6th IFRS Study Group Meeting

Indian Accounting Standard(Ind AS) 12
Income Taxes

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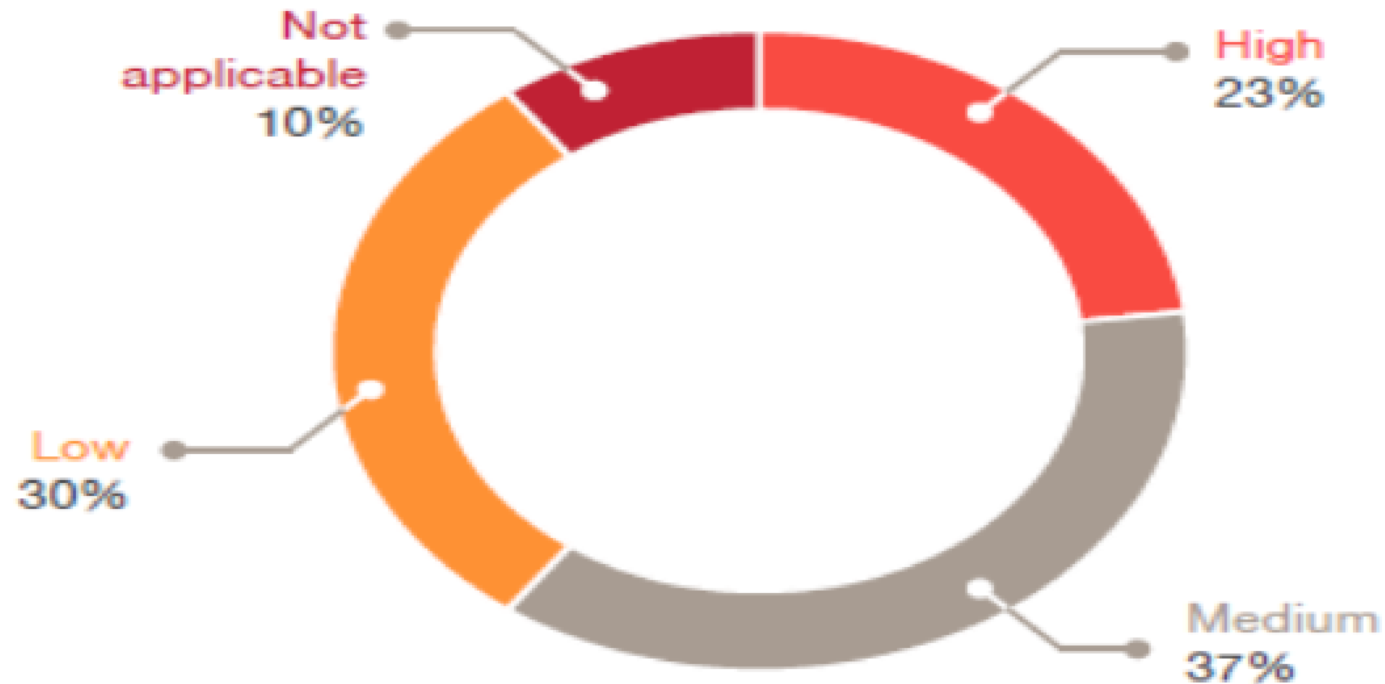
Today's Agenda:

- ❑ Objective & Scope
- ❑Some Important "New Definition" & "New Concepts"
- ❑Interesting aspects
- ❑Presentation & Disclosure
- ❑ ***9*** Step theory approach
- ❑Practical Challenges
- ❑Case Studies

Some Facts:



Source: PWC Ind AS Outlook Survey

Objective & Scope

Objective & Scope: *(Para 1 to Para 4)*

“*New*”-Definitions & Concepts

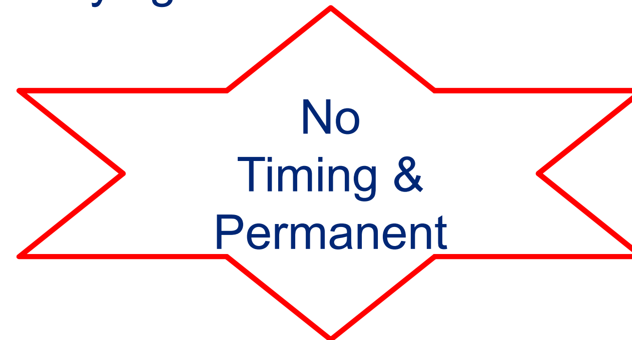
Definition & Concepts: *(Para 5 to Para 9)*

- Accounting Profit- "As per books of accounts- General Purpose Financial Statement"

- Taxable Profit- Profit/(Loss) determined in accordance with rules on which income taxes are payable/(recoverable)

- Temporary Difference-are differences between carrying amount of an asset or liability in the balance sheet & its ***tax base***

  - Taxable temporary differences
  - Deductible temporary differences

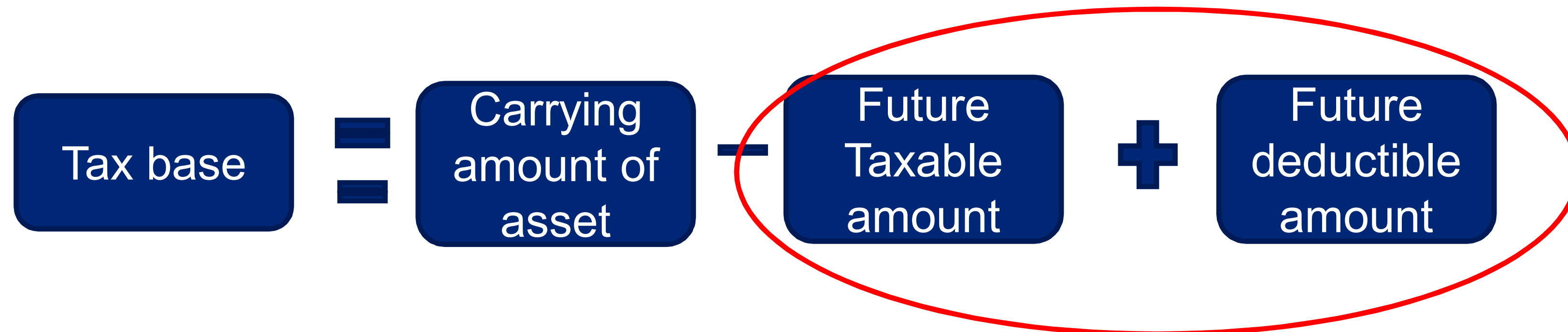


- ***Tax Base***- of an asset or liability is the amount attributed to that assets or liability for tax purpose
  - Tax Base of an asset
  - Tax Base of an liability

Tax Base:

- ***Tax Base of an Assets-***

*is the amount that will be **deductible for tax purpose** against any taxable economic benefit that will flow to an entity when it recovers the carrying amount of the asset*



- Tax base= Future deductible amount

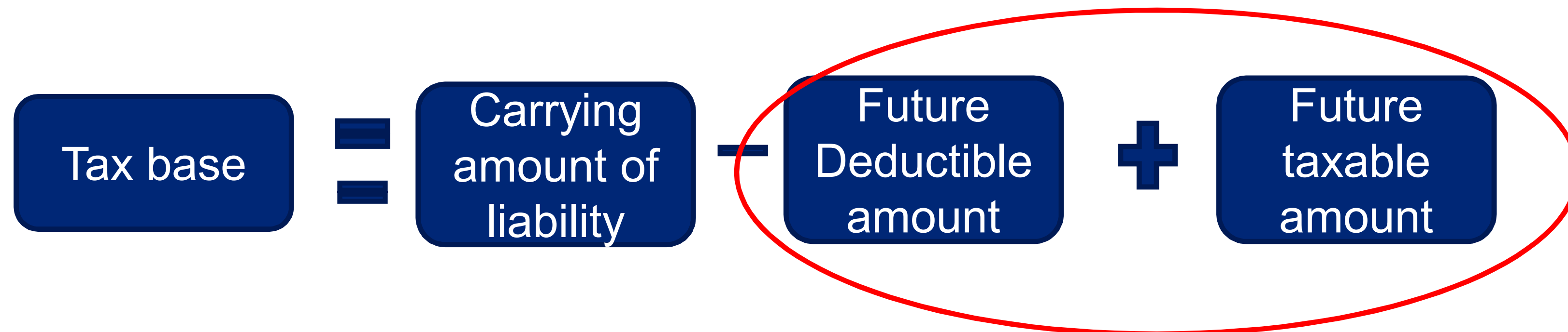
Did you get it?- Tax base of an assets

Situations	Tax Base
A machine cost INR 100. For tax purposes, depreciation of INR 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.	INR 70
Interest receivable has a carrying amount of INR 100. The related interest revenue will be taxed on a cash basis.	NIL
Trade receivables have a carrying amount of INR 100. The related revenue has already been included in taxable profit (tax loss).	INR 100
Inventory of INR 100 in the balance sheet will be recovered in the next period through transfer to cost of sales.	INR 100

Tax Base:

- ***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 period.

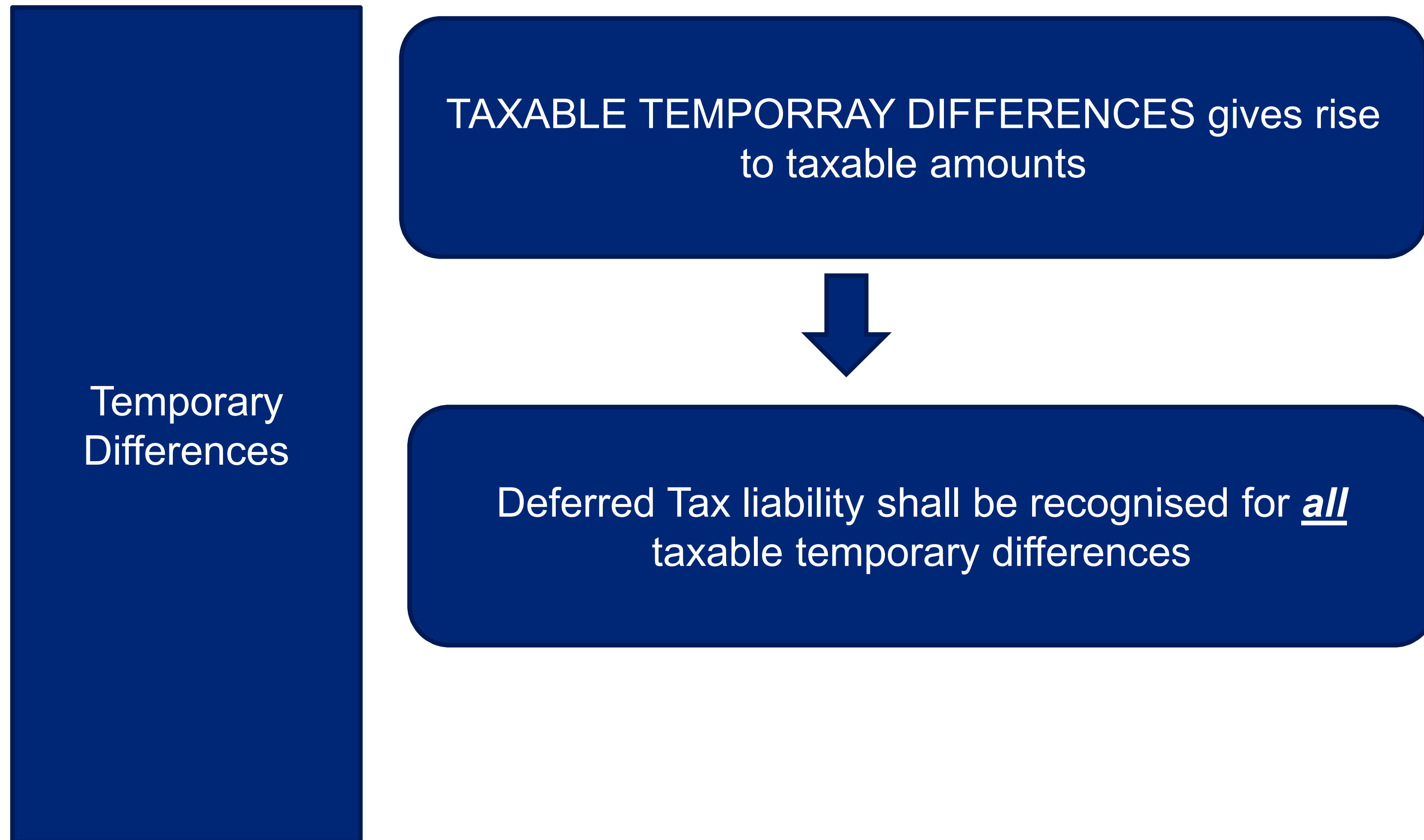


- Tax base= Future taxable amount

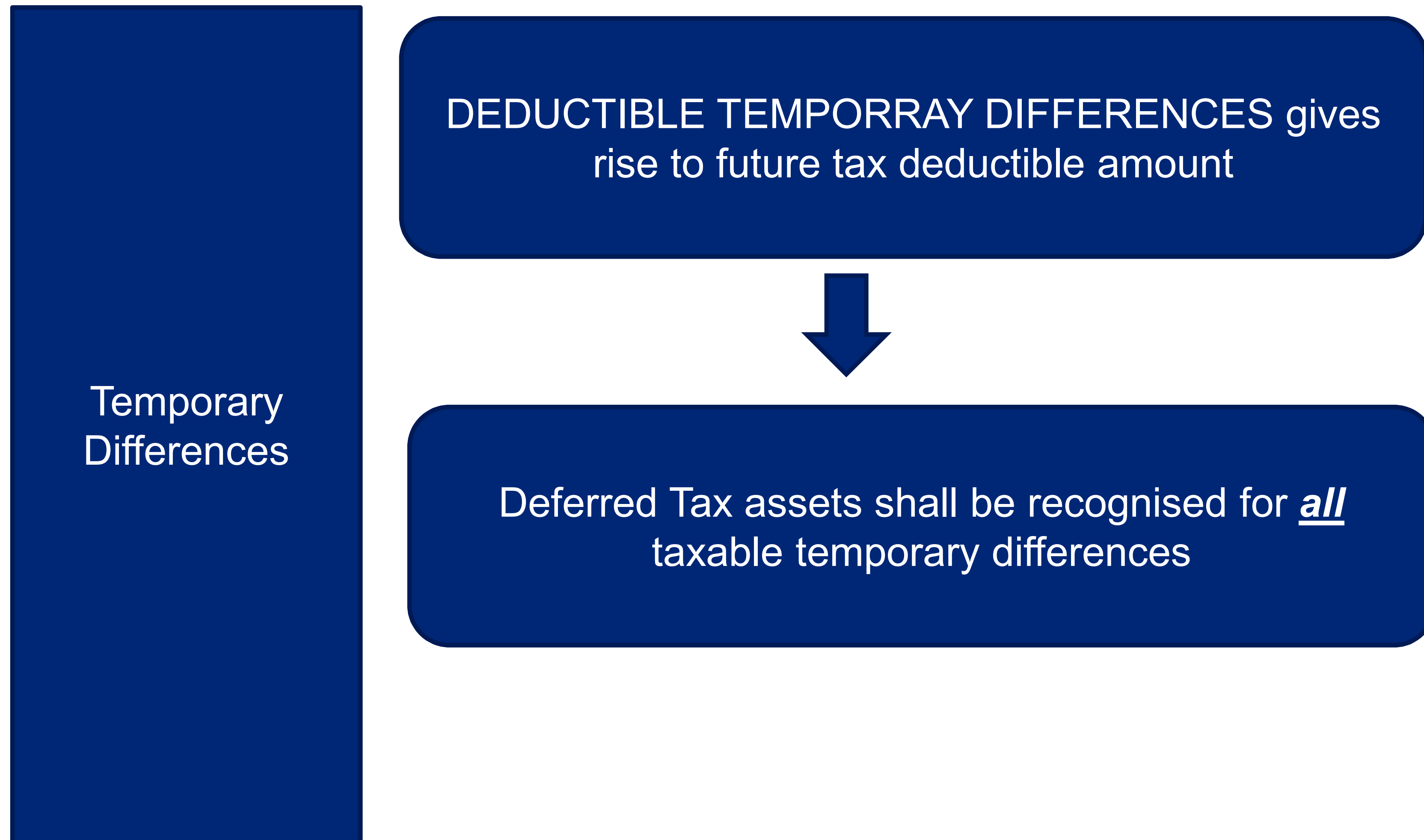
Did you get it?- Tax base of a liability

Situations	Tax Base
Current liabilities include accrued expenses with a carrying amount of INR 100. The related expense will be deducted for tax purposes on a cash basis.	Nil
Current liabilities include interest revenue received in advance, with a carrying amount of INR 100. The related interest revenue was taxed on a cash basis.	Nil
Current liabilities include accrued expenses with a carrying amount of INR 100. The related expense has already been deducted for tax purposes.	INR 100
Current liabilities include accrued fines and penalties with a carrying amount of INR 100. Fines and penalties are not deductible for tax purposes.	INR 100

Temporary Differences: *(Para 15 to Para 31)*



Temporary Differences: *(Para 15 to Para 31)*



Did you get it?- Temporary Differences

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

Effect in the Financial Statement

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

Situation	Effect
Normal Principle	Income Statement
Transactions recognised in OCI	OCI
Transaction recognised in equity	Equity

- Check the following:

Situations	Effects
Temporary difference due to depreciation	P & L
A change in carrying amount arising from the revaluation of PPE	OCI

“Interesting aspects”

Unused tax losses & Unused tax credits: *(Para 34 to Para 37)*

- DTA is recognised for unused losses and ununsed tax credits to the extent it is ***probable*** that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.

- ***Probable***- not defined in Ind AS 12, factors to consider:
  - Existence of sufficient taxable temporary differences
  - Taxable profit before UTL or UTC expires
  - Identified causes unlikely to recur

- Re-assess the unrecognised DTA on each reporting date

- Requirement under Ind AS 12 relaxed but not become easy **~~("Virtual Certainity")~~**

- Situation where DTA under Ind AS 12 but not under AS-22

Case Studies:

CS-1:

A newly set-up entity (New Co.) incurred significant losses in the first three years of operations due to reasons such as advertising and initial set-up related costs, significant borrowing costs and lower level of activity in the first two years of operations. Over the years, there has been a significant increase in the operations of New Co. and its advertisement cost has stabilised to a normal level.

Further, it has raised new capital during the year and repaid its major borrowing. The cumulative effect of all the events is that the New Co. has started earning profits from the fourth year. It is expected to make substantial profits in the next three years that may absorb the entire accumulated tax loss of the entity. However, the nature of the business is such that it does not have any binding orders. What will be your opinion in light of Ind AS-12?

Case Studies:

CS-2:

A battery manufacturer (Battery Co.), who had incurred tax losses in the past, enters into an exclusive sales agreement with a car manufacturer (Car Co.). According to the agreement, all the cars manufactured by Car Co. will only use batteries manufactured by Battery Co. Though Car Co. has not guaranteed any minimum off-take, there is significant demand for its cars in the market

Analysis:

The virtual certainty principal has a fatal law; since nothing in this world is virtually certain. Even profitable binding orders could be cancelled without receiving any penalty or the buyer/seller could end up getting bankrupt.

The principle of convincing evidence under Ind AS -12 is not only fair, but is also practical to apply, compared to the "Virtual certainty" principle under AS-22.

Investment in Group companies: *(Para 39 to Para 45)*

- Accounted at ***Cost*** when the parent or investor acquires such an Investment (i.e. Carrying amount of Investment)- in SFS

- CFS- investment is recorded as follows:
  - Subsidiary- line by line consolidation
  - Associates- Equity Method of Accounting
  - JV's- Proportionate Consolidation

- Carrying value and its tax base- temporary differences due to existence of undistributed profits

- DTL should be recognised for all taxable temporary differences except following:
  - *Investor is able to control the timing of reversal of temporary difference and*
  - *It is probable the difference will not reverse in future*

Case Studies:

CS-3:

On 1st April 2014, ABC Ltd acquired 100% shares of XYZ Ltd for Rs. 4,373 crores. By 31st March, 2015, XYZ Ltd had made profits of Rs. 5 crores, which remain undistributed. Based on the tax legislation in India, the tax base investment in XYZ Ltd is its original cost. Assume the dividend distribution tax rate applicable is 15%.

Analysis:

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

Case Studies:

CS-4:

On 15th March, 2015, XYZ Ltd sells to ABC Ltd inventory with a cost of Rs. 120 crores giving rise to taxable profit of Rs. 20 crores in the books of XYZ Ltd. The inventory is lying in the books of ABC Ltd as on 31st March, 2015.The corporate income tax rate applicable to ABC Ltd is 30% while that of XYZ Ltd is 34%.

Analysis:

Under Ind-AS 12, a deferred tax asset would be recognized on the unrealized profit of Rs. 20 based on the tax rate applicable for ABC Ltd.

Case Studies:

CS-5:

ABC Ltd acquired 50% of the shares in PQR Ltd on 1st January 2014 for Rs.1000 crores. By 31st March, 2015 PQR Ltd had made profits of Rs. 50 crores (ABC Ltd.'s share), which remained undistributed. Based on the tax legislation in India, the tax base of the investment in PQR Ltd is its original cost. Assume the dividend distribution tax rate applicable is 15%.

Analysis:

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

“Presentation & Disclosure”

Measurement: *(Para 46 to Para 56)*

Current Tax

- Measured at the amount expected to be paid(recovered from) the taxation authorities, using the tax rates(and tax laws) that have been enacted or substantively enacted by the end of reporting period

Deferred Tax

- Measured at 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 reporting period

DTA/DTL should not be discounted

Presentation:

- Major Component:
  - Current tax expenses
  - Prior period adjustment
  - Deferred expense/income

- Reconcilation:
  - Numerical reconcilation between tax expenses(income) & product of accounting profit multiplied by applicable tax rates
  - Numerical reconcilation between average effective tax rate and applicable tax rate

- Amount & Expiry, if any of deductible temporary differences, unused losses for which ***No DTA recognised***.

- Offsetting can be done subject to certain conditions as prescribed in Ind AS 12

Illustrative Financials:

- ***Infosys-2015-IFRS Financials:***

Deferred income tax assets and liabilities are measured using tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date and are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of changes in tax rates on deferred income tax assets and liabilities is recognized as income or expense in the period that includes the enactment or the substantive enactment date. A deferred income tax asset is recognized to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences and tax losses can be utilized. *Deferred income taxes are not provided on the undistributed earnings of subsidiaries and branches where it is expected that the earnings of the subsidiary or branch will not be distributed in the foreseeable future.* The group offsets current tax assets and current tax liabilities, where it has a legally enforceable right to set off the recognized amounts and where it intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.

Illustrative Financials:

- ***Wipro-IFRS-December 2015:***

Deferred tax is recognised using the liability method on taxable temporary differences between the tax base and the accounting base of items included in the balance sheet of the Group. Certain temporary differences are not provided for as follows:

i. goodwill not deductible for tax purposes;

ii. the initial recognition of assets or liabilities that affect neither accounting nor taxable profit; and

iii. differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted, or substantively enacted, at the year end.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Practical Challenges:

- No exemption on first time adoption of Ind AS 12- any changes need must be accounted retrospectively
- Deferred Tax assessment in case of carried forward losses
- Tax impact on Consolidation- unrealised intercompany profits
- Accounting of Deferred tax is linked to recording of the item to which it relate to
- Deferred Tax on special reserve u/s 36(1)(viii)
- DDT issue in Case of Consolidated Financial Statement

9 Step Model:

1. Calculate current income tax
2. Determine Tax base
3. Calculate temporary differences
4. Identify Exceptions
5. Review deductible "TD"s and tax losses
6. Determine tax rate
7. Recognise deferred taxes
8. Presentation & Off setting
9. Disclosure

Case Studies:

CS-6:

A Ltd. installed a power generation plant in a backward area for INR 10 crores. As an incentive, it received from the government a grant of INR 1.5 crores. A ltd recognized the power generation plant under Property Plant and equipments in its Statement of Financial position at INR 8.5 crores [i.e. INR 10 crores less tax free government grant of INR 1.5 crores]. You have been appointed as the accountant of A ltd. Please advise the management on the deferred tax implications of the above transaction. How would your answer differ if the tax free government grant of INR 1.5 crores was accounted by setting up deferred income in the Statement of Financial position?

Case Studies:

Analysis:

As per Para 33 of Ind AS 12 Income taxes, one case when a deferred tax asset arises on initial recognition of an asset is when a non-taxable government grant related to an asset is deducted in arriving at the carrying amount of the asset but, for tax purposes, is not deducted from the asset's depreciable amount (in other words its tax base); the carrying amount of the asset is less than its tax base and this gives rise to a deductible temporary difference. Government grants may also be set up as deferred income in which case the difference between the deferred income and its tax base of nil is a deductible temporary difference. Whichever method of presentation an entity adopts, the entity does not recognise the resulting deferred tax asset, for the reason given in paragraph 22. Para 22 states that a temporary difference may arise on initial recognition of an asset or liability, for example if part or all of the cost of an asset will not be deductible for tax purposes. The entity does not recognise the resulting deferred tax asset as it results from the initial recognition of the asset. Based on the above principle, no deferred tax asset is recognized for the deductible temporary difference of ` 1.5 crores

Case Studies:

CS-7:

A’s Ltd. profit before tax according to Ind AS for Year 2013 is $ 100 and taxable profit for year 2013 is $104. The difference between these amounts arose as follows: On 1st November 2013, it acquired a machine for $120. Depreciation is charged on the machine on a monthly basis for accounting purpose. Under the tax law, the machine will be depreciated for 6 month. The machine’s useful life is 10 years according to IFRS as well as for tax purposes. In the year 2013, expenses of $8 were incurred for charitable donations. These are not deductible for tax purposes. You are required to prepare necessary entries as at 31st December 2013, taking current and deferred tax into account. The tax rate is 25%. Also prepare the tax reconciliation in absolute numbers as well as the tax rate reconciliation

Case Studies:

Analysis:

Current tax= Taxable profit Tax rate= 104*25%=$26.*

Computation of Taxable Profit:

Accounting profit= 100

+ Donation not deductible 8

- Excess Depreciation 4

Total Taxable profit 104

Profit & loss a/c Debit 26

Current Tax Credit 26

Deferred tax:

Machine’s carrying amount according to IFRS is $118 ($120-$2)

Machine’s carrying for Taxation purpose= $114($120-$6)

Deferred Tax Liability= $ 4*25%= $ 1

Profit & loss a/c Debit 1

Deferred Tax liability Credit 1

Case Studies:

Analysis:

Tax reconciliation in absolute numbers:
Profit before tax according to Ind AS 100
Applicable tax rate 25%
Fictitious tax (at the applicable tax rate) 25
*Expenses not deductible for tax purposes ($8*25%) 2*
(Current and deferred) tax expense 27

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

Case Studies:

A Ltd. has as unresolved tax dispute over whether a specific item should be deductible in determining the taxable profit for specific period. A tax investigator did not accept this tax treatment but the entity appealed against this to the court. A Ltd. determines that it is not probable that the taxation authority will accept the tax treatment. The most likely amount is INR 100 cr. As management what should be accounting treatment in the books of accounts?

Analysis:

Ind AS-12????????????????

Case Studies:

CS-8:

Kappa prepares consolidated financial statements to 30 September each year. During the year ended 30 September 2013 Kappa entered into the following transactions:

(i) On 1 October 2012, Kappa purchased an equity investment for $200,000. The investment was designated as fair value through other comprehensive income. On 30 September 2013, the fair value of the investment was $240,000. In the tax jurisdiction in which Kappa operates, unrealised gains and losses arising on the revaluation of investments of this nature are not taxable unless the investment is sold. Kappa has no intention of selling the investment in the foreseeable future.

(ii) On 1 August 2013, Kappa sold products to Omega, a wholly owned subsidiary operating in the same tax jurisdiction as Kappa, for $80,000. The goods had cost Kappa $64,000. By 30 September 2013, Omega had sold 40% of these goods, selling the remaining 60% in October and November 2013.

Case Studies:

(iii) On 31 March 2013, Kappa received $200,000 from a customer. This payment was in respect of services to be provided by Kappa from 1 April 2013 to 31 January 2014. Kappa recognised revenue of $120,000 in respect of this transaction in the year ended 30 September 2013 and will recognise the remainder in the year ended 30 September 2014. Under the tax jurisdiction in which Kappa operates, the $200,000 received on 31 March 2013 was included in the taxable profits of Kappa for the year ended 30 September 2013.

Required:

Explain and show how the tax consequences (current and deferred) of the three transactions would be reported in the statement of financial position of Kappa at 30 September 2013 and its statement of profit or loss and other comprehensive income for the year ended 30 September 2013.

Note: The mark allocation is shown against each of the three transactions above.

You should assume that:

– The rate of income tax in the jurisdiction in which Kappa operates is 25%.

– Both Kappa and Omega are profitable companies which consistently generate annual taxable profits of at least $1,000,000

Case Studies:

Analysis:

(i)

Because the unrealised gain on revaluation of the equity investment is not taxable until sold, there are no current tax consequences.

Because the unrealised gain on revaluation of the equity investment is not taxable until sold, the tax base of the investment is $200,000.

The revaluation creates a taxable temporary difference of $40,000 ($240,000 – $200,000). This creates a deferred tax liability of $10,000 ($40,000 x 25%). The liability would be non-current. The fact that there is no intention to dispose of the investment does not affect the accounting treatment.

Because the unrealised gain is reported in other comprehensive income, the related deferred tax expense is also reported in other comprehensive income.

Case Studies:

Analysis:

(ii)

When Kappa sold the products to Omega, Kappa would have generated a taxable profit of $16,000 ($80,000 – $64,000). This would have created a current tax liability for Kappa and the group of $4,000 ($16,000 x 25%). This liability would be shown as a current liability and charged as an expense in arriving at profit or loss for the period.

In the consolidated financial statements the carrying value of the unsold inventory would be $38,400 ($64,000 x 60%). The tax base of the unsold inventory would be $48,000 ($80,000 x 60%).

In the consolidated financial statements there would be a deductible temporary difference of $9,600 ($38,400 – $48,000) and a potential deferred tax asset of $2,400 ($9,600 x 25%). This would be recognised as a deferred tax asset since Omega is expected to generate sufficient taxable profits against which to utilise the deductible temporary difference. The deferred tax asset would be recognised as a current asset. The resulting credit would

reduce consolidated deferred tax expense in arriving at profit or loss

Case Studies:

Analysis:

(iii)

The receipt of revenue in advance on 31 March 2013 would create a current tax liability of $50,000 ($200,000 x 25%) as at 30 September 2013.

The carrying value of the revenue received in advance at 30 September 2013 is $80,000 ($200,000 – $120,000). Its tax base is nil ($80,000 – $80,000).

The deductible temporary difference of $80,000 would create a deferred tax asset of $20,000 ($80,000 x 25%). The asset can be recognised because Kappa has sufficient taxable profits against which to utilise the deductible temporary difference. It would be recognised as a current asset since the remaining revenue is recognised in the following accounting period.

Case Studies:

CS-9

Epsilon prepares consolidated financial statements to 31 March each year. During the year ended 31 March 2014, the following events affected the tax position of the group:

(i) Lambda, a wholly owned subsidiary of Epsilon, made a loss adjusted for tax purposes of $3 million. Lambda is unable to utilise this loss against previous tax liabilities and local tax legislation does not allow Lambda to transfer the tax loss to other group companies. Local legislation does allow Lambda to carry the loss forward and utilise it against its own future taxable profits. The directors of Epsilon do not consider that Lambda will make taxable profits in the foreseeable future.

(ii) Just before 31 March 2014, Epsilon committed itself to closing a division after the year end, making a number of employees redundant. Therefore Epsilon recognised a provision for closure costs of $2 million in its statement of financial position as at 31 March 2014. Local tax legislation allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31 March 2015, Epsilon expects to make taxable profits which are well in excess of $2 million. On 31 March 2014, Epsilon had taxable temporary differences from other sources which were greater than $2 million.

Case Studies:

(iii) During the year ended 31 March 2014, Epsilon capitalised development costs which satisfied the criteria in paragraph 57 of Ind AS 38 – *Intangible Assets*. The total amount capitalised was $1·6 million. The development project began to generate economic benefits for Epsilon from 1 January 2014. The directors of Epsilon estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31 March 2014.

(iv) On 1 April 2013, the total goodwill arising on consolidation in Epsilon's consolidated statement of financial position was $4 million. On 31 March 2014, the directors reviewed the goodwill for impairment and concluded that the goodwill was impaired by $600,000. There was no tax deduction available for any group company as a consequence of this impairment charge as at 31 March 2014.

Case Studies:

(v) On 1 April 2013, Epsilon borrowed $10 million. The cost to Epsilon of arranging the borrowing was $200,000 and this cost qualified for a tax deduction on 1 April 2013. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31 March 2016 will be $13,043,800 this equates to an effective annual interest rate of 10%. Under the tax jurisdiction in which Epsilon operates, a further tax deduction of $3,043,800 will be claimable when the loan is repaid on 31 March 2016.

Required:

Explain and show how each of these events would affect the deferred tax assets/liabilities in the consolidated statement of financial position of the Epsilon group at 31 March 2014. Where relevant, you should assume the rate of corporate income tax is 25%

Case Studies:

Analysis:

(i)

The tax loss creates a potential deferred tax asset for the Kappa group since its carrying value is nil and its tax base is $3 million.

However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.

(ii)

The provision creates a potential deferred tax asset for the Kappa group since its carrying value is

$2 million and its tax base is nil. This deferred tax asset can be recognised because Kappa is expected to generate taxable profits in excess of $2 million in the year to 31 March 2015.

The amount of the deferred tax asset will be $500,000 ($2 million x 25%). This asset will be presented as a deduction from the deferred tax liabilities caused by the (larger) taxable temporary differences.

Case Studies:

Analysis:

(iii)

The development costs have a carrying value of $1·52 million ($1·6 million – ($1·6 million x 1/5 x 3/12)).

The tax base of the development costs is nil since the relevant tax deduction has already been claimed. The deferred tax liability will be $380,000 ($1·52 million x 25%). All deferred tax liabilities are shown as non-current.

(iv)

No deferred tax liability arises in respect of goodwill on consolidation when it is created. This is a

specific exception referred to in IAS 12. As a consequence of this, no adjustment is made for deferred tax purposes when goodwill is impaired. Therefore there are no deferred tax implications for the consolidated statement of financial position.

Analysis:

(v)

The carrying value of the loan at 31 March 2014 is $10·78 million ($10 million – $200,000 + ($9·8 million x 10%)). The tax base of the loan is $10 million ($10·78 million – ($980,000 – $200,000)).

This creates a deductible temporary difference of $780,000 and a potential deferred tax asset of $195,000 ($780,000 x 25%).

Due to the availability of taxable profits next year (see part (ii) above), this asset can be recognised as a deduction from deferred tax liabilities.

Ind AS Vs. IGAAP

Topic	IGAAP (AS-22)	IND-AS (IND-AS-12)
Approach	Based on Income statement approach and recognised on timing differences	Based on Balance sheet approach and recognised based on tax base and its carrying amount
Unrealised intra-group profits	Recognised at Buyer's rate	No such concepts
Investment in Subsidiary, Associates & JV's	All taxable temporary differences except with certain exceptions	No DTL is recognised on these cases
Disclosures	Reconciliation between income tax expenses and computed tax expenses, unrecognized DTL on undistributed profits	No such disclosures were required

Thank You