaluation, the carrying value of the building becomes ₹ 45 Cr and the tax base stays the same. Therefore, the new deferred tax liability is ₹ 4.85 Cr (20% x (₹ 45 Cr – ₹ 20.75 Cr)). The increase in the deferred tax liability of ₹ 1.4 Cr (₹ 4.85 Cr – ₹ 3.45 Cr) is charged to other comprehensive income.

(SOME MORE QUESTIONS FROM OTHER RESOURCES)

Q12: (Taken from CA Singapore Text Book)

The facts are as in Q7 above, except that if the asset is sold for more than cost, the cumulative tax depreciation will be included in taxable income (taxed at 30%) and the sale proceeds will be taxed at 20% after deducting an inflation-adjusted cost of Rs. 110

Solution

If the entity expects to recover the carrying amount by selling the asset immediately for proceeds of Rs. 150, the entity will be able to deduct the indexed costs of Rs. 110.
The net profit of Rs. 40 will be taxed at 20%.
In addition, the cumulative tax depreciation of Rs. 30 will be included in taxable income and taxed at 30%. On this basis, the tax base is Rs. 80 (Rs. 110 – Rs. 30), there is a taxable temporary difference of Rs. 70 and there is a deferred tax liability of Rs. 17 (Rs. 40 x 20% plus Rs. 30 x 30%).

Q13:

From the following information given below you are required to computed Deferred Tax Assets and Deferred Tax Liability for Ramanujam Ltd. as on 31st March, 2014. The tax applicable is 35%.

(1) ***The company has charged Rs. 7,42,900 in the books of accounts while as per Income Tax Computation, the depreciation available for the company is Rs. 8,65,400.***
(2) ***The Company has made provision for doubtful debts for Rs. 54,300 during the year.***
(3) ***The company has debited share issue expenses of Rs. 6,23,500 which will be available for deduction under the income tax Act from the next year.***
(4) ***The expenses of Rs. 7,84,500 has been charged to profit and loss account which are disallowed under the income tax act.***
(5) ***The company has made donation of Rs. 2,00,000 which has been debited to Profit and loss account and only 50% thereof will be allowed as deduction as per Income Tax law.***

Solution:

Particulars	Transaction Amount	Deferred Tax	Nature of DT	Effect on
Depreciation – Taxable TD	122500	42875	DTL	P&L
Provision for Doubtful Debts – Deductible TD	54300	19005	DTA	P&L
Share issue Exp. – Deductible TD	623500	218225	DTA	P&L
Exp. Disallowed – Permanent Diff.	784500	No DT	NA	NA
Donation – Permanent Diff.	100000	No DT	NA	NA

_Q13:_

Calculate Deferred Tax on following Items of PPE

Particulars	As on 1.4.21	During 21-22	During 22-23	Remarks
Opening Bal. as per Tax Records	25,00,000			Depreciation Rate – 12% (Tax)
Opening Bal. as per Books	23,30,000			Depreciation Rate – 10% (Books)
New PPE Purchased on 1.7.21	-	7,00,000	-	Tax Rate – 30%
One PPE Sold on 1/12/22	-	-	5,00,000 (sale value)	Org. Cost – 6 Lacs; WDV – 4.5 Lacs as per Books

(Suggested Answer – Opening DTA Bal. as on 1.4.21 – 51,000; Closing DTA Bal. as on 31.3.22 – 21450; Closing DTL Bal. as on 31.3.23 – 8091)

Student Notes:-

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