Income Taxes

Ind-AS 12

To be discussed....

- Scope of Ind-AS 12
- Current Tax and Deferred Tax
- Calculation of DTA and DTL
- Disclosures
- Ind-AS Vs. IFRS

Scope

Scope of Ind-AS 12

- This Standard shall be applied in accounting for income taxes
- For the purposes of this Standard, income taxes include
  - all domestic and foreign taxes which are based on taxable profits
  - taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint venture on distributions to the reporting entity
- This Standard does not deal with
  - the methods of accounting for government grants
  - investment tax credits
- However, this Standard does deal with the accounting for temporary differences that may arise from such grants or investment tax credits

Case Study 1

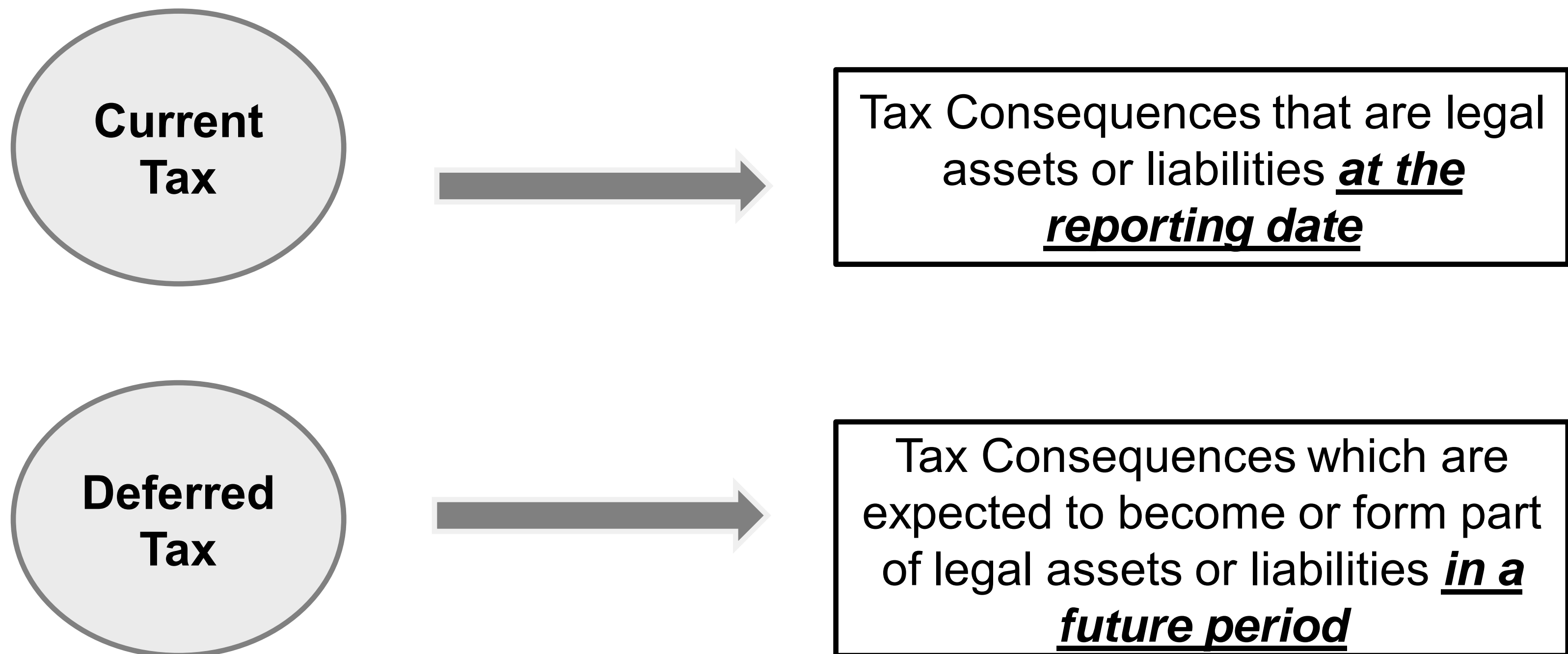
Identify if the following taxes are covered under the scope of Ind-AS 12

Tonnage Tax	No
Withholding Taxes	Yes
Wealth Tax	No
Dividend Distribution Tax	Yes

Current Tax and Deferred Tax

Current Tax and Deferred Tax

The timing of the recognition of transactions for the purpose of measuring the taxable profit is governed by the application of tax laws which might prescribe accounting treatment different from that used in financial statement. Accordingly,



Basis of Calculation – Deferred Tax

Indian GAAP

Profit and Loss A/c		Tax Profits		Timing Differences
Financial Statements	—	Tax Return	=	Deferred Tax Asset or Liability

Ind-AS

Accounting B/S		Tax B/S		Temporary Differences
Financial Statements	—	Tax Return	=	Deferred Tax Asset or Liability

Temporary vs. Timing Difference

	Financial Statements	Tax base	B/S appl'n	P/L appl'n
At 01/01/X5	15	15		
Charge for the year	(3)	(5)		2
At 31/12/X5	12	10	2	
Charge for the year	(3)	(4)		1
At 31/12/X6	9	6	3	3
Revaluation	4	-	4	-
	13	**6**	**7**	**3**

Calculation of DTA and DTL

Tax Base of An Asset

- 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

- Key Drivers
  - Timing of assessment/deduction for tax
  - Management's intention to recover the asset through either use or sale

- Tax base of non taxable items = Carrying amount

Tax Base = **Amount deductible for tax purpose against future economic benefits**

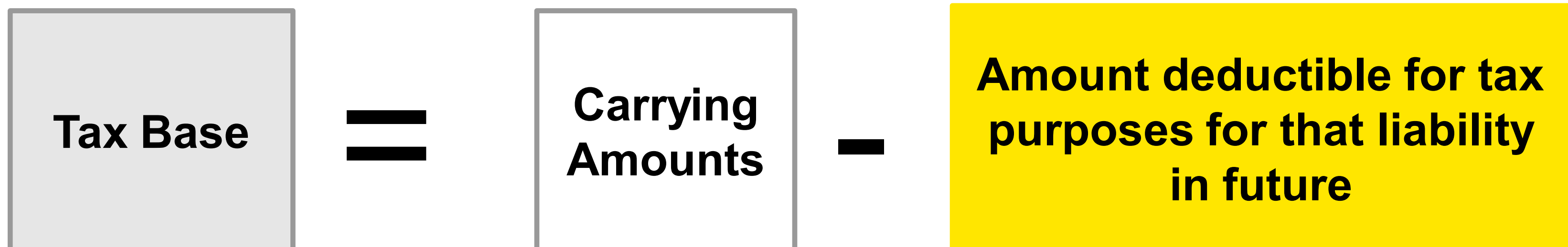
Tax Base of an Asset - Example

- A machine cost 100. For tax purposes, depreciation of 30 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the machine is taxable, any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes.

- *The tax base of the machine is 70.*

Tax Base of a Liability

- The tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods
- In case of revenue received in advance, the tax base is its carrying amount less any amount of revenue that will not be taxable in future periods
- Drivers
  - Timing of assessment/deduction for tax



Tax Base of a Liability - Example

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

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

Temporary differences

- Temporary differences are differences between the carrying amount of an asset or liability in balance sheet and its tax base.

- Temporary differences may be either:

  - Taxable temporary differences: that 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; or

  - Deductible temporary differences that 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.

Case study - 2

- An entity has an item of PP&E whose cost is fully tax deductible,
- Deductions being given over a period shorter than the period over which the asset is being depreciated under Ind-AS 16.
- At the reporting date,
  - the asset has been depreciated to CU 500,000 for financial reporting; and CU 300,000 for tax purposes.

Calculate Tax base, accounting base and temporary differences

Case Study - 3

- An entity (FY Ended : 31 December 2015) holds a medium-term cash deposit on which interest of CU 10,000 is received annually on 31 March.
- The interest is taxed in the year of receipt.
- At 31 December 2015, the entity recognises a receivable of CU 7,000 in respect of interest accrued but not yet received.

Calculate Tax base, accounting base and temporary differences

Solution -

The receivable has a tax base of nil, since its recovery has tax consequences and no tax deductions are available in respect of it. The temporary difference associated with the receivable is €7,000 (€7,000 carrying amount or accounting base less nil tax base).

Temporary differences

Temporary Difference = **Carrying Amounts** – **Tax Base**

Asset/liability	Carrying amount higher or lower than tax base?	Nature of temporary difference	Resulting deferred tax
Asset	Higher	Taxable	Liability
Asset	Lower	Deductible	Asset
Liability	Higher	Deductible	Asset
Liability	Lower	Taxable	Liability

Temporary difference example

The carrying amount of an asset is higher than its tax base

- For example, an item of PP&E is recorded in the financial statements at €8,000, but has a tax base of only €7,000. In future periods, tax will be paid on €1,000 more profit than will be recognised in the financial statements (since €1,000 of the remaining accounting depreciation is not tax-deductible).

The carrying amount of a liability is lower than its tax base

- For example, a loan payable of €100,000 is recorded in the financial statements at €99,000, net of issue costs of €1,000 which have already been allowed for tax purposes so that the loan is regarded as having a tax base of €100,000. In future periods, tax will be paid on €1,000 more profit than is recognised in the financial statements (since the €1,000 issue costs will be charged to the income statement but not be eligible for further tax deductions).

Temporary difference example

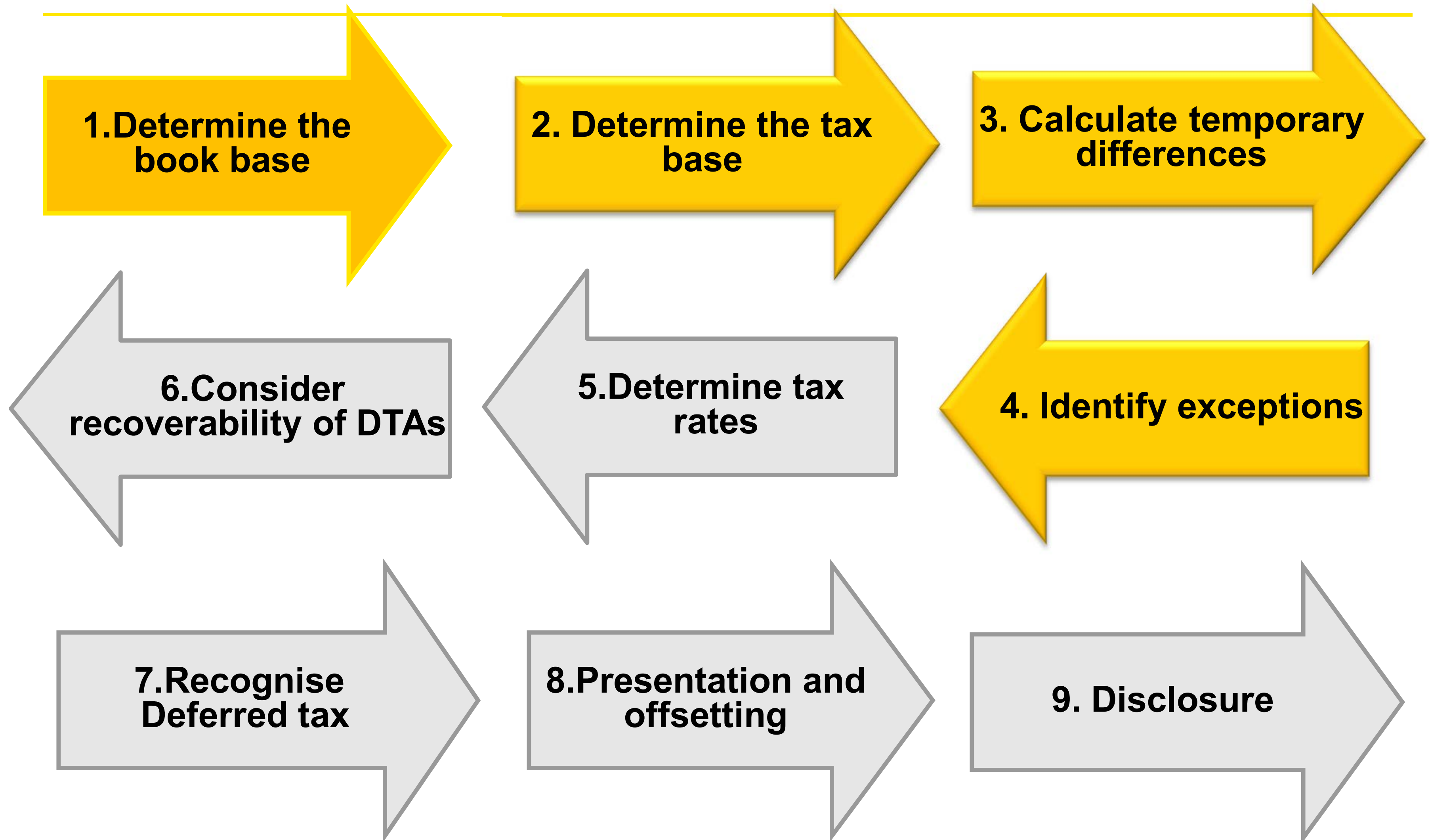
The carrying amount of an asset is lower than its tax base

- For example, an item of PP&E is recorded in the financial statements at €7,000, but has a tax base of €8,000. In future periods, tax will be paid on €1,000 less profit than is recognised in the financial statements (since tax deductions will be claimed in respect of €1,000 more depreciation than is charged to the income statement in those future periods).

The carrying amount of a liability is higher than its tax base

- For example, the financial statements record a liability for unfunded pension costs of €2 million. A tax deduction is available only as cash is paid to settle the liability so that the liability is regarded as having a tax base of nil. In future periods, tax will be paid on €2 million less profit than is recognised in the financial statements (since tax deductions will be claimed in respect of €2 million more expense than is charged to the income statement in those future periods).

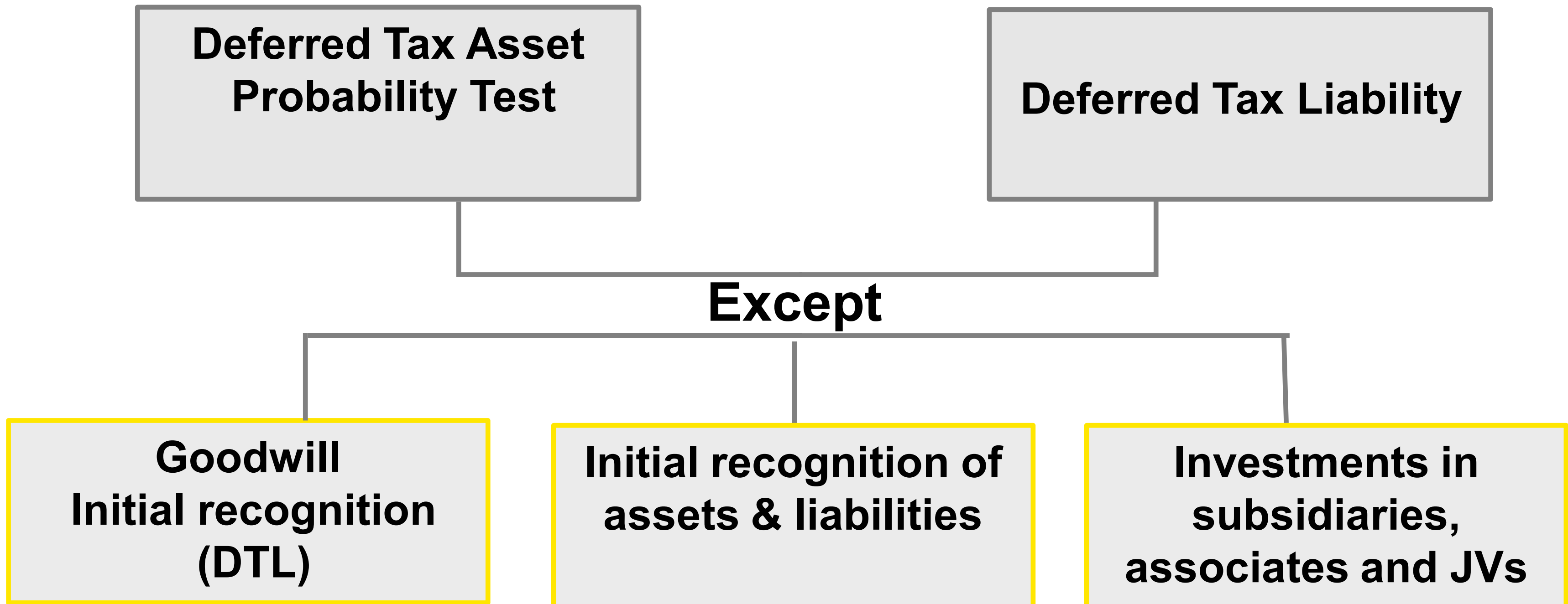
Step-wise approach to deferred tax



Temporary Differences

Temporary Differences = Difference between carrying amount and its tax base

Temporary difference gives rise to:



Goodwill Exception

- Initial recognition of goodwill
  - Recognition of deferred tax prohibited
- Subsequent treatment of non tax deductible goodwill
  - Do not recognize deferred tax
- Subsequent treatment of tax-deductible goodwill
  - Recognize deferred tax on temporary differences

Case Study 4

- Goodwill acquired in a business combination has a cost of CU100
- The above is deductible for tax purposes at a rate of 20 per cent per year starting from the year of acquisition
- There is no impairment on goodwill at the end of year 1
- Whether the company need to recognise any DTL for amortisation of goodwill?

Case Study 4- Solution

- The tax base of the goodwill is CU100 on initial recognition and CU80 at the end of the year of acquisition
- Entity would need to recognize DTL on temporary difference of CU20 since it does not relate to the initial recognition
- Difference would get reversed when amount is reduced or written off for financial reporting purposes

Initial Recognition Exception

- Do not recognize temporary differences arising on initial recognition when:
  - It arises from a transaction that is not a business combination; and
  - At the time of the transaction affects neither accounting profit nor taxable profit
    - 'accounting profit' clearly means any item recognised in total comprehensive income, whether recognised in profit or loss or in other comprehensive income.

- Limited application – mainly where assets have deemed values under tax laws

Investments in Subsidiaries, Associates and JVs

- Temporary differences must be considered at the parent & consolidated entity level

- Temporary differences may arise from:
  - Undistributed profits

- Temporary differences must be recognized subject to exceptions

Investments in Subsidiaries, Associates and JVs – DTL Exception

Recognize all taxable temporary differences except when:

- The parent controls timing of the reversal of the temporary difference (i.e., distributions); and
- It is probable that the temporary differences will not reverse in the foreseeable future

Investments in Subsidiaries, Associates and JVs – DTA Exception

Recognize only to the extent that it is probable that:

- The temporary difference will reverse in the foreseeable future; and
- Taxable profit will be available against which the temporary difference can be used

Investments in Subsidiaries, Associates and JVs – DTA Exception

- As a parent controls dividend policy of its subsidiary, it is able to control the timing of the reversal of temporary differences associated with that investment.
- When the parent has determined that undistributed profits of subsidiaries will not be distributed in the foreseeable future the parent does not recognize a deferred tax liability
- The same considerations are applicable to investment in branches as well
- If the entity's taxable profit or tax loss is determined in a different currency (for consolidation), changes in the exchange rate give rise to temporary differences that result in recognized deferred tax liability or asset.
- The resulting deferred tax is charged or credited to profit or loss/equity.

Case Study 5

- On 1 January 2014 entity H acquired 100% of the shares of entity S, whose functional currency is different from that of H, for INR600m. The tax rate in H's tax jurisdiction is 30% and the tax rate in S's tax jurisdiction is 40%.

- The fair value of the identifiable assets and liabilities (excluding deferred tax assets and liabilities) of S acquired by H is set out in the following table, together with their tax base in S's tax jurisdiction and the resulting temporary differences (all figures in INR millions).

Particulars	Fair value	Tax base	(taxable)/deductible temporary difference
PP&E	270	155	(115)
Accounts receivable	210	210	-
Inventory	174	124	(50)
Retirement benefits obligation	(30)	-	30
Accounts Payable	(120)	(120)	-
Fair value of net assets excluding goodwill	504	369	(135)

Case Study 5

Fair value of net assets acquired		504
Deferred tax:	135 * 40%	(54)
Fair value of net assets		450
Goodwill (bal. fig.)		150
Carrying amount		600

- No deferred tax is recognized on the goodwill, in accordance with the requirements of Ind-AS 12

- At the date of combination, the tax base, in H's tax jurisdiction, of H's investment in S is INR600 million. Therefore, in H's jurisdiction, no temporary difference is associated with the investment, either in the consolidated financial statements of H (where the investment is represented by net assets and goodwill of INR600 million), or in its separate financial statements (where the investment is shown as an investment at cost of INR600 million).

Case Study 5

- As at year end December 2014, H's consolidated financial statements the carrying value of its investment in S is INR645 million, comprising

		INR Million
Carrying amount		600
Retained profit	70	
Exchange loss		(15)
Impairment of goodwill		(10)
Carrying amount as on 31.12.14		645

Consolidated Financial statement:

Assuming that the tax base in H's jurisdiction remains INR600 million, there is a taxable temporary difference of INR45 million (carrying amount INR645m less tax base INR600m) associated with S in H's consolidated financial statements.

Whether or not any deferred tax is required to be provided for on this difference –

Irrespective of whether provision is made for deferred tax, H would be required to make disclosures in respect of this difference .

Case Study 5

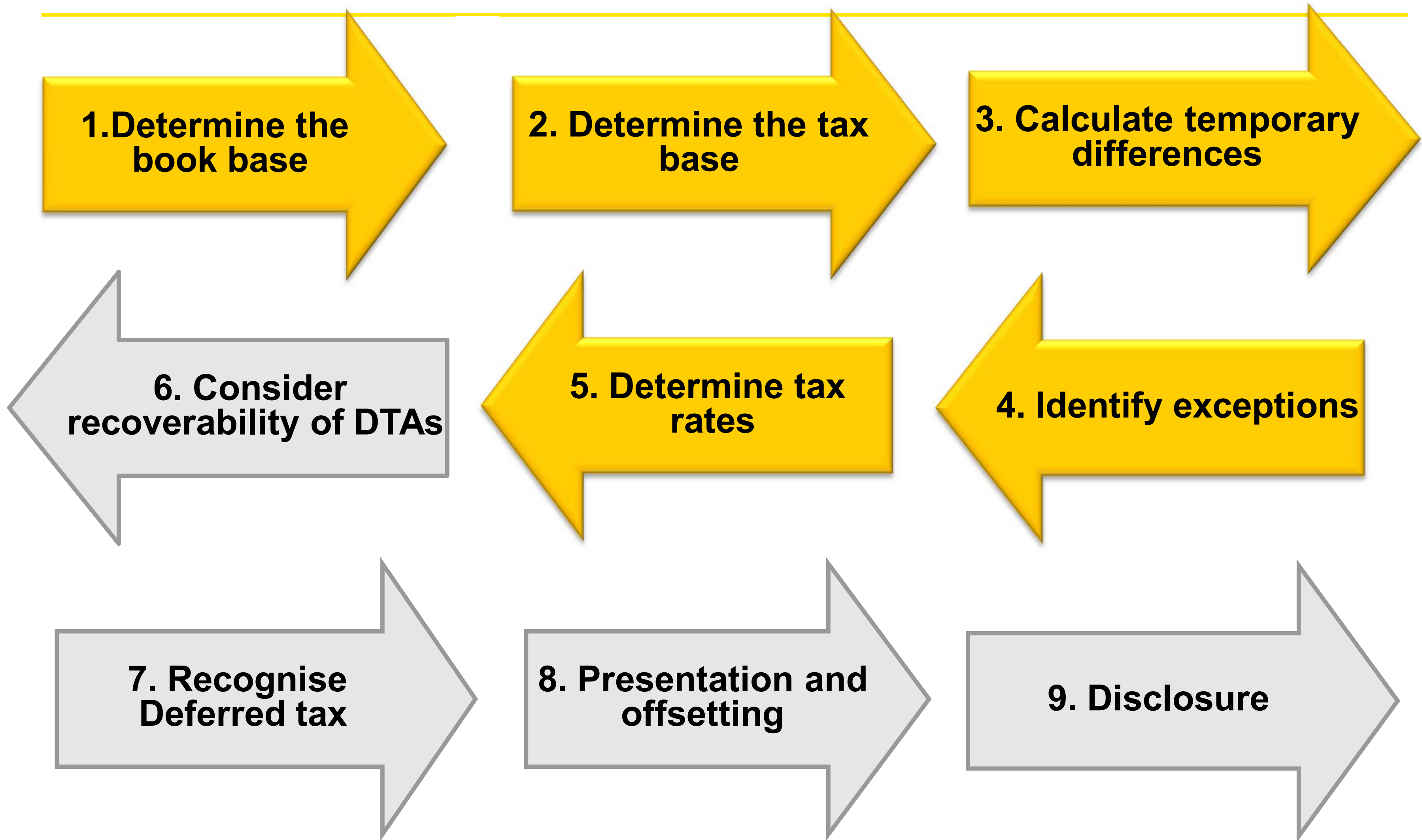
Separate Financial statement:

Ind - AS 27 – Consolidated and Separate Financial Statements – allows entities the choice of accounting for investments in group companies at either cost (less impairment) or at fair value. The amount of any temporary difference in H's separate financial statements would depend on the accounting policy adopted in those statements

- If, in its separate financial statements, H accounts for its investment at cost of INR600 million, there would be no temporary difference associated with S in H's separate financial statements, since the carrying amount and tax base of S would both be INR600 million
- If, however, in its separate financial statements, H accounts for its investment at its fair value of INR660 million (considering no impairment), there would be a taxable temporary difference of INR60 million (carrying amount INR660m less tax base INR600m) associated with S in H's separate financial statements.

Whether or not any deferred tax is required to be provided for on this difference – Irrespective of whether provision is made for deferred tax, H would be required to make disclosures in respect of this difference

Step-wise approach to deferred tax



Measurement – Tax Rates

- 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 or substantively enacted by the end of the reporting period

- Deferred tax assets and liabilities shall be measured
  - at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled
  - based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period

Measurement – Tax Rates

- When different tax rates apply to different levels of taxable income measurement will be based on average rates expected to apply in the periods in which the temporary differences are expected to reverse.

- The measurement shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities

Tax Rates - Example

- An item of property, plant and equipment has a carrying amount of 100 and a tax base of 60. A tax rate of 20% would apply if the item were sold and a tax rate of 30% would apply to other income.

- *The entity recognises a deferred tax liability of 8 (40 at 20%) if it expects to sell the item without further use and a deferred tax liability of 12 (40 at 30%) if it expects to retain the item and recover its carrying amount through use.*

Case Study 6

- An asset was acquired at a cost of Rs.1500
- The carrying amount is Rs.700 after an impairment write down of Rs.300 & cumulative depreciation of Rs.500.
- Tax rate is 30%
- What is the Deferred Tax?

Case Study 6 - Solution

Carrying Amount	Carrying Amount	Tax Base	Temporary Difference
At acquisition	1500	1500	Nil
Accumulated Depreciation	(500)	(500)	Nil
Impairment Loss	(300)	Nil	(300)
Tax Rate	-	-	30%
DTA	-	-	90

Compound instrument - example

An entity issues a zero-coupon convertible loan of €1,000,000 on 1 January 2018 repayable at par on 1 January 2021. In accordance with Ind AS 32, the entity classifies the instrument's liability component as a liability and the equity component as equity. The entity assigns an initial carrying amount of €750,000 to the liability component of the convertible loan and €250,000 to the equity component. Subsequently, the entity recognises the imputed discount of €250,000 as interest expense at the effective annual rate of 10% on the carrying amount of the liability component at the beginning of the year. The tax authorities do not allow the entity to claim any deduction for the imputed discount on the liability component of the convertible loan. The tax rate is 40%.

Compound instrument – example solution

Temporary differences arise on the liability element as follows (all figures in € thousands).

	1.1.18	31.12.18	31.12.19	31.12.20
Carrying value of liability component	750	825	908	1,000
Tax Base	1,000	1,000	1,000	1,000
Taxable temporary difference	250	175	92	-
Deferred Tax Liability @ 40%	100	70	37	-

Example

A company is a first-time adopter of Ind AS. It has opted for exemption under paragraph D7AA of Ind AS 101, First-time Adoption of Indian Accounting Standards and also elected the cost model under Ind AS 16, Property, Plant and Equipment for subsequent measurement. On the date of transition to Ind AS:

(i) What will be the accounting treatment of the balance outstanding in the "Revaluation Reserve" created as per previous GAAP.

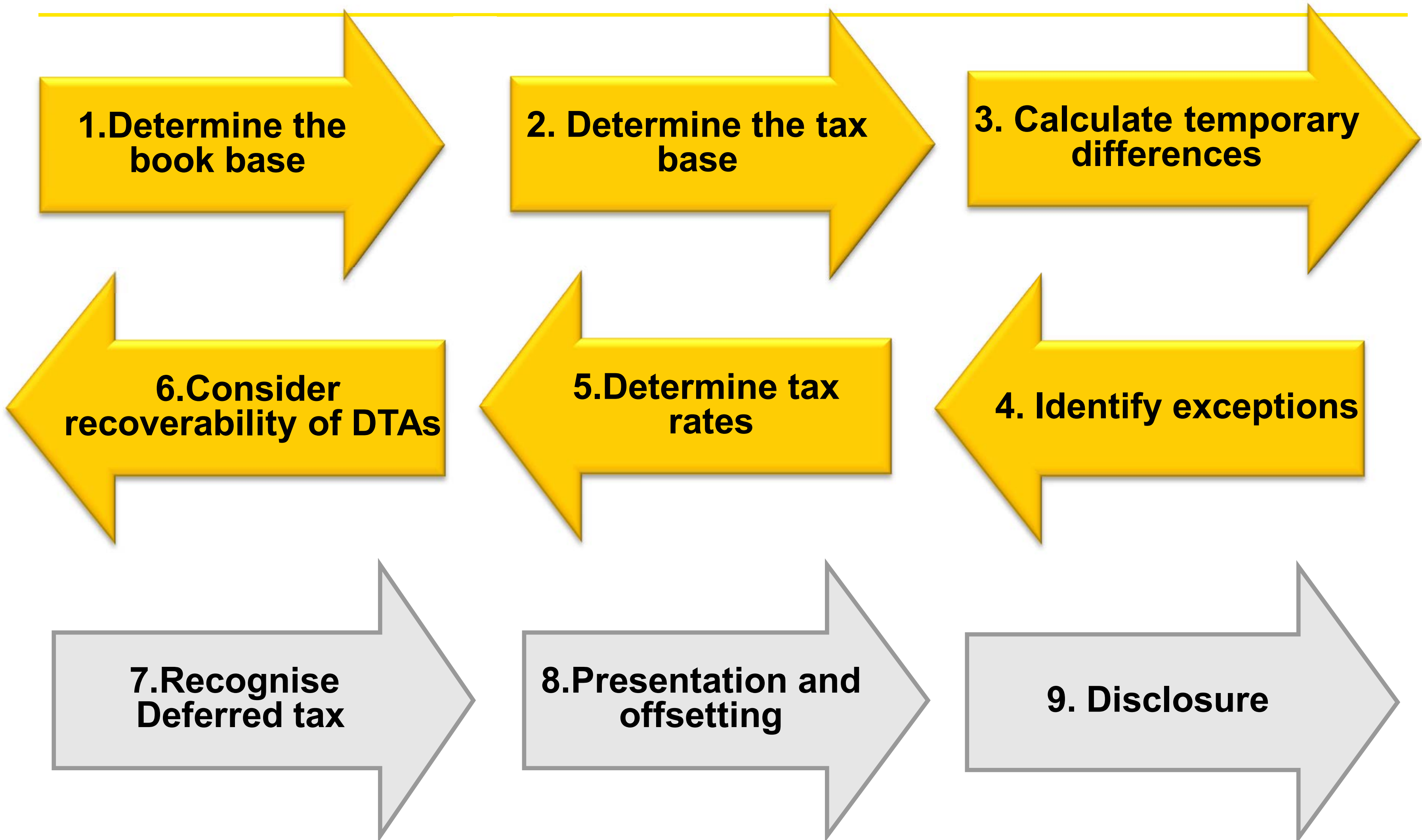
(ii) What will be the treatment of deferred tax on this transition revaluation reserve?

Solution

- In the given case balance outstanding in the revaluation reserve should be transferred to retained earnings or if appropriate, another category of equity disclosing the description of the nature and purpose of such amount in accordance.

- Further, it may also be noted that in accordance with Ind AS 12, *Income Taxes*, deferred tax would need to be recognised on any difference between the carrying amount and tax base of assets and liabilities. No deferred tax is created on equity components. However, since the asset has been revalued, there will be difference for the amount between carrying value and tax base. Hence, deferred tax will have to be recognised on such asset.

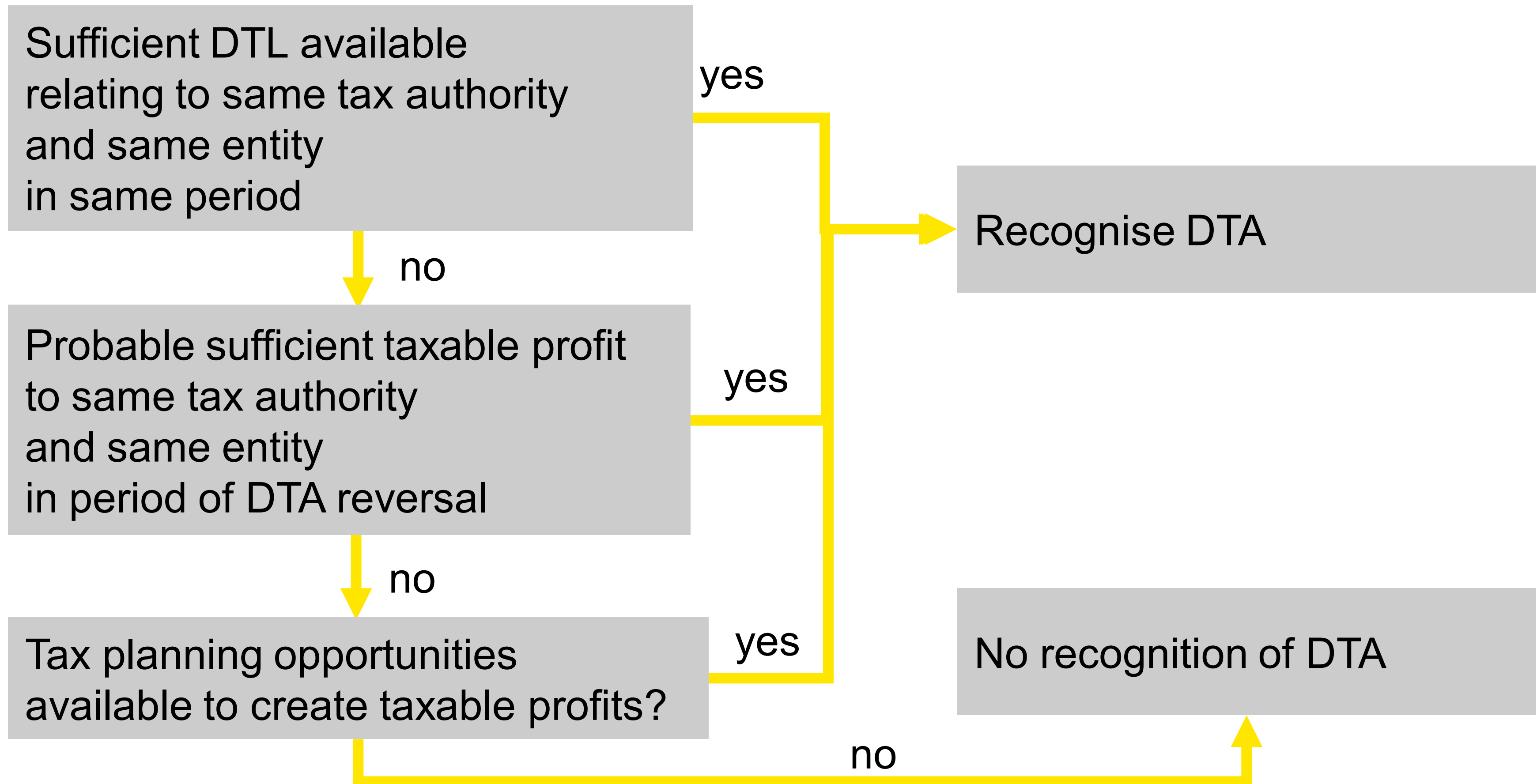
Step-wise approach to deferred tax



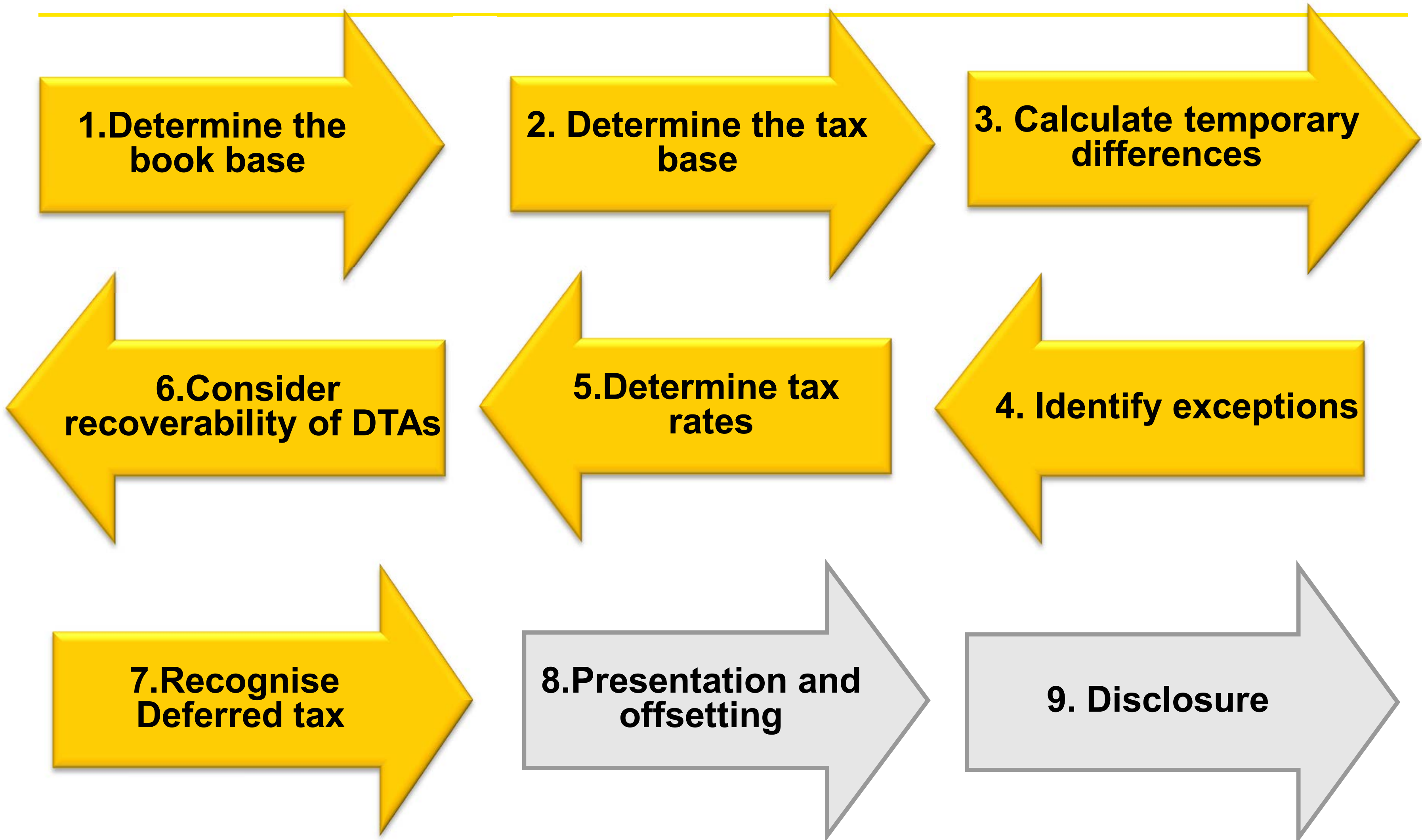
General recognition criteria for deductible temporary differences and tax losses

- DTA should be recognised to the extent it is probable that taxable profit will be available against which the deductible temporary difference can be utilised
- Probable is not defined in Ind-AS 12 but is interpreted as *"more likely than not"*
- Review of carrying amount of a DTA at each reporting date
- Reassessment of unrecognized DTAs at each reporting date
- Discounting prohibited

General recognition criteria for deductible temporary differences and tax losses



Step-wise approach to deferred tax



Recognition and reversal of tax effects through the P&L or Equity

Recognition

- Shall be recognised as income or expense, except to the extent that the tax arises from a:
  - transaction or event which is or was recognised directly in equity; or
  - business combination

Reversal

- Tax effect follows recognition of initial transaction
- Tax stays in equity until the underlying transaction impacts the P&L (i.e., until sale or derecognition)

Presentation and Disclosure

- DTA and DTL as well as current tax assets and liabilities should be presented separately from other assets and liabilities in the balance sheet.

- DTA and DTL should not be classified within current assets and liabilities

- Disclose separately the followings
  - the amount (and expiry date, if any) of the following for which no deferred tax asset is recognised in the statement of financial position
    - deductible temporary differences
    - unused tax losses
    - unused tax credits;

Presentation of Interest & Penalties

- Interest and penalties levied under Income Tax Act, not deductible in determining taxable income can be treated;
  - As part of the tax charge; or
  - As expense in arriving at profit before tax
- Entities should determine their accounting policy for such items and apply it consistently
- If, however, under some tax legislations, such interest and penalties are tax-deductible, it is generally appropriate to treat them as an expense in arriving at profit before tax.

Presentation and Disclosure

- The aggregate amount of temporary differences associated with the investments in the followings for which deferred tax liabilities have not been recognised
  - Investments in subsidiaries
  - Branches
  - Associates
  - Interests in joint ventures

- The amount of income tax consequences of dividends to shareholders that were proposed or declared before the financial statements were authorised for issue, but are not recognised as a liability in the financial statements

Presentation and Disclosure

- An explanation of the relationship between tax expense (income) and accounting profit in either or both of the following forms:
  - a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s)
  - disclosing also the basis on which the applicable tax rate (s) is (are) computed;

  or
- A numerical reconciliation between the average effective tax rate and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed;

- Disclose tax-related contingencies in accordance with Ind-AS 37

Sample : Reconciliation of tax expense

Reconciliation of tax expense and the accounting profit multiplied by Euroland's domestic tax rate for 2013 and 2014:

	2014	2013
	€000	€000
Accounting profit before tax from continuing operations	11,108	8,880
Profit/(loss) before tax from a discontinued operation	213	(193)
Accounting profit before income tax	**11,321**	**8,687**
At Euroland's statutory income tax rate of 30% (2013: 30%)	3,396	2,606
Adjustments in respect of current income tax of previous years	(18)	(44)
Government grants exempted from tax	(316)	(162)
Utilisation of previously unrecognised tax losses	(231)	(89)
Share of results of associates and joint ventures	(313)	(307)
Non-deductible expenses for tax purposes:		
Impairment of goodwill	60	–
Contingent consideration remeasurement (Note 7)	107	–
Other non-deductible expenses	10	–
Effect of higher tax rates in the United States	396	224
At the effective income tax rate of 27% (2013: 28%)	**3,091**	**2,228**
Income tax expense reported in the statement of profit or loss	3,098	2,233
Income tax attributable to a discontinued operation	(7)	(5)
	3,091	**2,228**

Indian GAAP Vs. Ind-AS

	Indian GAAP	Ind-AS
Income taxes – Classification	Schedule III requires net deferred tax assets and net deferred tax liabilities to be presented as part of non-current assets and non-current liabilities respectively	Always classified as non-current.
Income Tax – Disclosure	Certain additional disclosures like rate reconciliation, tax holidays and their expiry and unrecognized deferred tax liability on undistributed earnings of subsidiaries, branches, associates and joint ventures are not required.	Such disclosures are required under Ind-AS

Indian GAAP Vs. Ind-AS

	Indian GAAP	Ind-AS
Recovery of revalued non-depreciable assets	Revaluation is treated as permanent difference and hence no DT impact is given	Measurement of DTL or DTA arising from revaluation is based on the tax consequences from the sale of assets rather than use.

Indian GAAP Vs. Ind-AS

	Indian GAAP	Ind-AS
Recognition of DTA	Deferred tax asset for unused tax losses and unabsorbed depreciation is recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised. Deferred tax asset for all other unused credits/timing differences is recognised only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised	DTA should recognised to the extent that it is probable that future profits will be available against which the deductible temporary differences can be utilised.

Indian GAAP Vs. Ind-AS

	Indian GAAP	Ind-AS
Recognition of DT on items recognised in OCI or directly in equity	No Specific guidance in AS 22. However, an announcement made by the ICAI requires any expenses charged directly to reserves and/or securities premium account to be net of tax benefits expected to arise from the admissibility of such expenses for tax purpose	Current tax and DT is recognised outside profit or loss if the tax relates to items that are recognised in the same or a different period outside profit or loss

Indian GAAP Vs. Ind-AS

	Indian GAAP	Ind-AS
Recognition of DT on investments in subsidiaries, associates and joint ventures	DT is not recognised.	DTL should be recognised for all taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, if certain conditions are not satisfied.
DT on elimination of intra-group transactions	DT is not recognised. The DT in CFS is a simple aggregation of the deferred tax recognised by the group entities.	DT should be recognised on temporary differences that arise from the elimination of profit and losses resulting from the intra-group transactions.
Recognition of DT when tax reporting currency is not the functional currency	No DT is recognised	DT is recognised on the differences between the carrying amount determined using the historical rate of exchange and the tax base determined using the balance sheet date exchange rate.

Key Considerations / Impact of Ind-AS 12

- Prepare a tax balance sheet
- Consider Timing vs Temporary differences for calculation of deferred taxes
- Evaluate the implications of initial recognition exemptions
  - Goodwill
  - Initial recognition of Asset & Liabilities
  - Investment in Subsidiaries / JV and Associates
- Recognition and measurement of uncertain tax positions
- Disclose Tax Recompilation and tax effective rate

Thank you