Income Taxes- Ind AS 12

Agenda

1. Scope and key terms
2. Recognition and Measurement principles
3. Consolidation – Outside tax basis
4. Uncertain tax positions
5. Presentation and Disclosures
6. Summary-Nine step approach
7. Key GAAP Differences- Ind AS vs. Indian GAAP

Scope and Key Terms

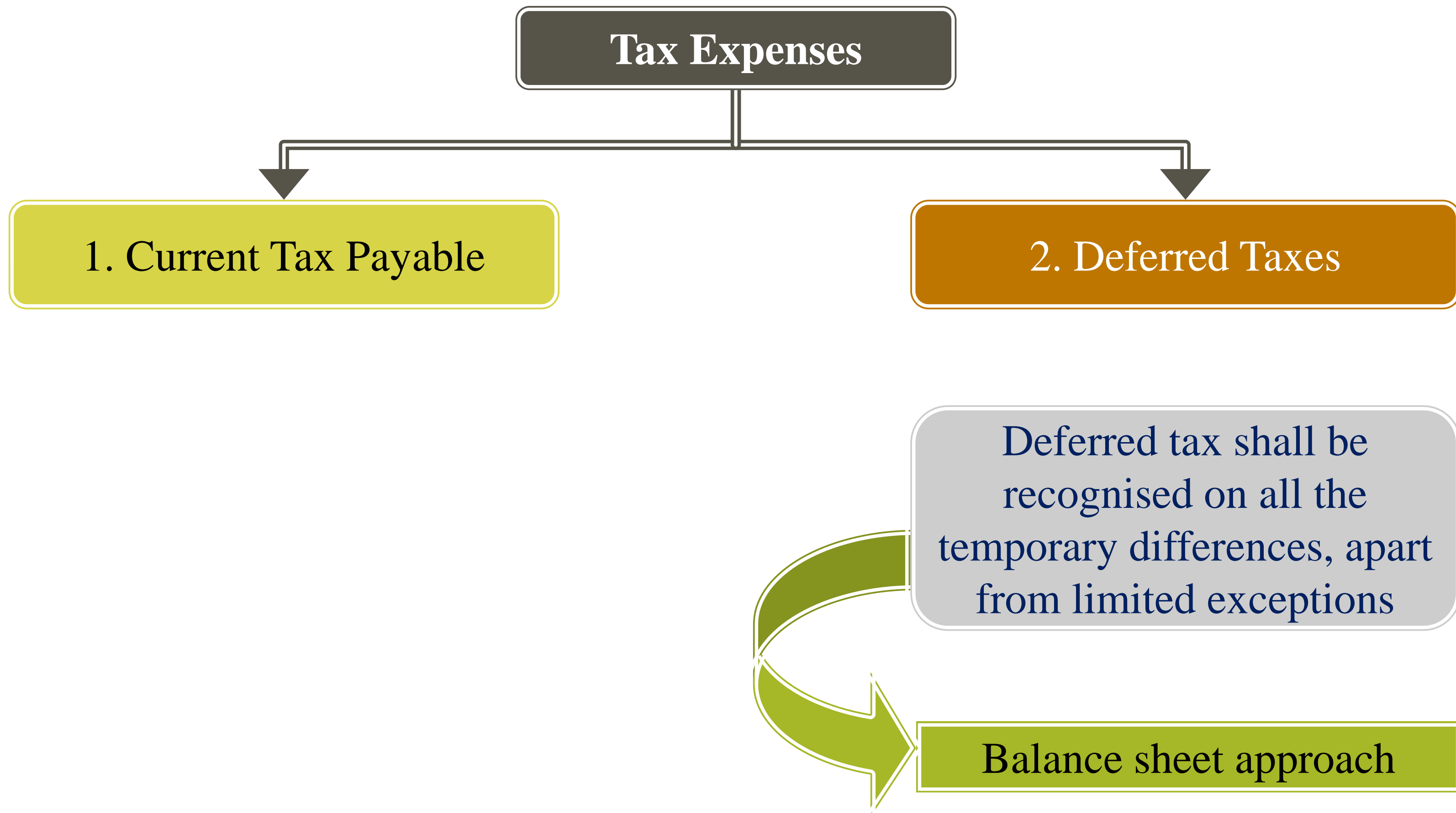
Objective

- Prescribe accounting treatment for current income taxes and future tax consequences i.e. deferred taxes.
- Deferred tax effects on business combinations and unused tax losses or credit.
- Presentation and disclosure requirements

Scope

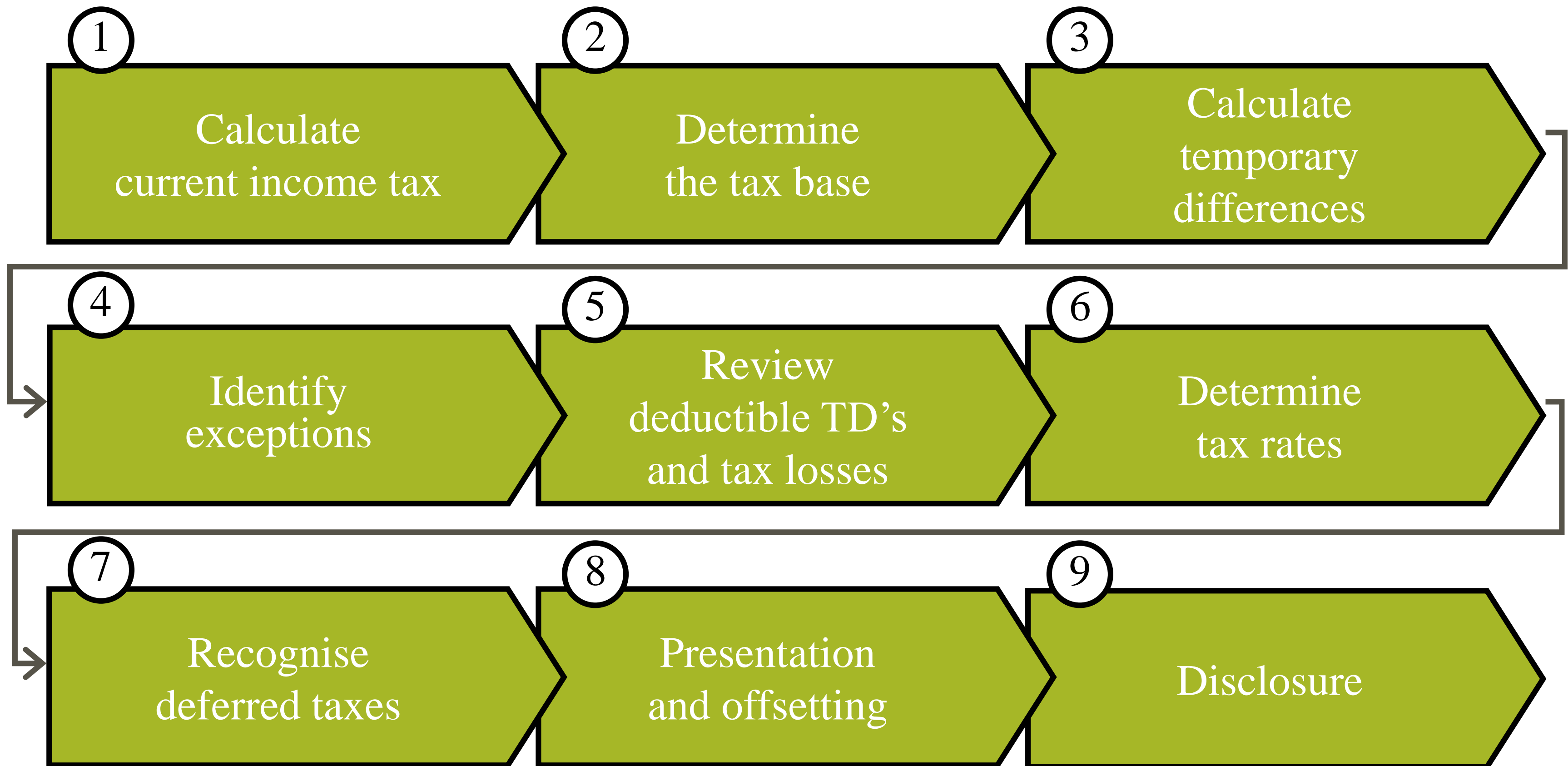
- Apply to all income taxes (domestic & foreign) based on "**taxable profit**"
- Includes withholding tax (payable by subsidiary on distribution by parent)
- Excludes other taxes (VAT/business taxes) and method of accounting for government grants.

Income Taxes – Basic



Recognition and Measurement Principles

Nine step approach to calculating deferred tax



Recognition

- 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.
- The benefit relating to a tax loss that can be carried back to recover current tax of a previous period shall be recognised as an asset.

Measurement

Current tax

- 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

- Measured at the tax rates that are expected to apply to the period when the assets is realized or the liability is settled, based on the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

DTA/ DTL should not be discounted.

Understanding Balance Sheet Method

How to Compute deferred tax ?

Apply the substantively enacted tax rate to calculate Deferred tax asset / liability

Tax Base of an Asset

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

Check your understanding – Tax Base of an Asset

	Scenarios	Tax Base
1	A machine cost Rs.100. For tax purposes, depreciation of Rs.30 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the machine is taxable, any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes.	Rs. 70
2	Interest receivable has a carrying amount of Rs.100. The related interest revenue will be taxed on a cash basis.	Nil
3	Trade receivables have a carrying amount of Rs.100. The related revenue has already been included in taxable profit (tax loss).	Rs. 100
4	Inventory of Rs. 100 in the balance sheet will be recovered in the next period through transfer to cost of sales.	Rs. 100
5	A loan receivable has a carrying amount of Rs.100. The repayment of the loan will have no tax consequences.	Rs. 100

Tax Base of a Liability

- 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"
- Tax base = Future taxable amount

Check your understanding – Tax Base of a Liability

	Scenarios	Tax Base
1	Current liabilities include accrued expenses with a carrying amount of Rs.100. The related expense will be deducted for tax purposes on a cash basis.	Nil
2	Current liabilities include interest revenue received in advance, with a carrying amount of Rs.100. The related interest revenue was taxed on a cash basis.	Nil
3	Current liabilities include accrued expenses with a carrying amount of Rs.100. The related expense has already been deducted for tax purposes.	Rs. 100
4	Current liabilities include accrued fines and penalties with a carrying amount of Rs.100. Fines and penalties are not deductible for tax purposes.	Rs. 100
5	A loan payable has a carrying amount of Rs.100. The repayment of the loan will have no tax consequences.	Rs. 100

Understanding Temporary Difference

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

Temporary Differences	
	TAXABLE TEMPORARY DIFFERENCE give rise to future taxable amounts
	DEDUCTIBLE TEMPORARY DIFFERENCE give rise to future tax deductible amounts

The following are examples of temporary differences:

a) An item of income or expenditure is included in accounting profit of the period, but recognised in taxable profit in later periods, eg gratuity accrual.

b) Assets are revalued and no equivalent adjustment is made for tax purposes.

c) The tax base of an asset/liability on initial recognition differs from initial carrying amount eg. when an entity benefits from non-taxable government grants related to assets.

d) Identifiable assets & liabilities of business combination recognised at fair value but no adjustment for the same is made for tax purpose.

e) Goodwill arises in business combination.

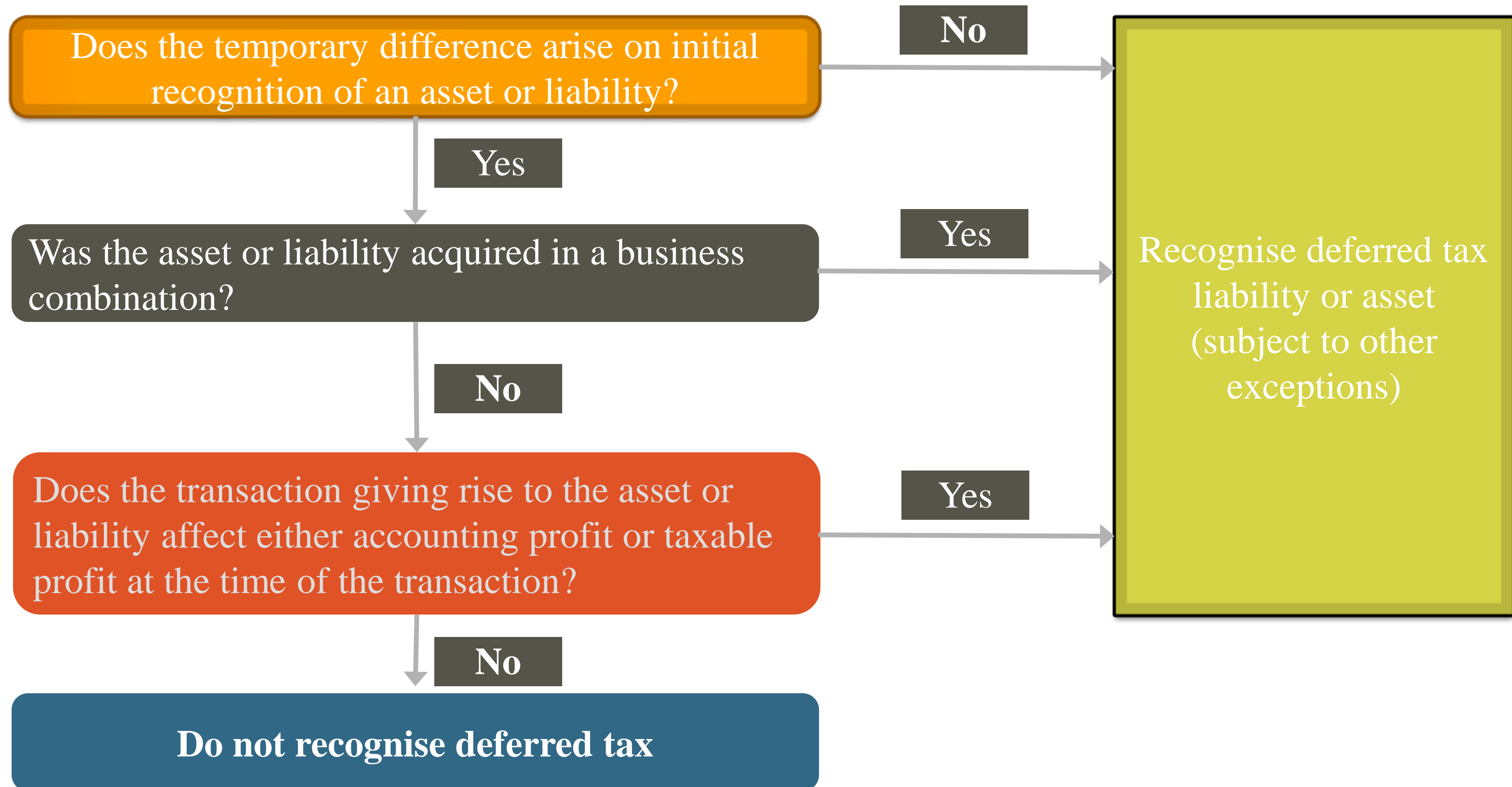
f) Difference in carrying amount and tax base of investment in subsidiaries, associates, JV, branches.

Check your understanding – Temporary Difference

	Scenarios	Temporary difference
1	A machine has cost Rs. 200 and now has a net book value of Rs. 150. For tax purposes, the cumulative depreciation (i.e. total tax allowances to date) is Rs. 110.	(60) DTL
2	An entity recognises a liability of Rs. 100 for product warranty costs. For tax purposes, the warranty costs are deductible only when claims are made.	100 DTA
3	An entity has taken out a foreign currency loan of $ 100 that is recorded at Rs. 6,250. At the reporting date, the carrying amount of the loan is Rs. 5,750. The unrealised exchange gain of Rs. 500 is included in profit or loss, but will be taxable when the gain is realised on repayment of the loan.	(500) DTL
4	Provision for doubtful debts made in accounting books for Rs. 200 but same will be allowed for tax purpose only when debts will be written off.	200 DTA

Temporary Difference Exceptions (Contd.)

Temporary difference arising on initial recognition of an asset or liability



Temporary differences – Where to give effect

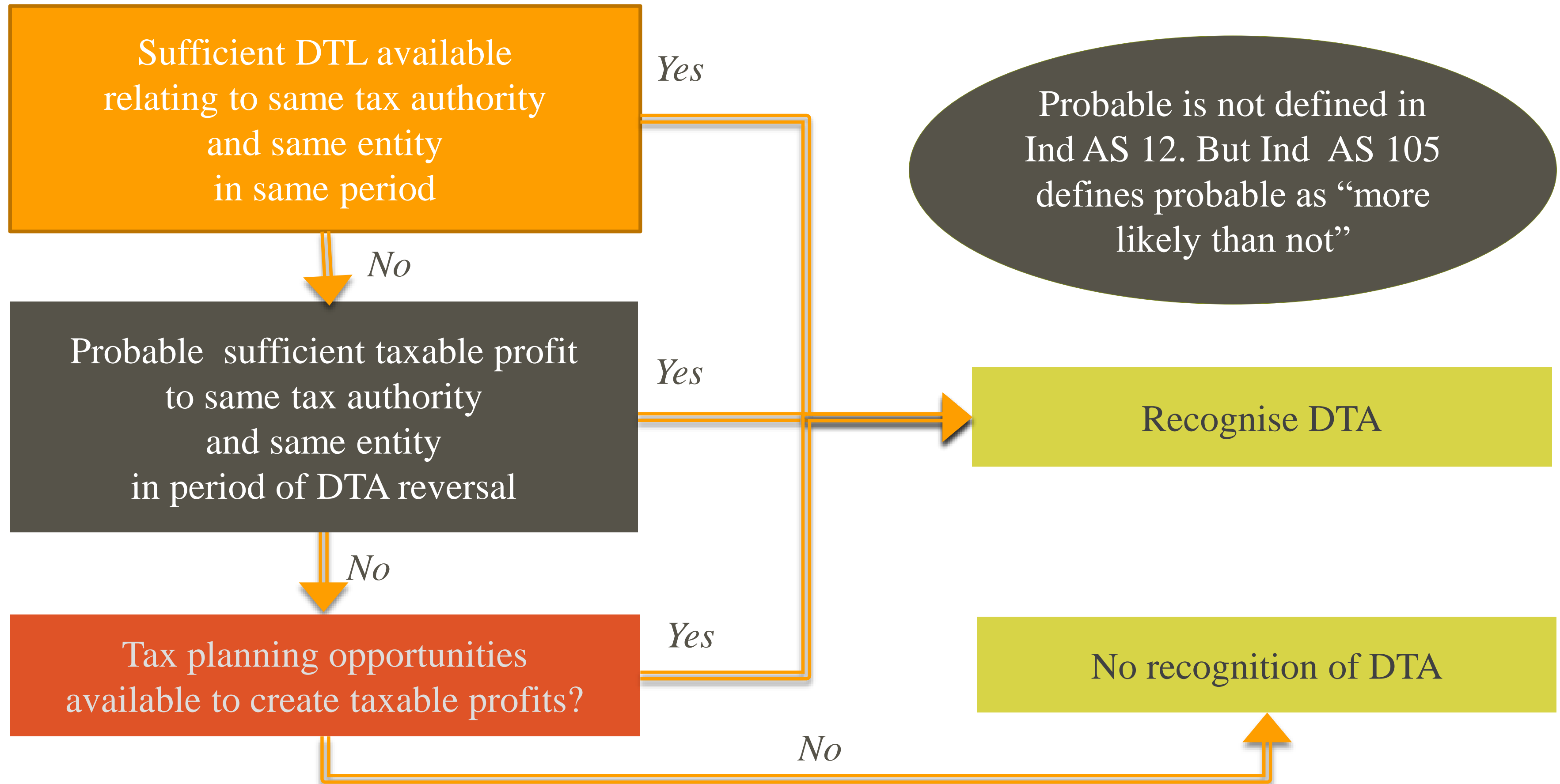
Deferred Tax effect: Account for deferred tax consequences of transaction in same way that it account for transaction themselves.

Situation	Where deferred tax is recorded
General rule	Income statement
Adjustment to FV on acquisition	Adjust goodwill
Transaction or event recognised in equity/OCI	Equity/OCI

Check your understanding – Where to give deferred tax effect

	Scenarios	Effect in
1	Temporary difference due to depreciation	P&L
2	A change in carrying amount arising from the revaluation of property, plant and equipment.	OCI
3	An adjustment to the opening balance of retained earnings resulting from either a change in accounting policy that is applied retrospectively or the correction of an error.	Equity
4	Adjustment to fair value of assets/liabilities on acquisition	Adjust goodwill
5	Temporary difference on MTM of derivative contract designated in hedge relationship (Cash flow hedge)	OCI

Deferred Tax Asset Recognition



The carrying amount of a deferred tax asset should be reviewed at each balance sheet date

Tax planning opportunity are not offset against DTL they are specifically used for DTA

Deferred Tax Asset – Certain points

- Future taxable profit

The future realisation of deferred tax assets depends on the expectation of sufficient taxable profit of the appropriate type (trading profit or capital gain) being available for the offset of deductible temporary differences or unused tax losses

Where there are insufficient taxable temporary differences against which the deferred tax asset can be offset, it is necessary to consider the likelihood that taxable profits will arise in the same period(s) as the reversal of the deductible temporary differences.

- Re-assessment of recoverability at each balance sheet date

Unused tax losses and unused tax credits

- DTA is recognised for unused losses and unused tax credits to the extent it is probable that future taxable profit will be available against which it can be utilised.
- In case when company has a history of recent losses, then recognise only to the extent of sufficient taxable temporary differences or convincing other evidence that future taxable profit will be available.
- Nature of evidence supporting its recognition needs to be disclosed.

Check your understanding – Unused tax losses and unused tax credits

Q. When assessing the recoverability of deferred tax assets arising from the carry forward of unused tax losses and unused tax credits, should a deferred tax asset be recognised where the amount of probable future taxable profit available is sufficient only for a portion, rather than the total, of the unused tax losses or unused tax credits?

Answer: Yes

Ind AS 12.34 states the following:

"A deferred tax asset shall be recognised for the carryforward 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 utilized."

Deferred Taxes on Business combination

- Assets acquired and liabilities assumed are recognised at fair values at the acquisition date.
- However, the tax bases of individual assets remains at cost to the previous owner.
- Changing the carrying amount (to fair value) affects temporary differences and accordingly deferred taxes.
- These tax consequences impact goodwill and are recognised when accounting for the business combination.
- However, no deferred tax liability is recognised on the initial recognition of goodwill itself as this would result in grossing up of goodwill.

Applicable Tax Rate

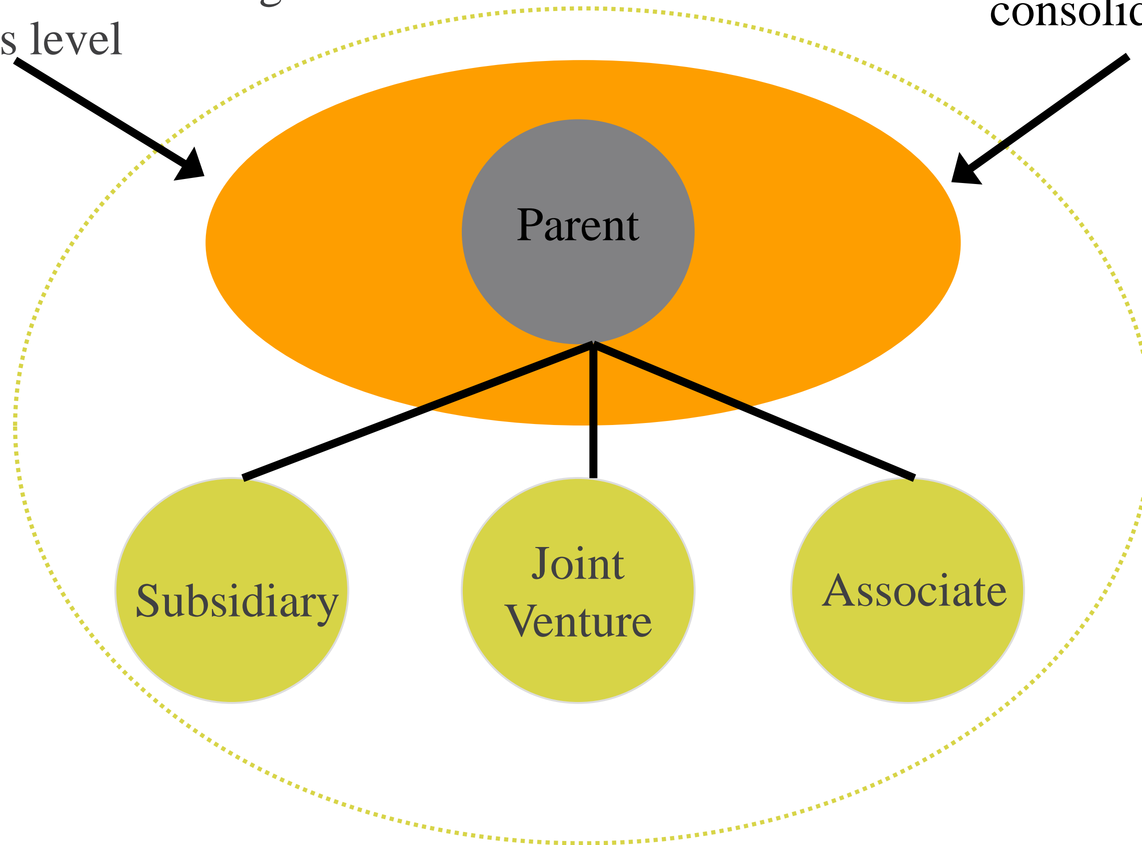
- Deferred tax to be measured based on tax rates and laws that have been enacted or substantively enacted at the balance sheet date.
- Impact of the changes in tax rates is recognised in profit and loss except to the extent it relates to the items previously recognised outside profit and loss e.g. OCI or equity.
- Expected manner of recovery or settlement of an asset or a liability depend on the manner in which the recovery of the asset or settlement of the liability takes place.

Consolidation – outside tax basis

Consolidation – outside basis

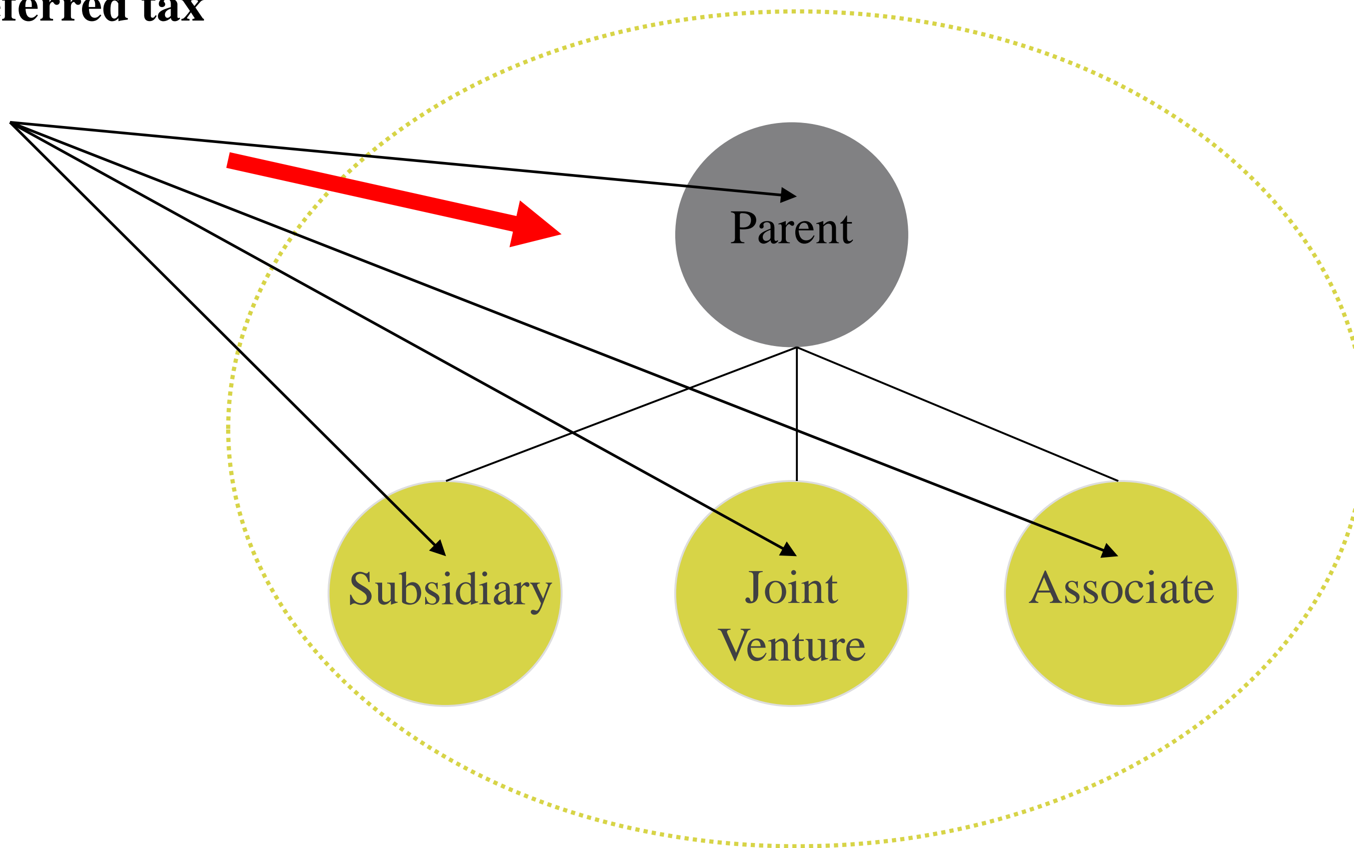
So far we have been thinking about accounts at this level

But, what about consolidated accounts?



Consolidation – outside basis vs inside basis

Deferred tax



Consolidation – outside basis example

- On 31 Dec 2015 JCN acquired a 30% stake in a Chinese laptop manufacturer and accounted for it as an associate.
- In 2016, the associate generated a profit of INR 60M.
- Withholding tax of 10% would be levied on any dividend distribution. JCN expects to realize its investment through dividend distribution.

How would you have accounted for the deferred tax on share of profit of the associate under Indian GAAP?

Solution : Do Nothing!

Consolidation – outside basis example

- On 31 Dec 2015 JCN acquired a 30% stake in a Chinese laptop manufacturer and accounted for it as an associate.
- In 2016, the associate generated a profit of INR 60M.
- Withholding tax of 10% would be levied on any dividend declaration. JCN expects to realize its investment through dividend declaration.

How will you account for the deferred tax on share of profit of the associate under Ind AS?

Solution : In consolidation, JCN accounts for its share in profit of the associate as INR 18 million and recognises a deferred tax liability of Rs. 1.8 million on unremitted profits of INR 18 million at rate of 10%.

DTL not to be recognised if:

- JCN can control the timing of the reversal of temporary difference i.e. declaration of dividend ; AND
- It is probable that the temporary difference will not reverse in the foreseeable future

Generally, this may be possible in case of dividends from subsidiaries.

Uncertain Tax Position

Ind AS 12 – Income taxes : Uncertain tax positions

Uncertain tax positions (e.g. item of expense or transaction that may be challenged by Tax authority)

Liability is measured using the expected value (weighted average probability) approach or a single best estimate of the most likely outcome

Entity K takes a deduction in a tax return that might be challenged by the tax authorities. It estimates a 40% probability that additional tax of 120 will be payable and a 60% probability that additional tax of 80 will be payable. Calculate the liability for uncertain tax position.

Most likely outcome 80.
Probability weighted outcome 96 ($120 \times 40\% + 80 \times 60\%$).

Presentation and Disclosures

Disclosures

- Major component of tax expenses (income) to be separately disclosed such as :
  - ✓ Current tax expense
  - ✓ Prior period adjustment
  - ✓ Deferred tax expense/income
- Aggregate current and deferred tax relating to items charged or credited directly to equity
- Income tax relating to each component of other comprehensive income
- **Reconciliation**
  - ✓ a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed; or

Disclosures (contd.)

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

- An explanation of **changes in the applicable tax rate** compared to the previous accounting period;
- **Amount and expiry date**, if any of deductible temporary differences, unused losses and credits for which **no DTA recognized**
- Aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, for which deferred tax liabilities **have not been recognised**;

Disclosures (contd.)

- In respect of discontinued operations, the tax expense relating to:
  - ✓ the gain or loss on discontinuance; and
  - ✓ the profit or loss from the ordinary activities of the discontinued operation for the period, and corresponding amounts for each prior period presented;

- Amount of deferred tax asset recognised and **nature of evidence** supporting its recognition, when:
  - ✓ the utilization of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and
  - ✓ the entity has suffered a loss in either the current or preceding period **(history of losses)**

Disclosures (contd.)

- In respect of each type of temporary difference, and in respect of each type of unused tax losses and unused tax credits:
  - ✓ the amount of the deferred tax assets and liabilities recognised in the balance sheet for each period presented;
  - ✓ the amount of the deferred tax income or expense recognised in profit or loss, if this is not apparent from the changes in the amounts recognised in the balance sheet;

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

Decoding Rate Reconciliation

Accounting Profit	2500
Tax@ Domestic rate of 30%	750
Tax effect of expenses that are not deductible for tax purposes	60
Effect of lower tax rates in country B	(50)
Tax expenses	760

Note:

- The above rate reconciliation will ensure accuracy of the Deferred Tax Computation. The rate reconciliation could also reflect rate changes.

Presentation – Offset

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

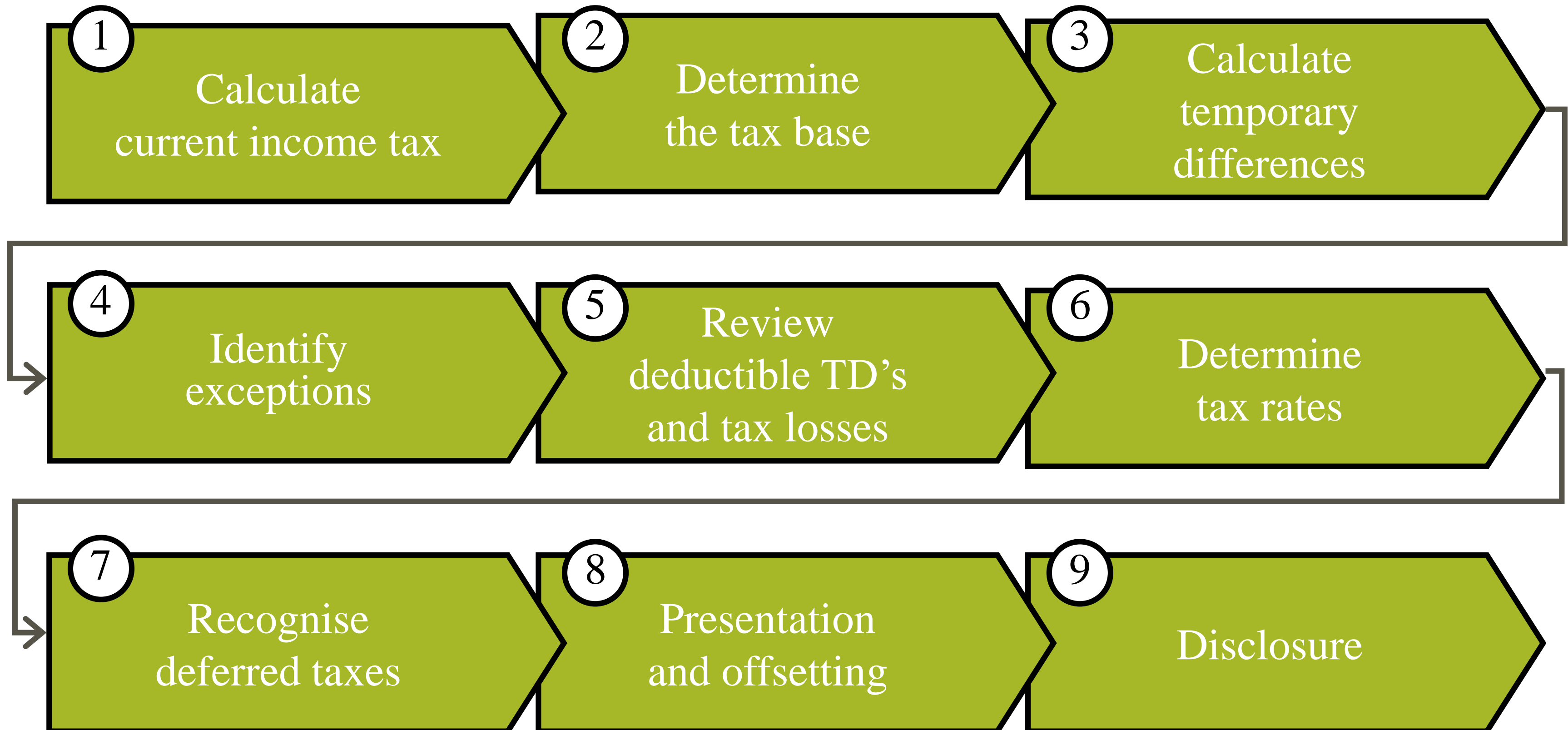
(b) the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the **same taxation authority** on either:

(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.

Summary – Nine Step Approach

Summary – Nine step approach to calculating deferred tax



Key GAAP Differences – Ind AS vs. Indian GAAP

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Particulars	Ind AS	Indian GAAP
Approach for deferred taxes	**Balance sheet approach** (Temporary differences)	**Profit and loss approach** (timing differences)
Recognition of taxes in OCI or Equity	Tax on items recognised in OCI or directly in equity is also recorded in OCI or equity, as appropriate	No specific guidance
Recognition of DTA on unused tax losses, etc.	DTA is recognised for unused losses and tax credits to the extent it is **probable** that future taxable profit will be available	Unused losses – **Virtual** certainty of future taxable profits
Deferred tax in business combination	Deferred tax to be recorded on fair value adjustment on acquisition.	No specific guidance

Key GAAP differences – Ind AS vs. Indian GAAP (contd.)

Particulars	Ind AS	Indian GAAP
Investment in Subsidiary, JV, branch, etc.	DTL for all taxable temporary difference are recognised except to the extent: • Parent control timing of reversal of difference, and • Probable that difference will not reverse in foreseeable future	No DTL – Simple aggregation from separate financial statements of subsidiary and no adjustment on consolidation.
Deferred tax on unrealised intra-group profits	Recognised at buyer's rate	Not recognised
Disclosures	Certain additional disclosures like Reconciliation, details of tax holiday and expiry of losses, unrecognised DTL etc. are required.	Not required

Thank you