TOPIC 5.

INDAS – 12
INCOME TAXES

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Quote:

"Develop a passion for learning.
If you do, you will never cease to grow".

Benjamin Franklin once wrote: "In this world nothing can be said to be certain, except death and taxes". Income tax is something that can hardly be avoided by a profit-making company.

Objective of INDAS12

To prescribe accounting treatment for the income taxes

Current and future tax consequences

Transactions / other events

Future recovery (settlement) of +/-

Deferred tax

IMPORTANT DEFINITIONS

1. **Accounting income** is the net profit or loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving.

2. **Taxable income (tax loss)** is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined.

3. **Tax expense (tax saving)** is the aggregate of Current tax and Deferred tax charged or credited to the statement of profit and loss for the period.

4. **Current tax** is the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.

5. **Deferred tax** is the tax effect of Temporary differences.

6. **Temporary Differences:** is a difference between the carrying amount of an Asset or Liability and its Tax Base Balance sheet Method.

7. **Tax Base:** is the amount that will be deductible for Tax purpose. If the economic benefits will not be taxable the tax base of the asset is equal to its carrying amount.

8. **Taxable Temporary Differences:** are temporary differences that will result in taxable amounts in determining taxable profits of future periods. It arises DTL

9. **Deductible Temporary Differences:** are temporary differences that will result in amounts that are deductible in determining taxable profits of future periods. It results in DTA subject to probability.

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Let us understand the concept of TAX BASE in detail:

What is a Tax Base?

Tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes. In my opinion, this definition does not say that much, so let's explain it in a greater detail:

Tax base of an Asset

Tax base of an 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 the asset.

For example, when you have an interest receivable and interest revenue is taxed on a cash basis, then the tax base of interest receivable is 0. Why? Because when you actually receive the cash and remove the interest receivable from your books, you will need to include full amount of cash received into your tax return. At the same time you cannot deduct anything from this amount for tax purposes.

Careful about items not shown in your balance sheet!

If you review all your assets and liabilities calculating their tax bases, be careful! There could be some items not recognized in your balance sheet that still do have a tax base. For example, you might have incurred some research costs included in the profit or loss in the past that you could not deduct for tax purposes until later periods. In such a case, the research costs are not shown in your statement of financial position but they do have a tax base.

This Is What You Should Ask First

Before trying to set a tax base of any asset or liability, ask yourself these questions:

What happens when in the future I recover this asset or settle this liability and remove it from my balance sheet? Will this removal affect my tax payments in the period of recovery or settlement? In other words, will I have to make some adjustment to my accounting profit in order to arrive to taxable profit?

If the answer is yes, then the tax base of this asset or liability is for sure different from its carrying amount.

If not, then the tax base of this asset or liability equals to its carrying amount.

Now let's understand the concept of Current Tax Asset and Current Tax Liability

(a) Current tax liability

- Current tax for current and prior periods shall, **to the extent unpaid**, be recognised as a liability (also known as Provision for Tax)
- The exact liability of current tax crystallises only on preparation and finalisation of financial statements at the end of the reporting period.
- Any excess of this liability over the prepaid taxes (advance tax) and withhold taxes (TDS) is to be treated as current liability. This liability may be for the current reporting period or may relate to earlier reporting periods.

(b) Current tax assets

- If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess shall be recognised as an asset.
- Further, wherever tax loss of a reporting period could be carried backwards, the entity is eligible as per tax laws to a benefit. **The entity recognises this benefit as an asset** in the period in which the tax loss occurs because it is probable that the benefit will flow the entity and the benefit can be reliable measured.

Example:

An entity has paid a tax in the previous year on a profit of Rs. 5,00,000 and suffered a loss in the current year of Rs. 6,00,000. Such loss of Rs. 6,00,000 can be adjusted against the loss to the extent of Rs. 5,00,000 and the entity will create Tax Asset to that extent. It is called carry backward of losses. Assume Tax @ 30%

Measurement of Current Assets and Current Liabilities:

(A)

Current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted.

(B)

Enacted or substantive enacted

- The tax rates in computing the current tax should be based on taxation laws that have enacted or substantively enacted.
- A proposed legislation is enacted when all the formalities with respect to the legislation is completed. In India, the enactment occurs when the legislation is

notified in the gazette on and from the date it comes into force as mentioned in the said gazette notification.

- Implicit in the word 'substantively enacted' is the emphasis that in the relevant situation the enactment process is not fully completed. The process of enactment of a taxation laws in India is as under:
  - ✓ Finance bill is presented in Lok Sabha of Indian Parliament.
  - ✓ It is discussed and passed by the Lok Sabha.
  - ✓ It then moves to Rajya Sabha of Indian
  - ✓ It is then presented before the President for assent.
  - ✓ It is then notified in the gazette of India.

Offsetting Current Tax Assets and Current Tax Liabilities:

An enterprise should offset assets and liabilities representing tax if the enterprise:

(a) has a legally enforceable right; and

(b) intends to settle the asset and the liability on a net basis.

Note:

In consolidated financial statements, a current tax asset of one entity in a group is offset against a current tax liability of another entity in the group if, and only if, the entities concerned have a legally enforceable right to make or receive a single net payment and the entities intend to make or receive such a net payment or to recover the asset and settle the liability simultaneously.

DEFERRED TAX LIABILITY

You need to recognize deferred tax liability *for all taxable temporary differences* you discovered, **EXCEPT** for the following situations:

A. No deferred tax liability shall be recognized from initial recognition of goodwill

Example

An entity acquires a subsidiary and pays Rs 1,00,000. The fair value of net identifiable assets is Rs 65,000. The following entry shall be made in the books:

Entry 1:

Goodwill	Dr.	35,000

Net Assets Dr. 65,000

To Consideration 1,00,000

The tax base of goodwill is Rs Nil. Hence the taxable temporary difference is Rs 35,000. Assuming tax rate to be 30%, deferred tax liability of Rs 10,500 needs to be created. Now because of recognition of this deferred tax liability, the following entry needs to be passed instead of the above entry:

Entry 2:

Goodwill Dr. 45,500

Net assets Dr. 65,000

To Consideration 1,00,000

To Deferred tax liability 10,500

The temporary difference now is Rs 45,500 and not Rs 35,000 and the resultant deferred tax liability should be Rs 13,650 (45,500 x 30%) and not Rs 10,500. Thus, deferred tax liability in entry 2 should be increased by Rs 3,150 which in turn will increase goodwill by a similar amount with consequent impact on taxable temporary difference and deferred tax liability. The circle goes on. Therefore, no deferred tax liability is to be recognised in the case of taxable temporary difference arising on the initial recognition of goodwill in a business combination in tax jurisdiction where such goodwill is not tax deductible.

B. No deferred tax liability shall be recognized from initial recognition of asset or liability in a transaction that is not a business combination and at the time of the transaction it affects neither accounting nor taxable profit (loss).

Example

Entity A acquires a foreign made vehicle for Rs 1,00,000 directly from the vehicle manufacturer. The transaction is not a part of any business combination. The tax laws do not permit any depreciation thereon. Also, any profits at the time of sale are not taxable or losses are not tax deductible. This vehicle thus has a tax base of Rs Nil. There is a taxable temporary difference of Rs 1,00,000. Assuming a tax rate of 30%, the entity should create a deferred tax liability of Rs 30,000. But the Standard does not permit.

So what are the areas where we can create DTL?

The most common areas of taxable temporary differences giving rise to deferred tax liabilities are:

1. ***Timing differences*** - Timing difference arises when the recognition of certain item in the financial statements occurs in a different time than its recognition in tax return, for example, interest received is taxed deductible only when cash is received.
2. ***Business combinations*** - In a business combination identifiable assets and liabilities can be revalued ***upwards*** to fair value at the acquisition date, but no adjustment is made for tax purposes. As a result, taxable temporary difference arises.
3. ***Assets carried at fair value*** - When a company applies policy of revaluation (for example, revaluation model for property, plant and equipment in line with INDAS 16) and some assets are revalued ***upwards*** to their fair value, taxable temporary difference arises.
4. ***Initial recognition of an asset / liability*** - When an asset or liability are initially recognized in the financial statements, part or all of it could be tax-non-deductible or not taxable. In this case, deferred tax liability is recognized based on the specific situation.

Example: 1

Machine Costing Rs. 100 lakhs. Useful life = 10 years, depreciation = 10%. Tax depreciation = 20%.

At year 1 end: Book value of Machine = Rs. 90 lakhs

Tax Base of Machine = Rs. 80 lakhs therefore its Taxable Temporary difference of Rs. 10 lakhs. DTL is to be recognized.

Example: 2 (DT on revaluation of Assets)

The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if:

(a) The entity does not intend to dispose of the asset. In such cases, the revalued carrying amount of the asset will be recovered through use and this will generate

taxable income which exceeds the depreciation that will be allowable for tax purposes in future periods; or

b) Tax on capital gains is deferred if the proceeds of the disposal of the asset are invested in similar assets. In such cases, the tax will ultimately become payable on sale or use of the similar assets.

Company A buys an asset worth Rs.100 on 1st April, 2010. The useful life of the asset is five years and the tax laws allow it to be depreciated over four years. One year later, on 31st March, 2011, the Company revalue the asset to Rs.120. Tax Rate is 30%. In such a case the temporary difference will be as shown in the following Table.

Table:

Year ending March 31,	2011	2012	2013	2014	2015
Net book value	120	90	60	30	0
Tax base	75	50	25	0	0
Temporary difference	45	40	35	30	0

In the above case, the deferred tax liability created on revaluation on 31st March, 2011, of Rs.45 reverses in the subsequent periods. The accounting entry for the year 2011 would be:

Revaluation reserve (OCI) A/c Dr. 40x30%

Profit and Loss A/c Dr. 5x30%

To Deferred tax liability A/c 45x30%

Suppose on 31st March, 2013, the Company decides to sell the asset at Rs.70. In this case, there would be a gain of Rs.10 as per the books of accounts. However, the tax books will show a gain of Rs.45, thus offsetting the temporary difference of Rs.35.

Example:3 (DT on Business Combination)

- Company A buys Company B for Rs. 1,500
- Book value of assets of B = 1 000
- Fair value of assets of B = 1,200
- Goodwill = 1,500 – 1,200 = 300
- Tax Rate = 30%
- Taxable temporary difference = 1,200 – 1,000 = 200
- DTL = 200x30% =60
- Goodwill = 300 + 60 = 360

ACCOUNTING ENTRY:

Goodwill A/c Dr. 60 (200 * 30%)

To DTL A/c 60

Example: 4 (DT on Financial Instruments)

If the instrument is classified on initial recognition in two components viz. Equity and Liability then Taxable temporary difference will arise since in books liability will have lower amount and in tax base the entire amount is liability. Therefore **DTL is recognized through Equity**.

Student Notes:-

DEFERRED TAX ASSET

While you need to recognize deferred tax liability for all taxable temporary differences, here the situation is different.

A deferred tax asset shall be recognized for all deductible temporary differences ***to the extent that it is probable that taxable profit will be available*** against which the deductible temporary difference can be utilized.

No deferred tax asset shall be recognized from initial recognition of asset or liability in a transaction that is not a business combination and at the time of the transaction it affects neither accounting nor taxable profit (loss).

The most common examples of deductible temporary differences giving rise to deferred tax assets are:

1. ***Timing differences*** - Timing difference arises when the recognition of certain item in the financial statements occurs in a different time than its recognition in tax return, for example, accrued expenses are tax deductible only when paid.
2. ***Business combinations*** - In a business combination identifiable assets and liabilities can be revalued ***downwards*** to fair value at the acquisition date, but no adjustment is made for tax purposes. As a result, deductible temporary difference arises.
3. ***Assets carried at fair value*** - When a company applies policy of revaluation (for example, revaluation model for property, plant and equipment in line with IndAS16) and some assets are revalued ***downwards*** to their fair value, deductible temporary difference arises.

Example 1: Unrealized Gain on Consolidation:

- Company X (Holding) sold goods costing ₹ 60 to Company Y (Subsidiary)
- In the Standalone Balance Sheet of Y stock is shown at ₹ 100
- In the Consolidated Balance Sheet Stock will be shown at ₹ 60
- Tax base for Y is ₹ 100 and Y's Tax rate is 30%, X's Tax rate is 25%
- Deductible Temporary Difference = 100-60 = ₹ 40
- DTA = Rs.40 x 30% = ₹12

ACCOUNTING ENTRY:

Deferred Tax Asset A/c Dr. 12

To Profit and Loss A/c 12

Example 2: Research Cost:

Carrying amount is nil (because entire amount is treated as an expense to determine accounting profit) and tax base is the amount which will be deductible in future. Difference is deductible temporary difference that results in a **DTA through P&L**.

DTA ON UNUSED TAX LOSSES AND TAX CREDITS

A deferred tax asset shall be recognized for the unused tax losses carried forward 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 utilized.

However existence of Unused tax losses and tax credits is a STRONG EVIDENCE that future taxable profits may not be available.

To assess the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the entity should consider the following:

(i) whether 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;

(ii) whether it is probable that the entity will have taxable profits before the unused tax losses

or unused tax credits expire;

(iii) whether the unused tax losses result from identifiable causes which are unlikely to recur;

and

(iv) whether tax planning opportunities are available to the entity that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity.

MISC PROVISIONS ON DTA & DTL:

1. MEASUREMENT OF DEFERRED TAXES

In measuring deferred tax assets / liabilities you need to apply the tax rates that are expected to apply to the period when the asset is realized or the liability is settled. However, these expected rates need to be based on tax rates or tax laws that have been enacted or substantively enacted by the end of the reporting period.

So please, don't use some estimates of the future tax rates, as this is not allowed.

Let me also point out that the measurement of deferred tax should reflect the tax consequences that would follow from the manner of expected recovery or settlement.

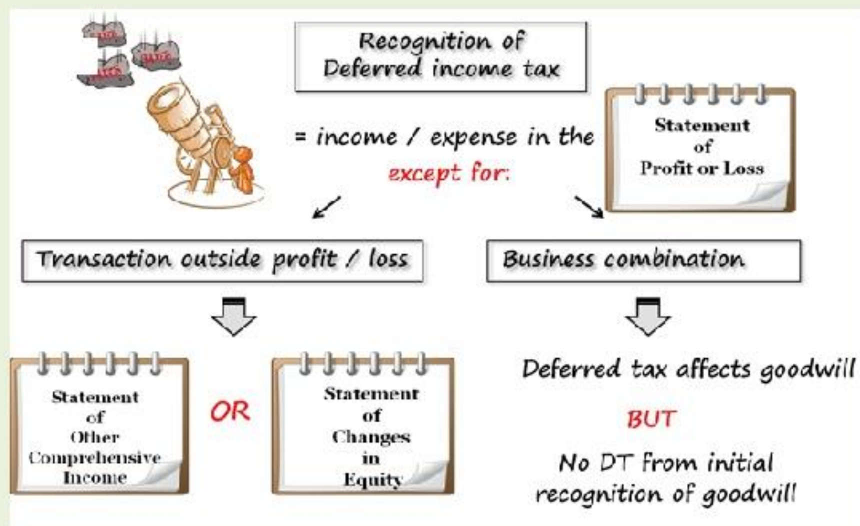
So for example, if in India, sales of property are taxed at 20% (long term gain) and other income at 30% (PGBP), then for calculation of deferred tax on your property you need to apply the tax rate based on your expected way of property's recovery – if you plan to sell it, then measure your deferred tax at 20% and if you plan to use it and then remove it, then measure your deferred tax at 30%.

2. HOW TO RECOGNIZE DEFERRED TAX ASSETS OR LIABILITIES?

In almost all situations you would recognize deferred tax as an income or an expense in profit or loss for the period. There are just 2 exceptions of this rule:

- if a deferred tax arose from a transaction or even recognized outside profit or loss, then you need to recognize deferred tax in the same way (in other comprehensive income or directly in equity)

If a deferred tax arose in a business combination, deferred tax affects goodwill or bargain purchase gain.



3. OFFSETTING DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES:

An enterprise should offset assets and liabilities representing tax if the enterprise:

(a) has a legally enforceable right; and

(b) intends to settle the asset and the liability on a net basis.

Just be careful when making consolidated financial statements because often you just cannot simply combine deferred tax assets of a parent with deferred tax liabilities of a subsidiary and present them as 1 net amount.

4. RE-ASSESSMENT OF UNRECOGNISED DEFERRED TAX ASSETS

At the end of each reporting period, an entity reassesses unrecognised deferred tax assets. The entity recognises a previously unrecognised deferred tax asset to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

DISCLOSURE

1. Components of TAX Expenses
2. Any Current Tax or Deferred Tax directly Charged to Equity (other than P&L)
3. Any Current Tax or Deferred Tax recognised in OCI (other than P&L)
4. A numerical Reconciliation between Tax Expense and the product of accounting profit multiplied by applicable tax rate.
5. A numerical Reconciliation between average effective tax rate (tax expense divided by accounting profit) and the applicable tax rate.

Example on Effective Tax Rate

An entity has made an accounting profit of Rs 1,00,000. The tax rate is 30%. In computing the accounting profit, a penalty of Rs 10,000 has been considered which is not tax deductible. There are no other tax impacts. In this case, the taxable profits are Rs 1,10,000 (Rs 1,00,000 + Rs 10,000) and tax expense @ 30% is Rs 33,000.

The two types of disclosures are as under:

Particulars	Amount (Rs)
Accounting profit	1,00,000
Tax at the applicable tax rate of 30%	30,000
Tax effect of expenses that are not deductible in determining taxable profits:-	3,000
Penalties Tax expense	33,000

The effective tax rate is as per the national income-tax rate.

Particulars	%
Applicable tax rate	30
Tax effect of expenses that are not deductible in determining taxable profits:- Penalties	3
Average effective tax rate	33

The effective tax rate is as per the national income-tax rate.

SPECIAL SITUATIONS

CASE I - CREATING DEFERRED TAX ON CAPITAL GAIN IN CASE OF INDEXATION

(a) Whenever an entity recognises an asset, it expects that it will recover the carrying value of that asset. For example, if an entity recognises an item of land at Rs 1,00,000, it expects that it will be able to recover at least Rs 1,00,000 if that land is sold is sometime in future.

(b) The income tax provisions, assuming, provides that if this piece of land is sold after one year, there will be an indexation benefit @ 10% per year. Thus, if the land is sold after one year, the cost of the land will for the purpose of taxation will be assumed at Rs 1,10,000 (Rs 1,00,000 + 10%). If it is sold after two years, the cost of the land for the purpose of taxation will be assumed at Rs 1,21,000 (Rs 1,10,000 + 10%).

(c) The tax rate in all years continues to be flat 30%.

(d) Thus, the recovery of the carrying value of land after two years will result into a tax saving of Rs 6,300 i.e. 30% of 21000 (121000-100000).

(e) Thus, if after two and half year, land is sold for Rs 1,50,000, the entity will pay a tax of Rs 8,700 at 30% of Rs 29,000 (Rs 1,50,000 – Rs 1,21,000). If there would have been no indexation benefits, the tax liability would have been Rs 15,000 at 30% of Rs 50,000 (Rs 1,50,000 – Rs 1,00,000). Saving in tax is of Rs 6,300 (15,000-8,700).

(f)The entity should recognise a deferred tax asset of Rs 6,300 in this case.

(g) This principle has to be applied to each item of asset.

Note: There are controversial view in case of Indexation of land for a temporary difference because if the land is not going to be sold in a near future particularly in business then in such case it is not advisable to calculate temporary difference.

Q7.

A Ltd purchase a Land on 1 April 1981 (when the cost inflation index was 100) for Rs 10,000. Land, being a non-depreciable asset, is not depreciated. Also, the Company does not revalue its Land. Hence, the Land is maintained by the Company at its cost, ie, Rs 10,000. However, as per the income tax law of the country, land is revalued based on the increase in the cost inflation index. As on 31 March 2016, the cost inflation index is 1081. Suggest measurement of deferred taxes. Assume tax rate of 20% on sale of land.

Solution:

Carrying value as per the books: Rs 10,000

*Tax base: 10,000*1081/100=Rs1,08,100*

Deductible Temporary difference =1,08,100-10,000=Rs 98,100

Tax Rate =20%

*Deferred Tax Assets = 98,100*20% =Rs19,620*

The effect of change in deferred tax assets shall be recognised in the profit or loss.

Note: *An entity recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary difference can be utilised. If an entity does not have plans to sell-off the land in the near-future, in the opinion of the Author, it will be difficult to assert that it is probable that sufficient taxable profits will be available in the year in which the deferred tax assets are reversed. Hence, a deferred tax asset may not be recognised.*

CASE 2 - DEFERRED TAXES ON BUSINESS COMBINATIONS

As a result of a business combination, the probability of realising a pre-acquisition deferred tax asset of the acquirer could change.

An acquirer may consider it probable that it will recover its own deferred tax asset that was not recognised before the business combination. For example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree. Alternatively, as a result of the business combination it might no longer be probable that future taxable profit will allow the deferred tax asset to be recovered. In such cases, the acquirer recognises a change in the deferred tax asset in the period of the business combination, but does not include it as part of the accounting for the business combination. Therefore, the acquirer does not take it into account in measuring the goodwill or bargain purchase gain it recognises in the business combination.

CASE 3 – CT & DT ARISING FROM SHARE BASED PAYMENT TRANSACTIONS

- *There might be a situation when entity recognize expense on share options granted to the employees in accordance with IndAS 102, and does not receive tax benefit/deduction of the same until the share options are exercised.*
- *In such a situation, DTA may be created for a difference between the TAX BASE of the employee services expenses (which are disallowed under income tax for future deduction*

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– treated as ASSET under Tax Base) and the Carrying amount of Nil, as a Deductible Temporary Difference.

- If the amount permitted as a deduction in future periods under tax laws is dependent upon the entity's share price at a future date, the measurement of the deductible temporary difference should be based on the entity's share price at the end of the period.

Q8.

X Ltd grants Employee Stock Option Plan (ESOP) to 100 employees on 1 April 2014. Employees would be required to fulfill a vesting condition (service condition) of 3 years. The options would vest on 31 March 2017. The employees exercise all the options on 31 March 2018. The fair value of the option is Rs 300 per option, ie, a total of Rs 30,000 for 100 options. As per Ind AS 102, the entity accounts for expense due to ESOP of Rs 30,000 over a period of 3 years on a straight-line basis with a corresponding effect in Equity. However, the Income Tax Law of the country allows this as deduction only when the options are exercised by the Employees, ie, on 31 March 2018. Tax rate is 30%.

Solution:

Particulars	Amount	Remarks
Carrying value of options in the books	Nil	Since no asset or liability is recognised
Tax base as on 31 March 2017	30,000	Being the amount permitted as deduction in future periods (2017-2018) under taxation laws
Deductible Temporary Difference	30,000	
Deferred Tax Assets	9,000	

CASE 4 - DISTRIBUTION OF DIVIDENDS

In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In some other jurisdictions, income taxes may be refundable or payable if part or all of the net profit or retained earnings is paid out as a dividend to shareholders of the entity. In these circumstances, current and deferred tax assets and liabilities are measured at the tax rate applicable to undistributed profits.

Example

The following example deals with the measurement of current and deferred tax assets and liabilities for an entity in a jurisdiction where income taxes are payable at a higher rate on undistributed profits (50%) with an amount being refundable when profits are distributed. The tax rate on distributed profits is 35%. At the end of the reporting period, December 31, 20X1, the entity does not recognise a liability for dividends proposed or declared after the reporting period. As a result, no dividends are recognised in the year 20X1. Taxable income for 20X1 is Rs 1,00,000. The net taxable temporary difference for the year 20X1 is Rs 40,000.

The entity recognises a current tax liability and a current income tax expense of Rs 50,000. No asset is recognised for the amount potentially recoverable as a result of future dividends. The entity also recognises a deferred tax liability and deferred tax expense of Rs 20,000 (Rs 40,000 at 50%) representing the income taxes that the entity will pay when it recovers or settles the carrying amounts of its assets and liabilities based on the tax rate applicable to undistributed profits.

Subsequently, on March 15, 20X2 the entity recognises dividends of Rs 10,000 from previous operating profits as a liability.

On March 15, 20X2, the entity recognises the recovery of income taxes of Rs 1,500 (15% of the dividends recognised as a liability) as a current tax asset and as a reduction of current income tax expense for 20X2.

CASE 5 - FINANCIAL LEASES

In some tax jurisdictions, asset is accounted for in the books of legal acquirer, even though in substance, it may be sold, ie, finance lease is accounted for as operating lease.

The total cost for both accounting and tax purposes is the same over the period of the lease; however, it may vary each year.

CASE 6 – TAX HOLIDAY PERIODS

Deferred tax calculation in case of tax holidays under Section 80-IA/80-IB of Income tax Act

Deferred tax in respect of temporary difference which reverses during the tax holiday period is not recognised to the extent of the entity's gross total income exempt during the tax holiday in accordance with s 80-IA/80-IB of the Income-tax Act, 1961.

Q9.

Y Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation temporary difference resulting in a tax liability in year 1 and 2 is Rs.200 lakhs and Rs. 400 lakhs respectively. From the third year it is expected that the temporary difference would reverse each year by Rs.10 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

Solution:

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CASE 7 – RECOGNITION OF DEFERRED TAX ASSETS/LIABILITIES IN CASE OF INVESTMENTS IN SUBSIDIARIES, BRANCHES, ASSOCIATES AND INTERESTS IN JOINT VENTURE ARRANGEMENTS:

Temporary differences arise when the carrying amount of investments in subsidiaries, branches, associates or interest in joint venture arrangements (parent or investor's share of net assets of the subsidiary, branch , associate or investee including the carrying amount of goodwill) becomes different from tax base (which is often the cost) of the investment or the interest. Such difference may arise due to:

(a) *The existence of undistributed profits of subsidiaries, branches, associates and joint arrangements;*
(b) *Changes in foreign exchanges rates when a parent or a subsidiary are based in difference countries; and*
(c) *A reduction in the carrying amount of an investment in an associate to its recoverable amount.*

For all taxable temporary difference arising from investments in subsidiaries, associates, investments in joint arrangements and branches, ***a deferred tax liability shall be recognised*** *expect to the extent that both following condition are satisfied:*

(a) *The parent, investor, joint operator or joint venture is able to control the timing of reversal of the temporary difference; and*
(b) *It is probable that the temporary difference will not reverse in the foreseeable future.*

Investments in Subsidiary:

As a parent ***control the dividend policy*** *of its subsidiary, it is able to control the timing of the reversal of temporary difference associated with that investment (including the temporary difference arising not only from undistributed profits but also from any foreign exchanges translation differences). Furthermore, it would often be impracticable to determine the amount of income taxes that would be payable when the temporary difference reverse. Therefore,* ***when the parent has determined that those profits will not be distributed in the foreseeable future the parent does not recognise a deferred tax liability.*** *The same considerations apply to investments in branches.*

Investments in Associate:

An investor in an associate **does not control that entity** and is usually not in a position to determine its dividend policy. Therefore, **in the absence of an agreement requiring that the profits of the associate will not be distributed in the foreseeable future, an investor recognise a deferred tax liability arising from temporary difference associated with its investment in the associate.** In some cases, an investor may not be able to determine the amount of tax that would be payable if it recovers the cost of its investment in an associate, but can determine that it will equal or exceed a minimum amount. In such cases, the deferred tax liability is measured at this amount.

Investment in Joint Ventures:

The arrangement between the parties to a joint arrangement usually deals with the distribution of the profits and identifies whether decisions on such matters require the consent of all the parties or a group of the parties. When the joint venturer or joint operator can control the timing of the distribution of its share of the profits of the joint arrangement and it is probable that its share of the profits will not be distributed in the foreseeable future, a deferred tax liability is not recognised.

DTA from Investments in Sub, Associates & JV

Similarly, for all deductible temporary difference arising from investments in subsidiaries, associates, investments in joint arrangements and branches, a deferred tax asset shall be recognised to the extent that it is *probable* that.

(a) The temporary difference **will reverse** in the foreseeable future; and

(b) **Taxable profit will be available** against which the temporary difference can be utilised.

IMPORTANT EXAMPLES

Example 1

Entity A has inventory with carrying amount of Rs 1,00,000 as at the reporting date. It recovers the value of inventory through sale in a subsequent reporting period. The sale value is the economic benefit derived by the entity and is taxable. However, as per the matching and other concepts, against this sale the entity is entitled to deduct its cost. The cost is the carrying amount of the inventory i.e., Rs 1,00,000. The tax base in this case is Rs 1,00,000.

Example 2

Entity A has acquired an item of asset for Rs 1,00,000 for production of certain items to be sold by the entity. It is deductible equally over two years in the books of accounts. The carrying

amount as the end of first reporting period is Rs 50,000 (Rs 1,00,000 – Rs 50,000). In the income tax, Rs 75,000 is deductible in year 1 and balance is deductible in year 2. We have to compute its tax base as on the last day of the first reporting period. However, in income-tax, it can claim only Rs 25,000 being 25% of the cost of the asset as 75% has already been claimed in year 1. Thus, the tax base in this case is Rs 25,000.

Example 3

Interest receivable have a carrying amount of 100. The related interest revenue will be taxed on a cash basis. The tax base of the interest receivable is nil.

Example 4

An entity that follows mercantile system of accounting has trade receivables of Rs 1,000. It creates a general bad debt allowance of Rs 50. The carrying amount in the books of accounts of trade receivables is thus Rs 950. However, in income-tax, general bad debt provision is not deductible. In the subsequent period, entity is able to recover only Rs 950. The amount recovered is a taxable economic benefit. But for tax purposes, entity is entitled for a deduction of Rs 1,000 against this recovery of trade receivable. The tax base is Rs 1,000.

Example 5

An entity that follows mercantile system of accounting has trade receivables of Rs 1,000. It creates a specific bad debt of Rs 50. The carrying amount in the books of accounts of trade receivables is thus Rs 950. However, in income-tax, specific bad debt provision is deductible in the very year it is created. In the subsequent period, entity is able to recover only Rs 950. The amount recovered is a taxable economic benefit. For tax purposes, entity will be entitled for a deduction of Rs 950 against this recovery of trade receivable; Rs 50 already deducted in the earlier period. The tax base is Rs 950.

- If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

It is quite feasible that in certain cases, the economic benefits that are derived from the recovery of an asset are not taxable. In these situations, the tax base of the asset is taken at its carrying amount.

Example 6

An entity has an investment in listed equity shares. There is no tax on gains that arise on sale of these listed equity shares. Thus, the tax base in this case will be the carrying amount of the investments.

Example 7

Current liabilities include accrued expenses with a carrying amount of Rs 100. The related expense will be deducted for tax purposes on a cash basis.
The tax base of the accrued expenses is nil.

Example 8

Current liabilities include accrued expenses with a carrying amount of Rs 100. The related expense has already been deducted for tax purposes.
The tax base of the accrued expenses is Rs 100.

Example 9

In the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in future periods. For example Current liabilities include interest revenue received in advance, with a carrying amount of Rs 100. The related interest revenue was taxed on a cash basis. The tax base of the interest received in advance is nil.

Example 10

Items with a tax base but no carrying amount

There are certain items that have a tax base but no carrying amount. These include items that are charged to revenue statement in the period in which they are incurred but are allowed as a deduction over a number of periods as per the taxation laws.
A Limited has been incorporated recently. It incurred Rs 1,00,000 on its incorporation. It has been charged to revenue in the very first accounting period. The taxation laws allow deduction over a period of 5 years. The carrying amount at the end of year 1 is Nil.
The tax base will be Rs 80,000 (20,000 x 4) as Rs 20,000 being 1/5th is allowable as a deduction in taxation laws over 4 years.

Example 11

An entity acquires an asset on the first day of reporting period for Rs 120 with a useful life of 6 years and no residual value. It depreciates the asset on SLM basis. The tax rate is 30%. The tax depreciation is as assumed in the computation below.
The following computations are performed.

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Financial Statements

Year	1	2	3	4	5	6
Gross Block	120	120	120	120	120	120
Cumulative Depreciation	20	40	60	80	100	120
Carrying Amount	100	80	60	40	20	0

Tax Computation

Year	1	2	3	4	5	6
Tax base brought forward	120	30	20	13	8	3
Depreciation charge (assumed)	90	10	7	5	5	3
Tax base carried forward	30	20	13	8	3	0

Temporary Difference

Year	1	2	3	4	5	6
Carrying Amount	100	80	60	40	20	0
Tax base carried forward	30	20	13	8	3	0
Temporary difference	70	60	47	32	17	0
Cumulative impact	+70	–10	–13	–15	–15	–17
	+70	–70				

Movement in Balance Sheet

Year	1	2	3	4	5	6
Temporary difference @ 30%	70	60	47	32	17	0
Deferred tax liability	21	18	14	10	5	0
Movement in provision	+21	-3	-4	-4	-5	-5
Cumulative	+21	-21				

Business combinations and consolidation

Example 12

The carrying amount of an asset is increased to fair value in a business combination and no equivalent adjustment is made for tax purposes.

Example 13

Reductions in the carrying amount of goodwill are not deductible in determining taxable profit and the cost of the goodwill would not be deductible on disposal of the business.

Example 14

Unrealised losses resulting from intragroup transactions are eliminated by inclusion in the carrying amount of inventory or property, plant and equipment.

Example 15

Retained earnings of subsidiaries, branches, associates and joint ventures are included in consolidated retained earnings, but income taxes will be payable if the profits are distributed to the reporting parent.

Example 16

Investments in foreign subsidiaries, branches or associates or interests in foreign joint ventures are affected by changes in foreign exchange rates.

Example 17

The non-monetary assets and liabilities of an entity are measured in its functional currency but the taxable profit or tax loss is determined in a different currency.

Situation	Carrying amount	Tax Base	Temporary difference	Taxable TD	Deductible TD
A machine's cost is Rs 100. Book value of machine as on 31 March 2017 is Rs 80 (cost of Rs 100 and accumulated depreciation of Rs 20). For tax purpose, depreciation of Rs 30 has already been deducted up to 31 March 2017 and the remaining carrying amount of Rs 70 will be deductible in future periods, either as depreciation or through a deduction on disposal	80	70	10	10	-

Interest receivable has a carrying amount of Rs 100. The related interest revenue will be taxed on a cash basis	100	0	100	100	-
Current liabilities include accrued expense with a carrying amount of a Rs 100. The related expense will be deducted for tax purpose on a cash basis	100	0	100	-	100
Dividend receivable from a subsidiary has a carrying amount of Rs 100. The dividends are not taxable as per tax laws of the country applicable to the Company	100	100	0	-	-
A loan receivable has a carrying amount of Rs 100. The repayment of the loan will have no tax consequences.	100	100	0	-	-
Current liabilities include accrued fines and penalties with a carrying amount of Rs 100. Fines and penalties are not deductible for tax purpose	100	100	0	-	-
Preliminary expenses of Rs 100 are recognised as an expense in determining accounting profit in the period in which they are incurred. As per the tax laws, preliminary expense are allowed as a deduction equally over five periods.	0	80	80	-	80

Hence, Rs 20 are recognised as tax expenses in the current period and the balance Rs 80 will be recognised as tax expense over the next four periods					
Current liabilities include accrued expense with a carrying amount of Rs 100. The related expense has already been deducted for tax purposes	100	100	0	-	-

QUESTIONS FROM ICAI MATERIAL:

Q10. (Module)

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, 20X1, 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.

Solution

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.

Q11. (Module)

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%.

Solution:

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 will reverse in the foreseeable future

Q12.

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%.

Solution

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%).

Q13.

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)

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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.

Solution:

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

Q14. (Module)

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 Rs 9,000. These are expected to reverse equally over next 3 years.

(b) Deductible temporary differences of Rs 4,000 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.

Solution:

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 (Rs 9,000/3)	3,000	3,000	3,000	Nil
Reversal of deductible temporary difference relating to preliminary expenses over next 4 years (Rs 4,000/4)	1,000	1,000	1,000	1,000

B Limited will recognise a deferred tax liability of Rs 2,700 on taxable temporary difference relating to accelerated depreciation of Rs 9,000 @ 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 Rs 900 (Rs 3,000 @ 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 Rs 1,000 (Rs 4,000 – Rs 3,000) of deductible temporary difference could be recognised at the 30% tax rate.

Q15.

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 la

Solution:

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Q16. RTP (MAY 18)

A's Ltd. profit before tax according to Ind AS for Year 20X1-20X2 is Rs 100 thousand and taxable profit for year 20X1-20X2 is Rs 104 thousand. The difference between these amounts arose as follows:

On 1st February, 20X2, it acquired a machine for Rs 120 thousand. Depreciation is charged on the machine on a monthly basis for accounting purpose. Under the tax law, the machine will be depreciated for 6 months. The machine's useful life is 10 years according to Ind AS as well as for tax purposes. In the year 20X1-20X2, expenses of Rs 8 thousand were incurred for charitable donations. These are not deductible for tax purposes.

You are required to prepare necessary entries as at 31st March 20X2, taking current and deferred tax into account. The tax rate is 25%.

Also prepare the tax reconciliation in absolute numbers as well as the tax rate reconciliation.

Solution:

Current tax= Taxable profit x Tax rate = Rs 104 thousand x 25% = Rs 26 thousand.

Computation of Taxable Profit:

	Rs in thousand
Accounting profit	100
Add: Donation not deductible	8
Less: Excess Depreciation	(4)
Total Taxable profit	104

	Rs in thousand	Rs in thousand
Profit & loss A/c Dr.	26	
To Current Tax		26

Deferred tax:

Machine's carrying amount according to Ind AS is Rs 118 thousand (Rs 120 thousand – Rs 2 thousand)

Machine's carrying amount for taxation purpose = Rs 114 thousand (Rs 120 thousand – Rs 6 thousand)

Deferred Tax Liability = Rs 4 thousand x 25%

	Rs in thousand	
Profit & loss A/c Dr.	1	
To Deferred Tax Liability		1

Tax reconciliation in absolute numbers:

	Rs in thousand
Profit before tax according to Ind AS	100
Applicable tax rate	25%
Tax	25
Expenses not deductible for tax purposes (8 thousand x 25%)	2
Tax expense (Current and deferred)	27

Tax rate reconciliation

Applicable tax rate	25%
Expenses not deductible for tax purposes	2%
Average effective tax rate	27%

Q17.(RTP Nov 18 & May 19)

X Ltd. prepares consolidated financial statements to 31st March each year. During the year ended31stMarch2018,thefollowing events affected the tax position of the group:

(i) Y Ltd., a wholly owned subsidiary of X Ltd., made a loss adjusted for tax purposes of Rs 30,00,000. Y Ltd. is unable to utilise this loss against previous tax liabilities. Income-tax Act does not allow Y Ltd. to transfer the tax loss to other group companies. However, it allows Y Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of X Ltd. do not consider that Y Ltd. will make taxable profits in the foreseeable future.

(ii) Just before 31st March, 2018, X Ltd. committed itself to closing a division after the year end, making a number of employees redundant. Therefore X Ltd. recognised a provision for closure costs of Rs 20,00,000in its statement of financial position as at 31stMarch, 2018. Income-tax Act allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31 March 2019, X Ltd. expects to make taxable profits which are well in excess of 20,00,000. On 31st March, 2018, X Ltd. had tax able temporary differences from other sources which were greater than Rs 20,00,000.

(iii) During the year ended 31 March 2017, X Ltd. capitalised development costs which satisfied the criteria in paragraph 57 of IndAS 38 'Intangible Assets'. Thetotal amount capitalised was Rs 16,00,000. The development project began to generate economic benefits for X Ltd. from 1stJanuary 2018. The directors of X Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31 March2018.

(iv) On 1 April 2017, X Ltd. borrowed Rs 1,00,00,000. The cost to X Ltd. of arranging the borrowing was Rs 2,00,000and this cost qualified for a tax deduction on 1 April 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31 March 2020 will be Rs 1,30,43,800. This equates to an effective annual interest rate of 10%. As per the Income-tax Act, a further tax deduction of Rs 30,43,800 will be claimable when the loan is repaid on 31st March, 2020.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of X Ltd. group at 31 March, 2018 as per Ind AS. Assume the rate of corporate income tax is 20%.

Solution:

I. The tax loss creates a potential deferred tax asset for the group since its carrying value is nil and its tax base is Rs 30,00,000.
   However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.

II. The provision creates a potential deferred tax asset for the group since its carrying value is Rs 20,00,000 and its tax base is nil.
   This deferred tax asset can be recognised because X Ltd. is expected to generate taxable profits in excess of Rs 20,00,000 in the year to 31st March, 2019.
   The amount of the deferred tax asset will be Rs 4,00,000 (Rs 20,00,000 x 20%).
   This asset will be presented as a deduction from the deferred tax liabilities caused by the (larger) taxable temporary differences.

III. The development costs have a carrying value of Rs 15,20,000 (Rs 16,00,000 – (Rs 16,00,000 x 1/5 x 3/12)).
   The tax base of the development costs is nil since the relevant tax deduction has already been claimed.
   The deferred tax liability will be Rs 3,04,000 (Rs 15,20,000 x 20%). All deferred tax liabilities are shown as non-current.

IV. The carrying value of the loan at 31st March, 2018 is Rs 1,07,80,000 (Rs 1,00,00,000 – Rs 2,00,000 + (Rs 98,00,000 x 10%)).
   The tax base of the loan is Rs 1,00,00,000.
   This creates a deductible temporary difference of Rs 7,80,000 (Rs 1,07,80,000 – Rs 1,00,00,000) and a potential deferred tax asset of Rs 1,56,000 (Rs 7,80,000 x 20%).
   Due to the availability of taxable profits next year (see part (ii) above), this asset can be recognised as a deduction from deferred tax liabilities.

Q18. (Mock Test March 19)

QA Ltd. is in the process of computation of the deferred taxes as per applicable Ind AS and wants guidance on the tax treatment for the following:

(i) QA Ltd. does not have taxable income as per the applicable tax laws, but pays 'Minimum Alternate Tax' (MAT) based on its books profits. The tax paid under MAT can be carried forward for the next 10 years and as per the Company's projections submitted to its bankers, it is in a position to get credit for the same by the end of eighth year. The Company is recognising the MAT credit as a current asset under IGAAP. The amount of MAT credit as on 31st March, 2016 is Rs. 8.5 crores and as on 31st March, 2017 is Rs. 9.75 crores;

(ii) The Company measures its head office property using the revaluation model. The property is revalued every year as on 31st March. On 31st March, 2016, the carrying value of the property (after revaluation) was Rs. 40 crores whereas its tax base was Rs. 22 crores. During the year ended 31st March, 2017, the Company charged depreciation in its Statement of Profit and Loss of Rs. 2 crores and claimed a tax deduction for tax depreciation of Rs. 1.25 crores. On 31st March, 2017, the property was revalued to Rs.45 crores. As per the tax laws, the revaluation of Property, Plant & Equipment does not affect taxable income at the time of revaluation.

The Company has no other temporary differences other than those indicated above. The Company wants you to compute the deferred tax liability as on 31st March, 2017 and the charge/credit to the Statement of Profit and Loss and/or Other Comprehensive Income for the same. Consider the tax rate at 20%.

Solution:

Computation of Deferred Tax Liability

(i) MAT credit as on 31st December of Rs. 9.75 crore will be presented in the Balance Sheet as Deferred tax asset. DTA in the current year will be Rs. 1.25 crore (Rs. 9.75 crore – Rs. 8.50 crore)

(ii)

(a) In case defer tax is created only on account of depreciation

	Carrying value without revaluation	Value as per tax records	Tax base	Taxable / (deductible) temporary difference	Total Deferred tax liability/ (asset) @ 20%	Credit to P&L during the year
A	b	c	D	E= b-d	F = e x 20%	G

31st March, 2016 .	22 crore	22 crore	22 crore	Nil	nil	Nil
Less: Depreciation for the year 2016-17	(2 crore)	(1.25 crore)				
Carrying value as on 31st March, 2017	20 crore	20.75 crore	20.75 crore	(0.75 crore)	DTA (0.15 crore)	DTA (0.15 crore)

(b) Computation of tax effect taking into account the revalued figures and adjusting impact of tax effect on account of difference in depreciation

S. No.		Carrying value after revaluation	Value as per tax records	Tax base	Taxable / (deductible) temporary difference	Total Deferred tax liability/ (asset) @ 20%	Credit to P&L during the year	Charged to OCI during the year
a		b	c	d	E= b-d	F = e x 20%	g	H
I	31st March, 2016	40 crore	22 crore	22 crore	18 crore	DTL 3.6 crore	-	DTL 3.6 crore
IV	Revalued again on 31.3.2017 (It is assumed that revaluation	45 crore	20.75 crore (22-1.25)	20.75 crore	24.25 crore	DTL 4.85 crore	DTA (0.15 crore) (Refer table (a) above)	DTL 5 crore (Refer Note below) [5 DTL (B/F) -

	has been done after taking into consideration the impact of depreciation for the current year)							0.15 DTA = 4.85 DTL]
V	Additional DTL/DTA required during the year (IV-I)					DTL 1.25 crore	DTA (0.15 crore) (Refer table (a))	DTL (1.40 crore) (Refer Note

Note:

As per para 65 of Ind AS 12, when an asset is revalued for tax purposes and that revaluation is related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects on account of revaluation of asset and the adjustment of the tax base are recognised in other comprehensive income in the periods in which they occur.

Here, it is important to understand that only the tax effects on account of revaluation of asset and the adjustment of the tax base are recognised in other comprehensive income. However, tax effects on account of depreciation of asset and the adjustment of the tax base are recognized in profit and loss.

Accordingly, first of all the tax effect has been calculated assuming that there is no revaluation (Refer Table (a) above) [Since the information for the carrying value before revaluation has not been mentioned, it is assumed to be equal to the carrying amount as per the tax records]. Later the DTA arrived due to difference in depreciation is adjusted with the DTL created due to revaluation. DTA of Rs. 0.15 crore on account of depreciation will be charged to Profit and Loss and DTL of Rs. 1.40 crore will be charged to OCI. Net effect in the year 31.3.2017 will be DTL 1.25 crore (DTL 1.4 crore – DTA 0.15 crore) [Refer Table (b) above.

Student Notes:-

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Student Notes:-

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