Educational Material on Ind AS 12, Income Taxes

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Accounting Standards Board
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Basic draft of this publication was prepared by CA. Ashish Bansal and CA. Mahendra Sharma

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Foreword

The adoption of global financial reporting standards has propelled nations towards harmonising their accounting principles with international norms. In India, the advent of Indian Accounting Standards (Ind AS) has led to greater transparency and consistency in financial reporting. Among these standards, Ind AS 12, *Income Taxes*, stands tall as a cornerstone for addressing income taxes in financial reporting.

It is with great pleasure to know that the Accounting Standards Board of ICAI is bringing out Educational Material on Ind AS 12, *Income Taxes*. Understanding the nuances of income tax accounting is essential for stakeholders to interpret financial information accurately, assess a company's tax position effectively, and make informed decisions. This educational material is a testament to the collaborative efforts of experts in the field who have put in their knowledge and experience into a comprehensive resource. From elucidating the fundamental concepts of income taxes to delving into the intricacies of deferred tax assets and liabilities, this publication offers clarity amidst complexity. Moreover, the summary and FAQs contained in this will bridge the gap between theory and application; facilitating a deeper understanding of principles of Ind AS 12 and their real-world implications.

I sincerely acknowledge the efforts of CA. Pramod Jain, Chairman, CA. Abhay Chhajed, Vice-Chairman, and all other Members of the Accounting Standards Board for bringing out this Educational Material.

I am confident that this Educational Material will help members to navigate the complexities of income tax accounting with confidence and clarity thereby fostering excellence in financial reporting practices.

5th February, 2024 **CA. Aniket Sunil Talati**
President, ICAI

Preface

Accounting practices in India have undergone a significant transformation owing to convergence with the globally recognised International Financial Reporting Standards (IFRS). This convergence has garnered widespread support from diverse stakeholders, facilitating a seamless implementation process. A robust understanding of accounting principles and proper implementation of these standards lay the groundwork for the advancement and prosperity of business entities and the overall economy.

As a crucial contributor to nation-building, ICAI spearheads the formulation of Accounting Standards through a rigorous, comprehensive, and inclusive process. With a keen eye on the broader interests of the Indian economy and industries, ICAI, through its Accounting Standards Board (the Board), undertakes various initiatives to educate accounting professionals, raise awareness, and offer essential guidance to its members and other stakeholders. This ensures that the Standards are implemented in alignment with their intended spirit. In its commitment to achieving high-quality, effective, and efficient implementation, the Board continuously develops and disseminates implementation guidance, including Educational Materials on Ind AS, addressing a spectrum of technical issues.

It is with great pleasure that I present this Educational Material on Ind AS 12, *Income Taxes* formulated to offer clarity, insight, and practical guidance to practitioners, educators, and other stakeholders on the application of principles of Ind AS 12. Ind AS 12 seeks to provide a structured framework for recognising and measuring income taxes, ensuring that financial statements accurately reflect an entity's tax obligations and the associated impacts on its financial performance and position. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's balance sheet; and transactions and other events of the current period that are recognised in an entity's financial statements. This Educational Material is designed to offer a comprehensive assessment of Ind AS 12 and its practical implications.

I would like to place on record my heartfelt gratitude to the Hon'ble President, CA. Aniket Sunil Talati, for his invaluable guidance in ensuring the efficient and effective functioning of the Board. I am also grateful to CA. Ranjeet Kumar Agarwal, Vice-President, for his constant support and to CA. Abhay Chhajed, Vice-Chairman of the Board, for his untiring dedication to the Board's effectiveness and for leading the Study Group. I extend my thanks to all members of the Board for their significant contributions to the various initiatives undertaken by the Board.

I extend my sincere appreciation to CA. Ashish Bansal alongwith CA. Mahendra Sharma, for their unwavering commitment in drafting this material. I am also thankful to other members of the Study Group, namely Dr. Avinash Chander, CA. Archana Bhutani, CA. Anand Banka, CA. Diwas Gupta and CA. Chandni Gupta for their active contribution to this endeavour.

I would like to acknowledge the sincere efforts and support of CA. S.N. Gupta, Head, Technical Directorate, CA. Parminder Kaur, Secretary to the Board and CA. Prachi Jain, Assistant Secretary for their valuable technical contribution in bringing out this Educational Material.

I am sure that readers will be equipped with the knowledge and skills necessary to navigate the intricacies of income tax accounting with confidence and proficiency.

New Delhi
January 31, 2024

CA. Pramod Jain
Chairman
Accounting Standards Board

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I. SUMMARY

[The purpose of this summary is to help the reader gain a broad understanding of the principal requirements of Ind AS 12 (or 'the Standard'). Reference should be made to the complete text of the Standard for a complete understanding of these requirements or in dealing with a practical situation.]

Introduction and Background

Ind AS 12 prescribes the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of:

(a) the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's balance sheet; and

(b) transactions and other events of the current period that are recognised in an entity's financial statements.

It is inherent in the recognition of an asset or liability that the reporting entity expects to recover or settle the carrying amount of that asset or liability. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, this Standard requires an entity to recognise a deferred tax liability (deferred tax asset), with certain limited exceptions.

Ind AS 12 also deals with the recognition of deferred tax assets arising from unused tax losses or unused tax credits, the presentation of income taxes in the financial statements and the disclosure of information relating to income taxes.

Ind AS 12 is based on balance sheet approach. It requires recognition of tax consequences of difference between the carrying amounts of assets and liabilities and their tax base.

Scope

Ind AS 12 is 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. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.

Ind AS 12 does not deal with the methods of accounting for government grants (see Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance) or investment tax credits. However, this Standard does deal with the accounting for temporary differences that may arise from such grants or investment tax credits.

Definitions

Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.

Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of:

(a) deductible temporary differences;

(b) the carryforward of unused tax losses; and

(c) the carryforward of unused tax credits.

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

(a) **taxable temporary differences**, which are 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 (

(b) **deductible temporary differences**, which are 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.

The **tax base** of an asset or liability is the amount attributed to that asset or liability for tax purposes.

Tax expense (tax income) comprises current tax expense (current tax income) and deferred tax expense (deferred tax income).

Tax Base

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

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 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.

Recognition of current tax liabilities and current tax assets

Current tax for current and prior periods shall, to the extent unpaid, be recognised as a liability. 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.

Recognition of deferred tax liabilities and deferred tax assets

Taxable temporary differences

A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction which is not a business combination; at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); and at the time of the transaction, does not give rise to equal taxable and deductible temporary differences. However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax liability shall be recognised in accordance with the paragraphs mentioned below.

It is inherent in the recognition of an asset that its carrying amount will be recovered in the form of economic benefits that flow to the entity in future periods. When the carrying amount of the asset exceeds its tax base, the amount of taxable economic benefits will exceed the amount that will be allowed as a deduction for tax purposes. This difference is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability.

Deductible temporary differences

A deferred tax asset shall be recognised 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 utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that is not a business combination; at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); and at the time of the transaction, does not give rise to equal taxable and deductible temporary differences. However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with the paragraphs mentioned below.

It is inherent in the recognition of a liability that the carrying amount will be settled in future periods through an outflow from the entity of resources embodying economic benefits. When resources flow from the entity, part or all of their amounts may be deductible in determining taxable profit of a period later than the period in which the liability is recognised. In such cases, a temporary difference exists between the carrying amount of the liability and its tax base.

A transaction that is not a business combination may lead to the initial recognition of an asset and a liability and, at the time of the transaction, affect neither accounting profit nor taxable profit. For example, at the commencement date of a lease, a lessee typically recognises a lease liability and the corresponding amount as part of the cost of a right-of-use asset. Depending on the applicable tax law, equal taxable and deductible temporary differences may arise on initial recognition of the asset and liability in such a transaction. The exemption provided in above paragraphs does not apply to such temporary differences and an entity recognises any resulting deferred tax liability and asset.

An entity recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised.

When an entity assesses whether taxable profits will be available against which it can utilise a deductible temporary difference, it considers whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. If tax law imposes no such restrictions, an entity assesses a deductible temporary difference in combination with all of its other deductible temporary differences. However, if tax law restricts the utilisation of losses to deduction against income of a specific type, a deductible temporary difference is assessed in combination only with other deductible temporary differences of the appropriate type.

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

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

An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, except to the extent that both of the following conditions are satisfied:

- the parent, investor, joint venturer or joint operator is able to control the timing of the reversal of the temporary difference; and
- it is probable that the temporary difference will not reverse in the foreseeable future.

An entity shall recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint arrangements, to the extent that, and only to the extent that, it is probable that the temporary difference will reverse in the foreseeable future; and taxable profit will be available against which the temporary difference can be utilised.

Measurement

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.

The measurement of deferred tax liabilities and deferred tax assets 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.

Deferred tax assets and liabilities shall not be discounted.

The carrying amount of a deferred tax asset shall be reviewed at the end of each reporting period. An entity shall reduce the carrying amount of a deferred tax asset to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of the deferred tax asset to be utilised. Any such reduction shall be reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Presentation

An entity shall offset current tax assets and current tax liabilities if, and only if, the entity has a legally enforceable right to set off the recognised amounts; and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:

(a) the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and

(b) the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:

   (i) the same taxable entity; or

   (ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

The major components of tax expense (income) shall be disclosed separately.

Income Taxes-Changes in the tax status of an Entity or its shareholders

Appendix A of Ind AS 12 addresses how an entity should account for the tax consequences of a change in its tax status or that of its shareholders. The Appendix prescribes that a change in the tax status of an entity or its shareholders does not give rise to increases or decreases in amounts recognised outside profit or loss. The current and deferred tax consequences of a change in tax status shall be included in profit or loss for the period, unless those consequences relate to transactions and events that result, in the same or a different period, in a direct credit or charge to the recognised amount of equity or in amounts recognised in other comprehensive income. Those tax consequences that relate to changes in the recognised amount of equity, in the same or a different period (not included in profit or loss), shall be charged or credited directly to equity. Those tax consequences that relate to amounts recognised in other comprehensive income shall be recognised in other comprehensive income.

Uncertainty over Income Tax Treatments

Appendix C of this Standard clarifies how to apply the recognition and measurement requirements in Ind AS 12 when there is uncertainty over income tax treatments. This standard requires an entity to determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments based on which approach better predicts the resolution of the uncertainty.

In assessing whether and how an uncertain tax treatment affects the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, an entity shall assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations.

Where an entity concludes it is probable that the taxation authority will accept an uncertain tax treatment, the entity shall determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings.

Where an entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment, the entity shall reflect the effect of uncertainty in determining the related taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates. An entity shall reflect the effect of uncertainty by either;

(a) The most likely amount — the single most likely amount in a range of possible outcomes, or

(b) The expected value — the sum of the probability-weighted amounts in a range of possible outcomes.

If the facts and circumstances on which the judgement or estimate of uncertainty over tax treatments was based changes or new information that affects the judgement or estimate is available, entity shall reassess the judgement or estimate and reflect the effect of a change in facts and circumstances or of new information as a change in accounting estimate applying Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*

II Frequently Asked Questions (FAQs)

(These FAQs are meant only to illustrate various requirement of Ind AS 12. It may be emphasised that where the facts and circumstances are different from those described in the relevant FAQ, the response as given herein may not hold valid.)

Question 1

How would a company ascertain whether a particular tax/levy is within the scope of Ind AS 12, *Income Taxes*? How are certain taxes that do not fall in the scope of Ind AS 12, accounted for and presented?

Response

Paragraphs 1 and 2 of Ind AS 12 state as follows:

"1 This Standard shall be applied in accounting for income taxes.

2 For the purposes of this Standard, income taxes include all domestic and foreign taxes which are based on taxable profits. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint arrangement on distributions to the reporting entity."

As per paragraph 5 of Ind AS 12, ***'Taxable profit (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).'***

In accordance with the above, it may be noted that Ind AS 12 applies to income taxes. Income taxes are taxes that are based on taxable profits. That implies that (i) not all taxes are within the scope of Ind AS 12 but (ii) because taxable profit is not the same as accounting profit, taxes do not need to be based on a figure that is exactly accounting profit to be within the scope of Ind AS 12. The latter point is also implied by the requirement in Ind-AS 12 to disclose the relationship between tax expense and accounting profits.

Taxes that are not in the scope of Ind AS 12 should be accounted as per other applicable standards that most appropriately relate to the nature of such tax (e.g. Ind AS 19, *Employee Benefits,* Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* including Appendix C, *Levies* to Ind AS 37 etc.). For instance, professional taxes levied on the employee's cost might fall in the scope of Ind AS 19, *Employee Benefits*.

Taxes covered in the scope of Ind AS 12 are required to be disclosed as 'Tax Expense' on the face of the statement of profit and loss and bifurcated into current tax and deferred tax.

Paragraph 85 of Ind AS 1, *Presentation of Financial Statements* states that additional line items, headings and subtotals in the statement of profit and loss shall be presented, when such presentation is relevant to an understanding of the entity's financial performance.

Accordingly, taxes that are not covered in the scope of Ind AS 12, may be disclosed either as part of the relevant expense head (to which it most appropriately pertains) or may be presented as an additional line item, heading or sub-total in statement of profit and loss, if that presentation is relevant to an understanding of entity's financial performance.

Question 2

Whether income taxes computed based on the following measures is covered in the scope of Ind AS 12?

(a) Revenue (a gross figure)

(b) A fixed amount per unit of production

(c) Notional income derived from tonnage capacity for shipping companies

(d) Presumptive taxation (tax is computed based on specified profit percentage on gross measure (revenue/ sales)

(e) Margin taxes (tax is assessed on margin which is computed by reducing specified costs from revenue)

Response

As explained in FAQ 1, income taxes which are based on taxable profits are in the scope of Ind AS 12. As taxable profit is determined in accordance with rules established by tax authorities, it is not necessarily the same as accounting profit. However, the term 'taxable profit' implies that taxes in the scope of Ind AS 12 are levied on a net (that takes into consideration both income and expenses) rather than on a gross amount.

Accordingly, evaluation of scope coverage under Ind AS 12 for taxes computed on the below measures are as follows:

Tax computation measures	Scope coverage
Revenue (a gross figure)	Not in scope of Ind AS 12 as tax is not computed on taxable profit. It is computed based on gross measure.
A fixed amount per unit of production	Not in scope of Ind AS 12 as tax is not computed based on taxable profit. It is computed based on fixed amount for each unit of production.
Notional income derived from tonnage capacity for shipping companies	Taxes on tonnage capacity are based on gross measure (e.g. tonnage capacity of shipping companies). Inherent notional income derived from tonnage capacity are not based on net measure (that takes into consideration the entity's actual income and expenses). Therefore, taxes on notional income derived from tonnage capacity are not in the scope of Ind AS 12.
Presumptive taxation (tax is computed based on a presumptive profit computed as a percentage of gross measure (revenue/ sales)	In case of presumptive taxation, taxes are computed based on presumptive profit computed as a specified percentage of revenue. Though, the amount computed is presumed net measure, however, it is based on a gross measure (i.e. revenue) and does not taken into consideration entity's expenses. Accordingly, presumptive taxation is not in the scope of Ind AS 12.
Margin taxes (tax is assessed on margin which is computed by reducing specified costs from revenue)	Tax assessed using taxable margin calculated as revenue less specified costs. Margin tax applies a tax rate to income less expenses which is net measure. Accordingly, margin tax is

	covered in the scope of Ind AS 12.

Taxes that are not covered in the scope of Ind AS 12 are accounted for as per other applicable standards (generally accounted for under Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets,* and classified as expense).

Question 3

Under certain foreign tax jurisdiction, customer of an entity withholds taxes on the gross invoiced amount as per the applicable tax regulation of the country. However, such withholding taxes cannot be claimed back as foreign tax credit by the entity. Are such withholding taxes in the scope of Ind AS 12? If no, where should these be presented in the financial statements?

Response

Paragraphs 1 and 2 of Ind AS 12 state as follows:

"***1 This Standard shall be applied in accounting for income taxes.***

2 For the purposes of this Standard, income taxes include all ***domestic and foreign taxes which are based on taxable profits****. Income taxes also include taxes, such as withholding taxes, which are payable by a subsidiary, associate or joint arrangement on distributions to the reporting entity."* ***(Emphasis added)***

Withholding taxes are generally considered as advance payment of income taxes under the local tax laws with respective tax treaties. In other words, the withholding taxes are essentially a substitute for a complete income tax calculation because the recipient of the payment (against which the tax is withheld) is outside the country and may not otherwise be required to file a local income tax return. Such withholding taxes would generally expect to generate foreign tax credit in the country of sale/ service origination.

If such withholding taxes results in foreign tax credit that can be claimed or adjusted against the taxes computed based on taxable profit (i.e., on a net measure) by the entity, then such withholding taxes are prepayment of taxes within the scope of Ind AS 12. However, if such withholding taxes cannot be claimed as foreign tax credit and withholding tax is computed based on gross measure (i.e. invoice amount), then it will not be covered in the scope of Ind AS 12. Furthermore, in situations where foreign tax credit cannot be claimed but, withholding tax is computed based on net measure, then it will be covered in the scope of Ind AS 12.

Withholding taxes that are not covered in the scope of Ind AS 12 are accounted for as per other applicable standards (generally accounted for under Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets* and classified as expense).

Question 4

How should an entity account for the interest and penalties related to income taxes in accordance with the principles of Ind AS?

Response

Paragraph 9.7.1 of '*Guidance Note on Division II- Ind AS Schedule III to the Companies Act, 2013'* issued by the ICAI *inter-alia* states as follows:

Any interest on shortfall in payment of advance income-tax is in the nature of finance cost and hence should not be clubbed with the Current tax. The same should be classified as Interest expense under finance costs. However, such amount should be separately disclosed.

Any penalties levied under Income tax laws should not be classified as Current tax. Penalties which are compensatory in nature should be treated as interest and disclosed in the manner explained above. Other tax penalties should be classified under 'Other Expenses'.

The above recommendations of the Guidance Note are based on the difference between the nature of current tax on the one hand and that of interest or penalties levied on an entity under the income-tax law on the other. As per Ind AS 12, *"current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period."* Thus, an entity's obligation for current tax arises because it earns taxable profit during a period. An entity's obligation for interest or penalties, on the other hand, arises because of its failure to comply with one or more of the requirements of income-tax law (e.g. failure to deposit income-tax). Thus, obligations for current tax and those for interest or penalties arise due to reasons that are fundamentally different in nature. Paragraph 29 of Ind AS 1, *Presentation of Financial Statements*, requires, *inter alia*, that *"an entity shall present separately items of a dissimilar nature or function unless they are immaterial except when required by law*." It is with a view to properly reflect the difference in the nature of current tax and interest/penalties imposed under income-tax law that the Guidance Note requires interest or penalties not to be clubbed with current tax and to treat penalties that are compensatory in nature and interest as part of finance cost and to treat other penalties as part of other expenses.

It may also be mentioned where an entity is in compliance of all of the applicable requirements of income-tax law, it incurs no obligation to pay any interest or penalties, regardless of the amount of its taxable profit for the period. The amount of the entity's taxable profit for a period, on the other hand, generally has a direct correlation with the amount of its current tax obligation for the period. However, even if the amount of interest or penalties for non-compliance with requirements of applicable income-tax law in a particular jurisdiction were linked directly to the amount of taxable profit, the differences in nature of current tax and interest/penalties would still warrant that current tax and interest/penalties not be clubbed together. In other words, similarity in a particular jurisdiction in the bases of computation of amount of current tax and interest/penalties for non-compliance is not a sufficient ground for clubbing these items, which are different in terms of their nature.

It is also pertinent to mention that as per an Agenda Decision issued by the IFRS IC[1] (in the meeting held on 12 September 2017); entities do not have an accounting policy choice between applying IAS 12 and applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to interest and penalties. Instead, if an entity considers a particular amount payable or receivable for interest and penalties to be an income tax, then the entity applies IAS 12 to that amount. If an entity does not apply IAS 12 to a particular amount payable or receivable for interest and penalties, it applies IAS 37 to that amount. An entity discloses its judgement in this respect applying paragraph 122 of IAS 1 *Presentation of Financial Statements*, if it is part of the entity's judgements that had the most significant effect on the amounts recognised in the financial statements.

[1] The IFRS Interpretations Committee (Interpretations Committee) is the interpretative body of the International Accounting Standards Board (Board). The Interpretations Committee works with the Board in supporting the application of IFRS Standards.

It is noted that as per the said agenda decision, there *might* be situations where an amount payable (or receivable) for interest or penalties may be in the nature of income-taxes and thus will be within the scope of IAS 12. In considering whether an amount of interest or a penalty is in the scope of IAS 12, an entity considers whether the interest or penalty is a tax and whether that tax is based on taxable profits.

In some situations, it might be difficult to identify whether an amount payable to (or receivable from) a tax authority includes interest or penalties. For example, this might be the case when the total amount payable to a tax authority is negotiated as a single amount and the tax authority often issues a single demand for unpaid taxes, which might also include interest and penalties. In such situations, since it may not be possible to segregate interest and penalty component, the entire amount would qualify within meaning of IAS 12.

It is noted that the applicability of IFRSs is across a large number of jurisdictions, each with its own income-tax law, therefore, an entity should determine whether a particular amount payable or receivable for interest and penalties is in the scope of IAS 12 considering the tax laws applicable in its individual jurisdiction. For this purpose, an entity should consider whether tax laws in the jurisdiction and other facts and circumstances indicate that this amount is based on a taxable profit – i.e. a 'net' amount. For example, in India, interest and penalty payable under section 234A/B/C of the Income-tax Act, 1961 will not qualify as income-taxes within the meaning of Ind AS 12. Thus, the related amount will be recognised as interest (similar to the approach under the guidance note).Other interest and penalties under the Indian income tax act are also generally not expected to qualify as income-taxes.

Question 5

What is the difference between current tax and deferred tax as per Ind AS 12?

Response

Accounting for income taxes in accordance with Ind AS 12 comprises of accounting for current tax and deferred tax.

As per paragraph 5 of Ind AS 12, Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period. A current tax liability (asset) is recognised for income tax payable (paid but recoverable) in respect of all periods upto the reporting date. Generally, current tax is computed considering the taxable and deductible amounts included in the income tax return.

Deferred tax is recognised for the estimated future tax effects of temporary differences, unused tax losses carried forward and unused tax credits carried forward. The Objective of Ind AS 12 notes that it is inherent in the recognition of an asset or a liability that the entity expects to recover or settle the carrying amount of that asset or liability. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, then the entity recognises a deferred tax liability (deferred tax asset), with certain limited exceptions.

Question 6

How are temporary difference defined under Ind AS 12, *Income Taxes*?

Response

As per paragraph 5 of Ind AS 12, ***Deferred tax liabilities are the amounts of income taxes payable in future periods in respect of taxable temporary differences.***

Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of:

(a) deductible temporary differences;

(b) the carryforward of unused tax losses; and

(c) the carryforward of unused tax credits.

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

(a) taxable temporary differences, which are 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

(b) deductible temporary differences, which are 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.

The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

In standalone financial statements, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the standalone financial statements with the appropriate tax base. In consolidated financial statements, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base.

Tax base is determined by reference to the tax returns of each entity in the group. However, in some jurisdiction, consolidated tax return is filed for the group entities in that jurisdiction. In such cases, the tax base is determined by reference to such consolidated tax return.

Question 7

During the year, the Income tax assessing officer has disallowed certain expenses of Company X in relation to a particular assessment year and has raised a tax demand. Company X has preferred an appeal with higher authorities for the tax demand. How should the Company X reflect the effect of the demand in measurement of income tax?

Company X has incurred these expenses in two other years for which no notice has yet been received from the tax authorities. How should the Company X consider the same in measurement of income tax or disclosure of contingent liabilities? Would the demand also have implications for tax measurement or disclosure for the two other years also?

Response

Appendix C to Ind AS 12, *Uncertainty over Income Tax Treatments* clarifies how to apply the recognition and measurement requirements in Ind AS 12 when there is uncertainty over income tax treatments.

As per the said appendix, an 'uncertain tax treatment' is a tax treatment for which there is uncertainty over whether the relevant taxation authority will accept the tax treatment under tax law.

'Tax treatments' are defined by the Appendix as the treatments used by an entity or that it plans to use in its income tax filings.

Examples of uncertain tax treatments can be:

- not to include particular income in taxable profit;
- transactions that could affect an entity's non-taxable or tax-exempt status;
- deductions taken on tax returns that may be disallowed by the tax authorities;
- an unresolved dispute between the entity and the relevant tax authority about the amount of tax due.

When there is uncertainty over income tax treatments, an entity should recognise and measure its current or deferred tax asset or liability applying the requirements in Ind AS 12 based on taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates determined applying the said Appendix.

Paragraphs 6,7 and 8 of Appendix C to Ind AS 12, *Uncertainty over Income Tax Treatments* state as follows:

Whether an entity considers uncertain tax treatments separately

6. An entity shall determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments based on which approach better predicts the resolution of the uncertainty. In determining the approach that better predicts the resolution of the uncertainty, an entity might consider, for example, (a) how it prepares its income tax filings and supports tax *treatments; or (b) how the entity expects the taxation authority to make its examination and resolve issues that might arise from that examination.*

7. If, applying paragraph 6, an entity considers more than one uncertain tax treatment together, the entity shall read references to an 'uncertain tax treatment' in this Appendix as referring to the group of uncertain tax treatments considered together.

Examination by taxation authorities

8. In assessing whether and how an uncertain tax treatment affects the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, an entity shall assume that a taxation authority will examine amounts it has a right to examine and have full knowledge of all related information when making those examinations.

In accordance with the above, if there is uncertainty about an income tax treatment, then an entity considers whether it is probable that a tax authority will accept the entity's tax treatment included or planned to be included in its tax filing. The underlying assumption in the assessment is that a tax authority will examine all amounts reported and will have full knowledge of all relevant information.

In this regard, paragraphs 10 and 11 of Appendix C to Ind AS 12 state as follows:

10 If an entity concludes it is probable that the taxation authority will accept an uncertain tax treatment, the entity shall determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings.

11. If an entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment, the entity shall reflect the effect of uncertainty in determining the related taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates. An entity shall reflect the effect of uncertainty for each uncertain tax treatment by using either of the following methods, depending on which method the entity expects to better predict the resolution of the uncertainty:

(a) *The most likely amount—the single most likely amount in a range of possible outcomes. The most likely amount may better predict the resolution of the uncertainty if the possible outcomes are binary or are concentrated on one value.*

(b) *The expected value—the sum of the probability-weighted amounts in a range of possible outcomes. The expected value may better predict the resolution of the uncertainty if there is a range of possible outcomes that are neither binary nor concentrated on one value.*

In the given scenario, if Company X concludes that it is not probable that the taxation authority will accept an uncertain tax treatment, then it should reflect the effect of uncertainty in determining the related taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates by using either of the above mentioned methods, depending on which method the entity expects to better predict the resolution of the uncertainty.

However, if it concludes that it is probable that the taxation authority will accept the uncertain tax treatment, then it should determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used or planned to be used in its income tax filings.

The Company should determine whether to disclose the potential effect of the uncertainty as a tax-related contingency applying paragraph 88 of Ind AS 12. As per paragraph 88 of Ind AS 12, an entity discloses any tax-related contingent liabilities and contingent assets in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

Further, the entity shall determine whether to disclose:

(a) judgements made in determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates applying paragraph 122 of Ind AS 1, *Presentation of Financial Statements*; and

(b) information about the assumptions and estimates made in determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates applying paragraphs 125–129 of Ind AS 1.

Same expenses which have been disallowed by the Income tax assessing officer in relation to a particular assessment year have been incurred by the Company in two other years although the Company has not received any tax notice from the tax authorities for these two years. As per the Appendix, the underlying assumption in the assessment is that a tax authority will examine all amounts reported and will have full knowledge of all relevant information. Hence, the deduction claimed for these expenses by the Company in the said two other years should also be considered as uncertain tax treatment to be accounted for as per the Appendix even though tax notice for these years has not yet been received from the tax authorities. However, due consideration should be given to the tax laws and regulations of the jurisdiction regarding whether the tax authorities have right to examine/ re-examine assessments of such other years.

Hence as discussed above for current year, in relation to these two other years as well:

- if the Company concludes that it is not probable that the taxation authority will accept the uncertain tax treatment, then the Company should reflect the effect of uncertainty in determining the related taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates. To do so, the Company should use either the most likely amount or the expected value method - whichever better predicts the resolution of the uncertainty.

- if the Company concludes it is probable that the taxation authority will accept the uncertain tax treatment, the Company should determine the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment used in its income tax filings. The Company should determine whether to disclose the potential effect of the uncertainty as a tax-related contingency applying paragraph 88 of Ind AS 12. As per paragraph 88 of Ind AS 12, an entity discloses any tax-related contingent liabilities and contingent assets in accordance with Ind AS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

Furthermore, paragraphs 13 and 14 of Appendix C to Ind AS 12 state as follows:

Changes in facts and circumstances

13. An entity shall reassess a judgement or estimate required by this Appendix if the facts and circumstances on which the judgement or estimate was based change or as a result of new information that affects the judgement or estimate.

For example, a change in facts and circumstances might change an entity's conclusions about the acceptability of a tax treatment or the entity's estimate of the effect of uncertainty, or both. Paragraphs A1–A3 set out guidance on changes in facts and circumstances.

14. An entity shall reflect the effect of a change in facts and circumstances or of new information as a change in accounting estimate applying Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors. An entity shall apply Ind AS 10, Events after the Reporting Period, to determine whether a change that occurs after the reporting period is an adjusting or non-adjusting event.

In accordance with the above, the Company is required to reassess estimates and assumptions if facts and circumstances change or new information emerges (like new pronouncements or judgements). In case change in facts and circumstances or new information results in a change in the estimate of whether it is probable that the taxation authority will accept the uncertain tax treatment, the tax balances should be adjusted. This requires careful consideration of the tax laws and regulations of the jurisdiction specifically in relation to whether pronouncements or judgements are applicable to or can be considered by the Company.

Question 8

Company X, an Indian company owns a freehold land with carrying value of INR 10,00,000 which is not depreciated for tax purposes, but is indexed for inflation. Indexed value and fair value of such land is INR 15,00,000 and INR 22,00,000 respectively as of the reporting date. What will be the tax base for such freehold land for measurement of deferred tax if:

a) Company X intends to sell it as a part of slump sale of business eventually after using it for business purpose
b) Company X intends to sell the land individually and not on a slump sale basis
c) Company X has classified such land as investment property and intends to sell it individually and not on a slump sale basis
d) Company X follows a revaluation model for freehold land and intends to sell it individually and not on a slump sale

As per the applicable tax laws in the jurisdiction, indexation benefit is not available if the freehold land is sold as a part of slump sale of business, but indexation benefit is available if freehold land is sold individually.

Response

Paragraphs 51 and 51A of Ind AS 12, state as follows:

"51 The measurement of deferred tax liabilities and deferred tax assets 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.

51A In some jurisdictions, the manner in which an entity recovers (settles) the carrying amount of an asset (liability) may affect either or both of:

(a) the tax rate applicable when the entity recovers (settles) the carrying amount of the asset (liability); and

(b) the tax base of the asset (liability).

In such cases, an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement."

The expectation of the entity at the end of the reporting period with regard to the manner of recovery or settlement of its assets and liabilities will require exercise of judgement based on evaluation of facts and circumstances in each case. It may be relevant to consider that there is substance to management's expectation of the entity being able to recover the asset through slump sale or otherwise. The Company normally needs to demonstrate its intent clearly in order for it to be reflected in the determination of the tax base. It may not always require that the Company perform a formal act demonstrating this intention. Instead, depending on the facts and circumstances, it is generally assumed that the Company will act in the most economically advantageous way.

However, it is also important to note the following paragraph of Ind AS 12:

"51B If a deferred tax liability or deferred tax asset arises from a non-depreciable asset measured using the revaluation model in Ind AS 16, the

measurement of the deferred tax liability or deferred tax asset shall reflect the tax consequences of recovering the carrying amount of the non-depreciable asset through sale, regardless of the basis of measuring the carrying amount of that asset. Accordingly, if the tax law specifies a tax rate applicable to the taxable amount derived from the sale of an asset that differs from the tax rate applicable to the taxable amount derived from using an asset, the former rate is applied in measuring the deferred tax liability or asset related to a non-depreciable asset."

In accordance with the above, it may be noted that if a non-depreciable asset is measured using the revaluation model, then an entity is required to measure the DTA/DTL considering the tax consequences of recovering the carrying amount through sale.

Accordingly, with the above specified guidance and assumption around supporting facts and circumstances to support management expectation around recovery or settlement, following will be the tax base for computing the deferred tax assets/ liability, in the given case:

a) Company X intends to sell it as slump sale eventually after using it for business purpose

If it is concluded based on evaluation of facts that the freehold land will be sold through slump sale, then the tax base of the land will be the same as the carrying amount of the land, as indexation benefit is not available in case of slump sale and hence there will not be any temporary difference.

b) Company X intends to sell the land individually and not on a slump sale basis

In the given scenario, the company intends to sell the land individually and not on a slump sale such that the company would get indexation benefit. Thus, book base of land, i.e. carrying amount of freehold land in the balance sheet is INR 10,00,000. As per paragraph 51A of Ind AS 12, the tax base (amount that will be deductible for tax purposes against any taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset) is the indexed valued of INR 15,00,000 since the company intends to sell the land individually and not on slump sale and thus get indexation benefit. Deferred tax assets will be set up, subject to recoverability, on a deductible tax difference of INR 5,00,000.

c) Company X has classified such land as investment property and intends to sell it individually and not on a slump sale

Paragraph 56 of Ind AS 40, *Investment property*, requires that after initial recognition, an entity shall measure all of its investment properties in accordance with Ind AS 16's requirement for cost model, other than those that meet the criteria to be classified as held for sale in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations*. Ind AS 40 does not allow fair value model. Accordingly, freehold land classified as investment property will be measured at cost.

Thus, book base of land, i.e. carrying amount of freehold land in the balance sheet is INR 10,00,000. The Company intends to sell the land individually and not on a slump sale and thus get indexation benefit. Hence, as per paragraph 51A of Ind AS 12, the tax base (amount that will be deductible for tax purposes against any taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset) is the indexed valued of INR 15,00,000. Accordingly, deferred tax assets will be set up, subject to recoverability, on deductible tax difference of INR 5,00,000.

d) Company X follows a revaluation model for freehold land and intends to sell it individually and not on a slump sale

If Company X follows a revaluation model, carrying amount of freehold land in the balance sheet would be INR 22,00,000. Thus, book base of land is INR 22,00,000.

The Company intends to sell the land individually and not on a slump sale and thus get indexation benefit. Hence, as per paragraph 51A of Ind AS 12, the tax base (amount that will be deductible for tax purposes against any taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset) is the indexed valued of INR 15,00,000. Accordingly, deferred tax liability will be set up on taxable temporary difference of INR 7,00,000.

As per paragraph 39 of Ind AS 16, *Property, Plant and Equipment*, if an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. Accordingly, the effect of deferred tax liability should also be recognised in other comprehensive income as per paragraph 57 and 61A of Ind AS 12.

Question 9

Company A paid INR 20,00,000 to acquire advertisement display right for 15 years at specified locations in and around airport which is recognised as intangible asset. As per applicable tax laws, the asset is not depreciable for tax purposes, but is amortised for accounting purposes. Further, if the right is used until expiry, then on expiry Company A will receive a tax deduction for the initial cost of INR 20,00,000. However, no deduction is available if the right is disposed of or transferred. What would be the tax base for such intangible asset?

Response

Paragraphs 51 and 51A of Ind AS 12 state as follows:

"51 The measurement of deferred tax liabilities and deferred tax assets 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.

51A In some jurisdictions, the manner in which an entity recovers (settles) the carrying amount of an asset (liability) may affect either or both of:

(a) the tax rate applicable when the entity recovers (settles) the carrying amount of the asset (liability); and
(b) the tax base of the asset (liability).

In such cases, an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement."

In accordance with the above, an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement.

In the given case, the tax base of the intangible asset will depend on the expected manner of recovery/settlement of the intangible asset. If Company A's intention is to use the said intangible asset until its expiry, then at the end of the useful life of the asset tax deduction equal to its cost of INR 20,00,000 is available. Accordingly, in this situation, the tax base equals the future tax deductions and hence would be INR 20,00,000.

However, if Company A's intention is to sell or dispose off the intangible asset before its expiry, then no tax deduction will be available. Since the tax base equals the future tax deductions, which is Nil in this case, hence the tax base for the intangible asset would be Nil.

Question 10

Company Y follows revaluation model to measure its property, plant and equipment. The Company acquires an item of PPE for a cost of INR 20,00,000 on April 1, 2022. The useful life of the said PPE for accounting purpose is 10 years (nil residual value). On March 31, 2023, the PPE is revalued to INR 28,80,000 (no change in residual value and remaining useful life). As per Ind AS 16, *Property, Plant and Equipment* if an asset's carrying amount is increased as a result of revaluation, increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. For tax purposes the value of the PPE is its cost i.e., INR 20,00,000. The useful life for tax purpose is 8 years (nil residual value). What is the amount of temporary difference and deferred tax (considering a tax rate of 30%) as per Ind AS 12 as of March 31, 2023 and as of March 31, 2024. Is this different from timing difference as per AS 22?

Response

The temporary difference and deferred tax liability as per Ind AS 12 is calculated as below:

Particulars	**Book base**	**Tax base**	**Temporary difference**	**DTL @ 30%**
As on April 1, 2022	20,00,000	20,00,000	-	-

Depreciation/ tax allowance	(2,00,000)	(2,50,000)		
As on March 31, 2023	18,00,000	17,50,000	50,000	15,000
Revaluation	10,80,000	-		
As on March 31, 2023	28,80,000	17,50,000	11,30,000	3,39,000
Depreciation/ tax allowance	(3,20,000)	(2,50,000)		
As on 31 March 2024	25,60,000	15,00,000	10,60,000	3,18,000

Paragraph 61A of Ind AS 12 provides that, ***"Current tax and deferred tax shall be 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. Therefore, current tax and deferred tax that relates to items that are recognised, in the same or a different period:***

(a) in other comprehensive income, shall be recognised in other comprehensive income (see paragraph 62).

(b) directly in equity, shall be recognised directly in equity (see paragraph 62A)."

The deferred tax liability of INR 15,000 arising as on March 31, 2023 (before revaluation) will be recognised in profit and loss. The deferred tax liability of INR 3,24,000 arising on revaluation during year ended 31 March 2023 will be recognised in other comprehensive income as per paragraph 61A of Ind AS 12. The reduction of deferred tax liability of INR 21,000 due to reduction of temporary difference from depreciation/ tax allowance during the year ended March 31, 2024 will be recognised in profit and loss.

Timing difference in Accounting Standard 22, Accounting for Taxes on Income:

In the given case, as revaluation gain is not recorded in statement of Profit and Loss; and is also disregarded for computation of taxable profit, following the income statement approach (difference in taxable income and accounting income), there is no timing difference. Accordingly, no deferred tax liability is set up under AS 22, '*Accounting for taxes on Income'*.

Question 11

Can there be a temporary difference and resultant deferred tax assets/ liabilities if entities are entitled to future tax deduction/ charge relating to transaction that does not result in any asset or liability in the balance sheet?

Response

Paragraph 9 of Ind AS 12 provides that, *"Some items have a tax base but are not recognised as assets and liabilities in the balance sheet. For example, preliminary expenses are recognised as an expense in determining accounting profit in the period in which they are incurred but may not be permitted as a deduction in determining taxable profit (tax loss) until a later period(s). The difference between the tax base of the preliminary expenses, being the amount permitted as a deduction in future periods under taxation laws, and the carrying amount of nil is a deductible temporary difference that results in a deferred tax asset."*

In accordance with the above, it may be noted that there may be situations wherein entities may be entitled to future tax deductions relating to transactions that do not result in any asset or liability being recognised in the balance sheet. Where there has been a past event that will affect the tax of future periods, entities calculate a tax base and temporary difference even if there is no asset or liability in the balance sheet. It is appropriate to calculate a tax base in such cases so that the item/expense is not reported in a different period to its related tax effect.

For example, Research costs are recognised as an expense in determining accounting profit (as per paragraphs 54–56 of Ind AS 38) but under tax laws applicable in a jurisdiction, these are not permitted as a deduction in determining taxable profit until a later period.

Accordingly, future tax allowance should be compared with the related carrying amount of nil in the balance sheet, and a deductible temporary difference would therefore exist that results in a deferred tax asset, to be recognised subject to recoverability.

Question 12

Parent Company A has sold an item of inventory with a carrying amount of INR 60,000 to its wholly owned subsidiary WS1. The sale was executed at fair value of INR 80,000 for tax purposes which resulted in a profit of INR 20,000 on which company A (the parent) paid tax in the year of sale. The inventory is lying unsold with WS1 as at year- end. WS1 would get a deduction of INR 80,000 when it further sells the inventory to end customer next year.

In the consolidated financial statements of Company A, impact of this intra-group transaction is eliminated and thus inventory is reflecting at INR 60,000 in the consolidated balance sheet.

Should there be any deferred tax asset on such intra-group profits eliminated in the consolidated financial statements?

Response

As per Ind AS 110, Intra-group transactions are required to be eliminated on consolidation. It may be natural to reverse not only the transaction itself, but also the tax effects thereof in order to fully eliminate the transaction in the consolidated financial statements.

However, paragraph 11 of Ind AS 12 provides that, "*The tax base is determined by reference to the tax returns of each entity in the group. In some jurisdictions, in consolidated financial statements, temporary differences are determined by comparing the carrying amounts of assets and liabilities in the consolidated financial statements with the appropriate tax base. The tax base is determined by reference to a consolidated tax return in those jurisdictions in which such a return is filed.*"

In the given case, intra-group transaction between parent and WS1 is fully eliminated on consolidation. However, this transaction has created a current tax liability (on profit of INR 20,000) for the parent in the year of sale and WS1 would get deduction for the cost paid (INR 80,000) when it sells the inventory in the next year to its customers.

In the consolidated financial statements, since the intra-group profit of INR 20,000 is eliminated, the inventory is measured at INR 60,000 in the consolidated balance sheet, i.e. book base of inventory in the consolidated financial statements is INR 60,000.

WS1 would get a deduction of INR 80,000 when it further sells the inventory to its customer next year. Thus, tax base of inventory is INR 80,000.

Furthermore, paragraph 47 of Ind AS 12 provides that, ***"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."***

Accordingly, subject to recoverability, a deferred tax asset should be recognised in the consolidated financial statements for deductible temporary difference of INR 20,000. This is recognised on consolidation at WS1's tax rate.

Question 13

Company X (investee of Company A) declared dividend of INR 1,00,000. Company A recognised a receivable in its financial statements. In Company A's jurisdiction, dividends are tax-exempt. How will this transaction be treated and accounted for under Ind AS 12?

Response

As per paragraph 7 of Ind AS 12, the 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. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

Accordingly, the tax base of the dividend receivable is INR 1,00,000 because in substance, the full amount will be tax deductible – i.e. the economic benefits are not taxable. Therefore, no deferred tax liability is recognised because the tax base of the receivable is equal to its carrying amount.

Question 14

Ind AS 12 provides that a deferred tax asset shall be recognised for the carryforward of unused tax losses to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.

(a) How should the term 'probable' be understood?
(b) Further, in case of unused tax losses how should a company assess the probability of future taxable profits?

Response

(a) Ind AS 12 states that, unlike deferred tax liabilities, a deferred tax asset is recognised in respect of deductible temporary differences only to the extent that it is probable that taxable profit will be available, against which the deductible temporary differences can be utilised.

Although a company is required to consider the probability of realising the benefit of deductible temporary differences, the term 'probable' is not defined in Ind AS 12. Companies are expected to consider the term 'probable' as 'more likely than not', which is consistent with the definition of 'probable' in other standards - e.g. in respect of provisions under Ind AS 37.

(b) If an entity has a history of recent losses, paragraph 35 of Ind AS 12 provides that a deferred tax asset is recognised only to the extent that the entity has sufficient taxable temporary differences or there is convincing evidence that sufficient taxable profit will be available against which the tax losses or tax credits can be utilised. Where the deferred tax liabilities are not sufficient to absorb all the tax losses, management should consider other convincing evidence suggesting that suitable taxable profits will be generated in future. This consideration becomes difficult, because the very existence of continuous tax losses is strong evidence that future taxable profit might not be available.

Furthermore, paragraph 36 of Ind AS 12 provides that, *"An entity considers the following criteria in assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised:*

(a) 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;

(b) whether it is probable that the entity will have taxable profits before the unused tax losses or unused tax credits expire;

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

(d) whether tax planning opportunities (see paragraph 30) 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. To the extent that it is not probable that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the deferred tax asset is not recognised.

To the extent that it is not probable that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the deferred tax asset is not recognised."

Management is thus required to apply its judgement in making such assessment. It might be important to note that evidence is a matter of fact which, in order to be convincing, should be supported by something in concrete form, such as, existence of a deferred tax liability, which will get reversed in the future resulting in the normal tax liability for the company. Mere projections of future profitability cannot be considered as convincing evidence.

The following are some factors which may be considered while making this assessment:

- Future binding profitable agreements
- There was an abnormal event during the year which resulted in tax losses whereas the company has been paying normal tax in earlier five years and the actual facts indicate that this would be so in the next few years

Because of this significant uncertainty about future taxable profits being available, in the absence of profits arising from the reversals of existing temporary differences, the amount of the deferred tax asset and the nature of the evidence supporting its recognition should be disclosed as per paragraph 82 of Ind AS 12.

Question 15

Company X purchased a debt instrument for INR 2,000 at the beginning of year 1. The following facts are also relevant:

- The debt instrument's nominal value is INR 2,000.
- The maturity date is at the end of year 8.
- Interest is payable annually at 8%.
- The effective interest rate is also 8%.
- For accounting purposes, the debt instrument is measured at fair value (FVTPL).

In the jurisdiction of Company X, any gains (losses) on the debt instrument are taxable (deductible) only when realised. The gains (losses) arising on the sale or maturity of the debt instrument are calculated for tax purposes as the difference between the amount collected and the original cost of the debt instrument. Accordingly, the instrument's tax base is its cost of INR 2,000.

At the end of year 2, the debt instrument's fair value decreases to INR 1,900 as a result of an increase in market interest rates. It is probable that Company X will receive all the contractual cash flows if it continues to hold the debt instrument.

What is the amount of temporary difference at the end of year 2?

Response

As per paragraph 26(d) of Ind AS 12, certain assets may be carried at fair value, or may be revalued, without an equivalent adjustment being made for tax purposes (see paragraph 20). A deductible temporary difference arises if the tax base of the asset exceeds its carrying amount.

Since, the instrument is carried at FVTPL, a loss of INR 100 would be recognised in year 2. As per the applicable laws in the jurisdiction of Company X, any gains (losses) on the debt instrument are taxable (deductible) only when realised. Hence, the unrealised loss of INR 100 would not be allowed as deduction in year 2. Company X obtains a deduction of INR 2,000 in determining taxable profit (tax loss) either on sale or on maturity. Hence, the tax base of the instrument is INR 2,000.

Accordingly, in the given case, at the end of year 2, the difference between the carrying amount of the debt instrument in Company X's financial statements of INR 1,900 and the corresponding tax base of INR 2,000 gives rise to a deductible temporary difference of INR 100 irrespective of whether Company X expects to recover the carrying amount of the debt instrument by sale or use.

Question 16

A holding company X Ltd. has 2 wholly owned subsidiaries A Ltd. and B Ltd.. The company had acquired 100% equity of these companies as at April 1, 2019. The investment was made as under:

Company	**Invested on April 1, 2019**	**Profit (loss) for the FY 19-20**	**Profit (loss) for the FY 20-21**	**Profit (loss) for the FY 21-22**
A Ltd.	INR 5,00,000	(50,000)	(60,000)	(70,000)
B Ltd.	INR 5,00,000	50,000	60,000	70,000

As at March 31, 2022 in the standalone financial statements of X Ltd., the future projections of company A Ltd. being negative, the entire investment was impaired by INR 5,00,000. The same was disallowed under income tax laws of X Ltd.'s jurisdiction. Further, in the consolidated financial statements of X Ltd., the net assets in relation to A Ltd. was also fully impaired.

As at March 31, 2022, B Ltd. has excess earnings available which would be transferred to the holding company in future but it cannot be repatriated in a tax free manner.

Question arising on the preparation of the consolidated financial statements of X Ltd. are:

(i) Would a deferred tax liability be recorded for the difference in the carrying value and tax books value of A Ltd. in the consolidated financial statement (CFS) of X Ltd.? Assume no indexation benefit is available on investment in A Ltd.

(ii) Would a deferred tax liability be recorded for the difference in the carrying value and tax books value of B Ltd. in the CFS of X Ltd.? Assume no indexation benefit is available on investment in B Ltd.

Response

Paragraphs 38 and 39 of Ind AS 12 state as follows:

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

38 Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint arrangements (namely the parent or investor's share of the net assets of the subsidiary, branch, associate or investee, including the carrying amount of goodwill) becomes different from the tax base (which is often cost) of the investment or interest. Such differences may arise in a number of different circumstances, for example:

(a) the existence of undistributed profits of subsidiaries, branches, associates and joint arrangements;

(b) changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and

(c) a reduction in the carrying amount of an investment in an associate to its recoverable amount.

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

39 An entity shall recognise a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, except to the extent that both of the following conditions are satisfied:

(a) the parent, investor, joint venturer or joint operator is able to control the timing of the reversal of the temporary difference; and

(b) it is probable that the temporary difference will not reverse in the foreseeable future.

Further, paragraph 44 of Ind AS 12 provides that, ***"An entity shall recognise a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint arrangements, to the extent that, and only to the extent that, it is probable that:***

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

(b) taxable profit will be available against which the temporary difference can be utilised."

(i) In consolidated financial statements of X Ltd., the investment in subsidiary is eliminated and the net assets including goodwill are recorded. For comparing the tax base of investment with the books in case of a consolidated financial statements the carrying value of investment is replaced with the net assets (including goodwill).

Thus, book base of A Ltd. in consolidated financial statements of X Ltd. is Nil (i.e. INR 5,00,000 less losses amounting to INR 1,80,000 less impairment of INR 3,20,000).

The impairment on investment in subsidiary (A Ltd.) recognised in standalone financial statements (amounting to INR 5,00,000) was disallowed under the Income tax laws of X Ltd.'s jurisdiction. The entire cost of investment of INR 5,00,000 is deductible upon sale of investment under the applicable tax laws. Thus, the tax base of investment in A Ltd. is INR 5,00,000.

Thus, there is a temporary difference of INR 5,00,000. In practice, such temporary differences are commonly referred to as 'outside basis differences'.

A deferred tax asset should be recorded for this outside basis difference only if the conditions specified in paragraph 44 of Ind AS 12 mentioned above are met.

(ii) In consolidated financial statements of X Ltd., the investment in subsidiary is eliminated and the net assets including goodwill are recorded.

The book base of B Ltd. in consolidated financial statements of X Ltd. is INR 6,80,000 (i.e. INR 5,00,000 add profits amounting to INR 1,80,000).

The entire cost of investment of INR 5,00,000 is deductible under tax upon sale of investment. Thus, the tax base of investment in B Ltd. is INR 5,00,000.

The difference in the book base and tax base lead to an outside basis difference of INR 1,80,000.

Paragraph 40 of Ind AS 12 provides that, "*As a parent controls the dividend policy of its subsidiary, it is able to control the timing of the reversal of temporary differences associated with that investment (including the temporary differences arising not only from undistributed profits but also from any foreign exchange translation differences). Furthermore, it would often be impracticable to determine the amount of income taxes that would be payable when the temporary difference reverses. 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.*"

In the given scenario, for B Ltd., the company proposes to repatriate the surplus to its holding company in the foreseeable future and it cannot be repatriated in a tax free manner. Thus, it is probable that the temporary difference would reverse in the foreseeable future.

Thus, a deferred tax liability would be recorded for this temporary difference at the tax rate applicable to the repatriation of surplus by B Ltd. to its holding company on such portion which will reverse in the foreseeable future. To illustrate if the company expects that out of the temporary difference of INR 1,80,000 the company expects to repatriate only INR 1,00,000 and would re-invest the balance INR 80,000 in the B entity itself or requires it for its working capital requirements. Thus, deferred tax liability would be recorded on INR 1,00,000 only as this is the amount which is reversible in the foreseeable future and not the entire amount.

If however, it is probable that the temporary difference will not reverse in the foreseeable future (e.g. by way of dividend distribution or sale of investment), then no deferred tax liability is recognised on outside basis difference of INR 1,80,000 in the consolidated financial statements of X Ltd..

Question 17

Company X has a subsidiary Company Y. During the year 2022-23, Company X sold 10% of its stake in Company Y. At the date of the partial disposal, the net assets in Y are INR 5,00,000 and the tax base of the investment is the original cost of INR 4,00,000 (assume no indexation benefit). The sale consideration was INR75,000.

No deferred tax liability on undistributed profits was recognised in the consolidated financial statements.

While Company X's ownership interest decreased by 10%, it continued to have control over Company Y. There is a taxable gain of INR 35,000 (75,000 - 10% of 4,00,000) on which tax @ 20% amounting INR 7,000 is paid.

Whether tax effect on gain on equity shares of a Company Y should be recognised in equity or statement of profit and loss in the consolidated financial statements?

Response

Paragraph 23 of Ind AS 110 state as follows:

"Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners)."

Transactions that result in changes in ownership interests while retaining control are accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes is recognised in profit or loss; instead, it is recognised in equity. There is a gain of INR 25,000 in CFS (75,000 – 10% of 5,00,000) which is recognised directly in equity.

Before the disposal, Y had undistributed profits of INR 1,00,000 which represented taxable outside basis difference in respect of X's investment in Y. X did not recognise any deferred tax liability on the taxable outside basis difference, because X was able to control the timing of the reversal of the temporary difference, and had determined that it is probable that the temporary difference will not reverse in the foreseeable future. It was not until the sale that the part of the outside basis difference relating to the disposed interest failed to satisfy the recognition exception for outside basis differences. At the date of the sale, X also reassesses its assertion regarding the reversal of the remaining outside basis difference associated with the retained interest in Y, and determines that it is still probable that that part of the outside basis difference will not reverse in the foreseeable future.

In this example, current tax of INR 7,000 comprises both direct and indirect components, which should be accounted for separately:

- The part of the current tax relating to X's accounting 'gain' on the sale - i.e. 5,000 (25,000 x 20%) – is a direct tax effect of the equity transaction and should therefore be recognised directly in equity.
- The balance of the current tax, which in accounting terms is the crystallisation of the outside basis difference on the change in X's interest in Y - i.e. 2,000 (1,00,000 x 10% x 20%), or ((35,000 – 25,000) x 20%) - is not directly related to, and should therefore be recognised separately from, the equity transaction in line with the original underlying transactions or other events that give rise to such differences.

Question 18

Whether any deferred tax should be recognised in the consolidated financial statements for foreign currency translation reserve recognised in the consolidated financials on translation of foreign operations? If yes, where should the same be recognised?

Response

Paragraph 78 of Ind AS 12 state as follows:

"Ind AS 21 requires certain exchange differences to be recognised as income or expense but does not specify where such differences should be presented in the statement of profit and loss. Accordingly, where exchange differences on deferred foreign tax liabilities or assets are recognised in the statement of profit and loss, such differences may be classified as deferred tax expense (income) if that presentation is considered to be the most useful to financial statement users."

The foreign currency translation reserve arising from the translation of foreign operations in the consolidated financial statements does not in itself result in deferred tax assets or liabilities.

However, exchange differences arising on the translation of the financial statements of foreign operations might have associated tax effects that affect the financial statements. For example, an entity intends to sell an investment in a subsidiary in the foreseeable future. In this case, it recognises deferred taxes on temporary differences arising from that investment. Suppose that part of these differences arises from translating the financial statements of foreign operations; in this case, the deferred tax effect in respect of these differences will be recognised in OCI.

Question 19

How should a company compute weighted average effective annual income tax rate for its annual financial statements when the accounting year and the tax year are different?

Response

Section 2(41) of the Companies Act, 2013 *inter alia* requires that the financial year of every company should end on 31 March unless approval from the National Company Law Tribunal has been obtained in prescribed cases. Under the Income Tax Act, 1961 income tax is assessed from April to March. Thus, a difference between accounting year and tax year will arise only when the company has obtained necessary approvals under the Companies Act, 2013.

Paragraph 30(c) of Ind AS 34 provides that, *"income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes."*

If an entity's accounting year and tax year differs, the income tax expense for the interim periods of that accounting year should be measured using separate weighted average estimated effective tax rates for each of the tax years applied to the portion of pre-tax income earned in each of those tax years. In other words, an entity should compute a weighted average estimated effective tax rate for each tax year, rather than for its accounting year.

Illustration

A listed company's accounting year end on 31 December 2023. The tax year of the company end on 31 March 2023. During the accounting year ended December 2023 the company earned INR 5,000 pre-tax each quarter. The estimated average annual income tax rate in 30% and 40% for the tax year ending 31 March 2023 and 31 March 2024.

Quarter ending	Pre-tax earnings	Effective tax rate (%)	Tax expense
March 2023	5,000	30	1,500
June 2023	5,000	40	2,000
September 2023	5,000	40	2,000
December 2023	5,000	40	2,000
Annual	**20,000**		**7,500**

Question 20

Company A has acquired 100% stake in Company B for a consideration of INR 10,00,000 and the same is accounted for as business combination as per Ind AS 103, *Business Combinations*.

At the acquisition date, the tax base in A's tax jurisdiction of A's investment in B is INR 10,00,000. Goodwill is not deductible for tax purposes.

The fair values of the identifiable assets acquired and liabilities assumed (excluding deferred tax assets and liabilities) by A is set out in the following table, together with their tax bases in B's tax jurisdiction:

Particulars	Fair value	Tax base
Intangible assets (brand, customer relationship, etc.)	7,00,000	-
Other net assets	2,00,000	1,00,000

How should deferred tax be recognised on the aforesaid acquisition at the acquisition date in the consolidated financial statements. Assume a tax rate of 30% is applicable to Company B.

Response

Paragraph 15 of Ind AS 12 states as follows:

"A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:

(a) the initial recognition of goodwill; or

(b) the initial recognition of an asset or liability in a transaction which:

(i) is not a business combination;

(ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss);and

(iii) at the time of the transaction, does not give rise to equal taxable and deductible temporary differences.

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax liability shall be recognised in accordance with paragraph 39."

Computation of deferred tax

As per paragraph 15 of Ind AS 12, initial recognition exemption does not apply on initial recognition of assets and liabilities in a business combination. Hence, deferred tax liability would be recognised on taxable temporary difference arising on initial recognition of intangibles and other net assets as below:

Particulars	**Book base (carrying amount as per CFS)**	**Tax base**	**Temporary difference**	**DTL**
Intangibles	7,00,000	-	7,00,000	2,10,000
Other net assets	2,00,000	1,00,000	1,00,000	30,000
				2,40,000

Determination of goodwill

Particulars	Amount (in INR)
Fair value of identifiable assets acquired and liabilities assumed, excluding deferred tax	9,00,000
Less: Deferred tax liability	(2,40,000)
Fair value of identifiable assets acquired and liabilities assumed	6,60,000
Less: Consideration	10,00,000
Goodwill	3,40,000

As per paragraph 15 of Ind AS 12, no deferred tax liability is recognised on initial recognition of goodwill.

Question 21

A company acquired a business. As a part of acquisition, it acquired a brand. The fair value of the brand on the date of acquisition is INR 10,00,000. The company incurred acquisition related cost amounting to INR 2,00,000 which was recognised in profit and loss in the financial statements. In the tax jurisdiction of the company, this acquisition-related cost is added to the value of intangible assets and deduction of INR 12,00,000 can be claimed over a period of 5 years.

Is there a need for recognising deferred tax asset on the acquisition cost proposed to be capitalised for income tax purposes. If yes, where should the same be recognised?

Response

Paragraphs 24 of Ind AS 12 state as follows:

"A deferred tax asset shall be recognised 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 utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

(a) is not a business combination;

(b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); and

(c) at the time of the transaction, does not give rise to equal taxable and deductible temporary differences.

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44."

As per paragraph 53 of Ind AS 103, the acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received except for costs to issue debt or equity securities which shall be recognised in accordance with Ind AS 32 and Ind AS 109. In the instant case, since the acquisition-related costs do not relate to issue debt or equity securities and hence are expensed in the period in which such costs are incurred. Hence, the book base of the brand is INR 10,00,000.

The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset. Hence, the tax base of the brand is INR 12,00,000.

Initial recognition exemption does not apply since on initial recognition, acquisition cost impacts the accounting profits. Further, initial recognition exemption does not apply on initial recognition of assets and liabilities in a business combination.

Hence, a deferred tax asset on deductible temporary difference of INR 2,00,000 should be recognised subject to recoverability.

The deferred tax effects attributed to acquisition-related costs are recognised outside the business combination because the costs themselves are accounted for separately from the acquisition accounting.

As per paragraph 58 of Ind AS 12, "***Current and deferred tax shall be recognised as income or an expense and included in profit or loss for the period except to the extent that the tax arises from:***

(a) a transaction or event which is recognised, in the same or a different period, outside profit or loss, either in other comprehensive income or directly in equity or

(b) a business combination (other than the acquisition by an investment entity, as defined in Ind AS 110, Consolidated Financial Statements, of a subsidiary that is required to be measured at fair value through profit or loss) (see paragraphs 66 -68).”

Hence, DTA should be recognised in profit and loss and not adjusted against goodwill.

Question 22

A company has an equity settled share-based payment issued to employees. The company recognised ESOP expense for grant date fair value over the vesting period:

Year	**ESOP expense**	**ESOP reserve**
Year 1	250	250
Year 2	250	500
Year 3	250	750

There is no forfeiture. The ESOP is exercised at the end of year 4. In the tax jurisdiction of the company, tax deduction of ESOP is based on the excess of the fair value of the equity instrument at a future date when the ESOP is exercised over the exercise price (‘Tax value').

Whether and how deferred tax should be recognised on ESOP. Assume a tax rate of 30%.

Response

Paragraphs 68B and 68C of Ind AS 12 state as follows:

“68B As with the preliminary expenses discussed in paragraphs 9 and 26(b) of this Standard, the difference between the tax base of the employee services received to date (being the amount permitted as a deduction in future periods under taxation laws), and the carrying amount of nil, is a deductible temporary difference that results in a deferred tax asset. If the amount permitted as a deduction in future periods under taxation laws is not known at the end of the period, it shall be estimated, based on

information available at the end of the period. For example, if the amount permitted as a deduction in future periods under taxation 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.

68C As noted in paragraph 68A, the amount of the tax deduction (or estimated future tax deduction, measured in accordance with paragraph 68B) may differ from the related cumulative remuneration expense. Paragraph 58 of the Standard requires that current and deferred tax should be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from (a) a transaction or event that is recognised, in the same or a different period, outside profit or loss, or (b) a business combination (other than the acquisition by an investment entity of a subsidiary that is required to be measured at fair value through profit or loss). If the amount of the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, the excess of the associated current or deferred tax should be recognised directly in equity."

As per paragraph 68B of Ind AS 12, the expected future tax deduction in case of share-based payment is estimated based on the information available at the reporting date. This includes, for example, the share price, exercise price and the number of options expected to be exercised. The information used to estimate the deductions available in future periods needs to be consistent with that applied in measuring the share-based payment expense.

Assuming below is the excess of the fair value of the equity instrument over the exercise price at the end of each year:

Year 1	600
Year 2	900
Year 3	1200
Year 4	1500

Further, as per paragraph 68C of Ind AS 12, if the amount of the tax deduction (or estimated future tax deduction) exceeds the amount of the related cumulative share-based payment expense, then the tax deduction relates not only to remuneration expense, but also to an equity item. In this situation, the excess of the associated income tax is recognised directly in equity.

Deferred tax would be recognised as below:

Particulars	Book base	Excess of the fair value of the equity instrument over the exercise price	Tax base	Cumulative ESOP expense	DTA @ 30%	Recognised in PL	Recognised in equity
Year 1	0	600	600*1/3 = 200	250	60	60	-
Year 2	0	900	900*2/3 = 600	500	180	90	30 [(600-500)*30%]
Year 3	0	1,200	1,200	750	360	75	105 [(1200-750)*30%-(30)]
Year 4		1,500	1,500	750	450	-	90 [(1500-750)*30%-(135)]

Question 23

A company issues 0% optionally convertible debt for proceeds of INR 1,00,000. The holder has an option to convert it into fixed number of shares or take cash upon maturity. The optionally convertible debt instruments are accounted for as a compound financial instrument as per Ind AS 32 and Ind AS 109 and a liability of INR 80,000 is recognised on initial recognition and the remaining INR 20,000 is recognised as equity. The tax base of the liability is INR 1,00,000.

At the end of year 1, the Company recognises an interest of INR 8,000 on financial liability component. However, there is no change in the tax base. How deferred tax should be recognised on these instruments on initial recognition and at the end of year 1. Assume a tax rate of 30%.

Response

Paragraph 23 of Ind AS 12 state as follows:

"23 In accordance with Ind AS 32, Financial Instruments: Presentation, the issuer of a compound financial instrument (for example, a convertible bond) classifies the instrument's liability component as a liability and the equity component as equity. In some jurisdictions, the tax base of the liability component on initial recognition is equal to the initial carrying amount of the sum of the liability and equity components. The resulting taxable temporary difference arises from the initial recognition of the equity component separately from the liability component. Therefore, the exception set out in paragraph 15(b) does not apply. Consequently, an entity recognises the resulting deferred tax liability. In accordance with paragraph 61A, the deferred tax is charged directly to the carrying amount of the equity component. In accordance with paragraph 58, subsequent changes in the deferred tax liability are recognised in profit or loss as deferred tax expense (income)."

In the given case, the book base of liability is INR 80,000 and the tax base of the liability is INR 1,00,000. The temporary difference arises from a difference in the classification of the instrument, rather than from a difference in initial recognition - the total carrying amount in both cases is INR 1,00,000. Therefore, as per paragraph 23 of Ind AS 12, the initial recognition exemption does not apply and deferred tax in respect of the taxable temporary difference of INR 20,000 amounting to INR 6,000 is recognised in equity (As per the GN on Ind AS based Schedule III, such equity component is required to be presented as a part of 'Other Equity' under the head, 'Equity component of compound financial instruments').

At the end of year 1, the company recognises an interest of INR 8,000 on financial liability component. Now the book base of the liability is INR 88,000 and the tax base of liability remains at INR 1,00,000. Deferred tax liability of INR 2,400 is reversed in profit and loss in accordance with paragraphs 23 and 58 of Ind AS 12.

Question 24

A company issues mandatorily convertible debt for proceeds of INR 1,00,000 carrying mandatory interest of 10%. The instrument is convertible into fixed number of equity shares upon maturity (3 years).

Compulsorily convertible debt (CCD) instruments are accounted for as compound financial instruments as per Ind AS 32 and Ind AS 109 and a liability of INR 20,000 is recognised (present value of interest payments of INR 30,000 to be paid in future) on initial recognition and the remaining INR 80,000 is recognised as equity (obligation to issue fixed number of equity shares at the maturity).

In the tax jurisdiction of the company, all interest payments of INR 30,000 made on CCD are tax deductible as and when paid. How should deferred tax be recognised on CCD on initial recognition. Assume a tax rate of 30%.

Response

Paragraph 8 of Ind AS 12 state as follows:

"8 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 the given case, the liability recognised represents present value of future interest payments of INR 30,000 as per Ind AS 32. Further, in the tax jurisdiction of the company, all interest payments of INR 30,000 made on CCD are tax deductible as and when paid.

The tax base of the CCD as per paragraph 8 of Ind AS 12 is its carrying amount (INR 20,000) less any amount that will be deductible for tax purposes in respect of that liability in future periods (INR 30,000). Thus, tax base of CCD liability is Nil.

Hence, deferred tax asset should be recognised on deductible temporary difference of INR 20,000 (book base is INR 20,000 and tax base is nil) subject to recoverability. Applying tax rate of 30%, Deferred tax asset of INR 6,000 is to be recognised with corresponding adjustment to equity, i.e. equity recognised is INR 86,000 (INR 80,000 plus INR 6,000).

It should be noted that the tax base of liability for compulsorily convertible debt (CCD) is zero while the tax base of liability for optionally convertible debt instrument (OCD) in question 24 above is the face value of the OCD. The difference is due to the fact that for CCD the liability component includes only the obligation to pay interest coupon which are fully tax deductible and for OCD the liability component includes both obligations to pay interest coupon and principal.

Question 25

X Ltd. enters into a 3 year lease of building on April 1, 2023. Rent of INR 1,000 is payable at the end of every year.

Considering an incremental borrowing rate of 10%, ROU and lease liability at different relevant dates as per Ind AS 116 are as below:

Relevant date	ROU	Lease liability
Lease commencement date (1 April 2023)	2,487	2,487
31 March 2024	1,658	1,736
31 March 2025	829	909
31 March 2026	-	-

Under the applicable tax law of X Ltd., the company gets tax deduction for lease payments as and when the same is paid. Tax deductions are attributable to the lease liability. Tax rate is 30%.

How should deferred tax be recognised after considering the amendment to Ind AS 12 *Deferred Tax related to Assets and Liabilities arising from a Single Transaction?*

Response

Paragraphs 15 and 24 of Ind AS 12 state as follows:

15 A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:

(a) the initial recognition of goodwill; or

(b) the initial recognition of an asset or liability in a transaction which:

(i) is not a business combination;

(ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); and

(iii) at the time of the transaction, does not give rise to equal taxable and deductible temporary differences.

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax liability shall be recognised in accordance with paragraph 39.

24 A deferred tax asset shall be recognised 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 utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

(a) is not a business combination;

(b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); and

(c) at the time of the transaction, does not give rise to equal taxable and deductible temporary differences.

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44."

X Ltd. determines the temporary differences on initial recognition of the lease as follows:

Particulars	**Carrying amount (book base)**	**Tax base**	**Deductible/ (taxable) temporary difference**
Right of use asset	2,487	-[a]	(2,487)
Lease liability	(2,487)	-[b]	2,487

<u>Notes</u>

(a) The tax base of the right-of-use asset is zero because the tax deduction relates to the lease liability and no tax deduction will be available for the asset.

(b) The tax base of the lease liability is zero because it is determined as the carrying amount of 2,487 less the future tax deduction of 2,487.

Thus, on initial recognition, there is equal taxable and deductible temporary differences. Hence, initial recognition exemption as per paragraphs 15 and 24 of Ind AS 12 does not apply and the company should recognise deferred tax asset (subject to recoverability) and deferred tax liability.

Particulars	**Carrying amount (book base)**	**Tax base**	**Deductible/ (taxable) temporary difference**	**Deferred tax asset*/ (liability)**
Lease commencement date (1 April 2023)				
Right of use asset	2,487	-	(2,487)	(746)
Lease liability	(2,487)	-	2,487	746
As of 31 March 2024				
Right of use asset	1,658	-	(1,658)	(497)
Lease liability	(1,736)	-	1,736	521
As of 31 March 2025				
Right of use asset	829	-	(829)	(249)
Lease liability	(909)	-	909	273
As of 31 March 2026				
Right of use asset	-	-	-	-
Lease liability	-	-	-	-

* Assuming recoverability criteria is met

Question 26

On April 1, 2018, Company A and Company B each entered into a 10-year lease of a building with the following identical terms:

− The annual lease payments of 15 are payable at the end of each year.

− The interest rate implicit in the lease cannot be readily determined. The lessee's incremental borrowing rate is 8.15%.

The right-of-use asset and the lease liability at the relevant dates are as follows:

Relevant date	**ROU**	**Lease liability**
Lease commencement date (1 April 2018)	100	(100)
1 April 2022	60	(69)
1 April 2023	50	(60)
31 March 2024	40	(50)

Company A and Company B applied the Ind AS 12 amendments with respect to Deferred Tax related to Assets and Liabilities arising from a Single Transaction in their annual financial statements for the year ending 31 March 2024 and presented comparatives for one year – i.e. the beginning of the earliest comparative period presented is 1 April 2022.

Under the tax law of the jurisdiction of both the companies, the companies get tax deduction for lease payments as and when the same is paid. Tax deductions are attributable to the lease liability.

Previously, company A accounted for deferred tax on a lease under the net approach – i.e. it assessed the temporary differences on a net basis and treat the lease asset and lease liability as 'integrally linked'. On a net basis, on initial recognition of the lease, there is a net temporary difference of zero and hence initial recognition exemption was not applied by company A.

Initial recognition	**Carrying amount**	**Tax base**	**(Taxable)/ Deductible difference**
Right of use asset	100	-	(100)
Lease liability	(100)	-	100
Net	**-**	**-**	**-**

At the end of year 4 (31 March 2022), a taxable temporary difference of 60 existed on the asset, and a deductible temporary difference of 69 existed on the liability. That gave a net deductible temporary difference of 9. Company A recognised a deferred tax asset of 3 for this net difference (assuming recoverability criteria was met) at corporate tax rate of 30%.

As at the end of year 4	**Carrying amount**	**Tax base**	**(Taxable)/ Deductible difference**	**Deferred tax asset/ (liability) at 30% tax rate**
Right of use asset	60	-	(60)	(18)
Lease liability	(69)	-	69	21
Net	**(9)**	**-**	**9**	**3**

Company B applied the gross approach – i.e. it assessed the temporary differences on a gross basis treating the lease asset and lease liability as separate.

Initial recognition	**Carrying amount**	**Tax base**	**(Taxable)/ Deductible difference**
Right of use asset	100	-	(100)
Lease liability	(100)	-	100

Since the taxable temporary difference on ROU asset and deductible temporary difference on lease liability arise on initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss), company B applied initial recognition exemption and therefore recognised no deferred tax for leases as per paragraphs 15 and 24 of Ind AS 12 (both upon initial recognition and as on 31 March 2022). Recoverability criteria were met for recognition of deferred tax asset by company B as well.

How should Company A and Company B apply the transition requirements with respect to Deferred Tax related to Assets and Liabilities arising from a Single Transaction under Ind AS 12.

Response

Paragraphs 15 and 24 of Ind AS 12 state as follows:

15 A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:

(a) the initial recognition of goodwill; or

(b) the initial recognition of an asset or liability in a transaction which:

(i) is not a business combination;

(ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); and

(iii) at the time of the transaction, does not give rise to equal taxable and deductible temporary differences.

However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax liability shall be recognised in accordance with paragraph 39.

24 A deferred tax asset shall be recognised 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 utilised, unless the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that:

(a) is not a business combination;

(b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss); and

(c) at the time of the transaction, does not give rise to equal taxable and deductible temporary differences.

However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint arrangements, a deferred tax asset shall be recognised in accordance with paragraph 44.

Temporary differences on initial recognition of the lease are as follows:

Particulars	**Carrying amount (book base)**	**Tax base**	**Deductible/ (taxable) temporary difference**
Right of use asset	100	-[a]	(100)
Lease liability	(100)	-[b]	100

Notes: Since the tax deduction in respect of lease payments relates to the lease liability:

(a) The tax base of the right-of-use asset is zero because no amount of ROU asset 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

(b) The tax base of the lease liability is zero because it is determined as the carrying amount of 100 less the future tax deduction of 100

Thus, on initial recognition, there is an equal taxable and deductible temporary differences. Hence, as per Ind AS 12 (post amendment), initial recognition exemption as per paragraphs 15 and 24 of Ind AS 12 does not apply and the Company should recognise corresponding deferred tax liability and deferred tax asset subject to recoverability.

Particulars	**Carrying amount (book base)**	**Tax base**	**Deductible/ (taxable) temporary difference**	**Deferred tax asset/ (liability)**
Lease commencement date (1 April 2018)				
Right of use asset	100	-	(100)	(30)
Lease liability	(100)	-	100	30
As of 31 March 2022				
Right of use asset	60	-	(60)	(18)
Lease liability	(69)	-	69	21

Ind AS 12 includes the following transition requirements with respect to Deferred Tax related to Assets and Liabilities arising from a Single Transaction:
98K An entity shall apply Deferred Tax related to Assets and Liabilities arising from a Single Transaction to transactions that occur on or after the beginning of the earliest comparative period presented.

98L An entity applying Deferred Tax related to Assets and Liabilities arising from a Single Transaction shall also, at the beginning of the earliest comparative period presented:

(a) recognise a deferred tax asset-to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised-and a deferred tax liability for all deductible and taxable temporary differences associated with:

(i) right-of-use assets and lease liabilities; and

(ii) decommissioning, restoration and similar liabilities and the corresponding amounts recognised as part of the cost of the related asset; and

(b) recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at that date.

Because company A previously accounted for deferred tax on a lease under the net approach, it should record the following entry on transition (1 April 2022) to reflect the deferred tax asset and the deferred tax liability separately relating to the lease. The deferred tax asset and deferred tax liability should be offset for the purpose of presentation on the face of balance sheet (with separate disclosures in notes), if requirements of paragraph 74 of Ind AS are met.

Particulars	**Debit**	**Credit**
Deferred tax asset	18*	
Deferred tax liability		18

* Company A has already recognised deferred tax of 3 at 1 April 2022 so the deferred tax asset becomes 21.
There is no impact on company A's retained earnings at 1 April 2022.

Company B previously applied the initial recognition exemption and recognised no deferred tax for leases. Therefore, company B should record the following entry on transition (1 April 2022) to recognise the deferred tax asset and the deferred tax liability relating to the lease.

Particulars	**Debit**	**Credit**
Deferred tax asset	21	
Deferred tax liability		18
Retained earnings		3

Appendix I

[Note: The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 12, Income Taxes and the corresponding International Accounting Standard (IAS) 12, Income Taxes, issued by the International Accounting Standards Board.]

Major difference between Ind AS 12, *Income Taxes* and IAS 12, *Income Taxes*

(i) Since fair value model is not allowed in Ind AS 40, paragraphs 20 and 51E of Ind AS 12 have been modified by not giving reference of Ind AS 40 and consequently paragraphs 51C-51D have been deleted.

(ii) IAS 12 (paragraph 68(a) provides that acquired deferred tax benefits recognised within the measurement period that results from new information about facts and circumstances existed at the acquisition date shall be applied to reduce the carrying amount of goodwill related to that acquisition. If the carrying amount of that goodwill is zero, any remaining deferred tax benefits shall be recognised in profit or loss. As a consequence of different accounting treatment of bargain purchase gain prescribed in Ind AS 103, in comparison to IFRS 3, Ind AS 12 provides that if the carrying amount of such goodwill is zero, any remaining deferred tax benefits shall be recognised in other comprehensive income and accumulated in equity as capital reserve or recognised directly in capital reserve.

Appendix II

[Note: The purpose of this Appendix is only to bring out the major differences, if any, between Indian Accounting Standard (Ind AS) 12, Income Taxes and Accounting Standard (AS) AS 22, Taxes on Income]

Major differences between Ind AS 12, *Income Taxes and Accounting Standard (AS) AS 22, Taxes on Income*

(i) Ind AS 12 is based on balance sheet approach. It requires recognition of tax consequences of differences between the carrying amounts of assets and liabilities and their tax base. AS 22 is based on income statement approach. It requires recognition of tax consequences of differences between taxable income and accounting income. For this purpose differences between taxable income and accounting income are classified into permanent and timing differences.

(ii) As per Ind AS 12, subject to limited exceptions, deferred tax asset is recognised 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 utilised. The criteria for recognising deferred tax assets arising from the carry forward of unused tax losses and tax credits are the same that for recognising deferred tax assets arising from deductible temporary differences. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. 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. While, as per AS 22, deferred tax assets are recognised and carried forward 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. Where deferred tax asset is recognised against unabsorbed depreciation or carry forward of losses under tax laws, it 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. AS 22 explains what may be considered as virtual certainty supported by convincing evidence.

(iii) As per Ind AS 12, current and deferred tax are recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from a transaction or event which is recognised outside profit or loss, either in other comprehensive income or directly in equity, in those cases tax is also recognised in other comprehensive income or in equity, as appropriate. AS 22 does not specifically deal with this aspect.

(iv) As per Ind AS 12, deferred tax liability is recognised for all taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, if certain conditions are satisfied. AS 22 does not deal with this aspect.

(v) As per Ind AS 12, deferred tax should be recognised on temporary differences that arise from the elimination of profit and losses resulting from the intra- group transactions. While as per AS 22, deferred tax in consolidated financials are a simple aggregation of the deferred tax recognised by the group entities.

(vi) Ind AS 12 requires that deferred tax asset/liability arising from revaluation of non-depreciable assets shall be measured on the basis of tax consequences from the sale of asset rather than through use. AS 22 does not deal with this aspect.

(vii) Ind AS 12 provides guidance as to how an entity should account for the tax consequences of a change in its tax status or that of its shareholders. AS 22 does not deal with this aspect.

(viii) AS 22 specifically provides guidance regarding recognition of deferred tax in the situations of Tax Holiday under Sections 80-IA and 80-IB and Tax Holiday under Sections 10A and 10B of the Income Tax Act, 1961. Similarly, AS 22 provides guidance regarding recognition of deferred tax asset in case of loss under the head 'capital gains'.

Ind AS 12 does not specifically deal with these situations.

(ix) AS 22 specifically provides guidance regarding tax rates to be applied in measuring deferred tax assets/liabilities in a situation where a company pays tax under section 115JB. Ind AS 12 does not specifically deal with this aspect.

(x) Ind AS 12 specifically provides guidance on Uncertainty over Income Tax treatment whereas AS 22 gives no such guidance.

(xi) Disclosure requirements given in Ind AS 12 are more detailed as compared to AS 22.