UNIT 1:
INDIAN ACCOUNTING STANDARD 12 : INCOME TAXES

LEARNING OUTCOMES

After studying this unit, you will be able to:

- Understand the objective and scope of the standard
- Define the terms used in the standard like accounting profit, taxable profit (tax loss), tax expense (tax income), current tax, deferred tax liabilities, deferred tax assets, temporary differences, taxable temporary differences, deductible temporary differences and the tax base.
- Recognise current tax liabilities and current tax assets
- Recognise deferred tax liabilities and deferred tax assets
- Appreciate when Ind ASs permit or require certain assets to be carried at fair value or to be revalued
- Identify the situations where temporary difference may arise on initial recognition of an asset or liability
- Recognise deferred tax asset for all deductible temporary differences
Evaluate the cases, when a deferred tax asset arises on initial recognition of an asset

Measure current tax liabilities (assets) for the current and prior periods

Measure deferred tax assets and liabilities using the tax rates

Identify the items recognised outside profit or loss

Calculate the deferred tax arising from a business combination

Calculate current and deferred tax arising from share-based payment transactions

Account for tax assets and tax liabilities

Offset tax assets with tax liabilities

Present the tax expense in the Statement of Profit and Loss with respect to various transactions

Disclose the major components of tax expense (income).

Account for the Income Taxes on account of changes in the tax status of an entity or its shareholders
UNIT OVERVIEW

Definition
- Accounting profit
- Taxable profit (tax loss)
- Tax expense (tax income)
- Current tax
- Deferred tax liabilities
- Deferred tax assets
- Temporary differences
- Taxable temporary differences
- Deductible temporary differences
- Tax base

Tax Expense
- Current Tax
- Deferred Tax

Current tax
- Recognition
- Measurement
- Accounting of Current Tax Effects
- Offsetting Current Tax Assets and Current Tax Liabilities

Deferred Tax
- Compute carrying amount
- Compute tax base
- Compute temporary differences
- Classify temporary differences
- Identify exceptions
- Assess (also reassess) deductible temporary differences, tax losses and tax credits
- Determine the tax rate (law)
- Calculate and recognise deferred tax
- Accounting of deferred tax
- Offsetting deferred tax assets and deferred tax liabilities

Practical Application
- Deferred tax arising from a business combination
- Current and deferred tax arising from share-based payment transactions
- Change in tax status of an entity or its shareholders

Disclosure
- Disclose components of tax expenses (income)
- Tax related to items charged directly to equity
- Tax related to items recognised in statement of other comprehensive income
- Explanation of the relationship between tax expense (income) and accounting profit
- Change in tax rates
- Unrecognised deductible temporary differences, unused tax losses and unused tax credits
- Temporary differences associated with investments in subsidiaries etc.
- Amount of deferred tax liabilities (assets) or income (expense)
1.1 INTRODUCTION

There was a time in India, few decades back when the concept of zero income tax entities was prevalent. Due to various income tax benefits, these companies had no current tax liability for any income tax that was payable based on that year’s accounting profit. Thus, no provision of income tax was created. Profit after tax used to be equal to profit before tax. But from accounting perspective, this was not a correct reflection of results. Quite a few of these tax benefits were primarily accelerated benefits.

For example, depreciation was deductible in taxation on written down value method (WDV) whereas in the books of accounts, entities could claim depreciation on straight line method (SLM). As everybody knows that under WDV method, in initial years depreciation charge is greater than depreciation under SLM. This resulted into accounting profits but no taxable profits. But over the useful life of the asset, depreciation under both methods is equal. In later years, depreciation charge under SLM would be higher than in depreciation under WDV. Therefore, in later years, in such a situation, the taxable profits will be higher than the book profits. This will require a higher tax provision in books when compared to the accounting profits of that year. Basically, this differential will be due to non-provision of tax liability in an earlier year.

Example 1:

An entity has acquired an asset for ₹ 10,000. The depreciation rate as per income tax is 40% on WDV basis. In books of account, entity claims depreciation on equivalent SLM basis of 16.21%. The entity has accounting and taxable profits of ₹ 20,000 from year 1 to year 4, inclusive, before any allowance of depreciation in either case.

The tax rate is 30%. Assuming no concept of deferred tax, the provision for current tax would be computed as under:

<table>
<thead>
<tr>
<th>Year</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of the asset</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Depreciation rate – WDV</td>
<td>40%</td>
<td>40%</td>
<td>40%</td>
<td>40%</td>
</tr>
<tr>
<td>Depreciation amount – WDV</td>
<td>4,000</td>
<td>2,400</td>
<td>1,440</td>
<td>864</td>
</tr>
<tr>
<td>Taxable profits before depreciation</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Less: Depreciation</td>
<td>(4,000)</td>
<td>(2,400)</td>
<td>(1,440)</td>
<td>(864)</td>
</tr>
<tr>
<td>Taxable profits after depreciation</td>
<td>16,000</td>
<td>17,600</td>
<td>18,560</td>
<td>19,136</td>
</tr>
<tr>
<td>Tax rate</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
<td>30%</td>
</tr>
<tr>
<td>Tax amount</td>
<td>4,800</td>
<td>5,280</td>
<td>5,568</td>
<td>5,741</td>
</tr>
</tbody>
</table>
However, in the books of accounts, the situation will be as under:

<table>
<thead>
<tr>
<th>Year</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a)</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>(b)</td>
<td>16.21%</td>
<td>16.21%</td>
<td>16.21%</td>
<td>16.21%</td>
</tr>
<tr>
<td>(c)</td>
<td>1,621</td>
<td>1,621</td>
<td>1,621</td>
<td>1,621</td>
</tr>
<tr>
<td>(d)</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>(e)</td>
<td>(1,621)</td>
<td>(1,621)</td>
<td>(1,621)</td>
<td>(1,621)</td>
</tr>
<tr>
<td>(f)</td>
<td>18,379</td>
<td>18,379</td>
<td>18,379</td>
<td>18,379</td>
</tr>
<tr>
<td>(g)</td>
<td>4,800</td>
<td>5,280</td>
<td>5,568</td>
<td>5,741</td>
</tr>
<tr>
<td>(h)</td>
<td>26.12%</td>
<td>28.73%</td>
<td>30.30%</td>
<td>31.24%</td>
</tr>
<tr>
<td>(i)</td>
<td>5,514</td>
<td>5,514</td>
<td>5,514</td>
<td>5,514</td>
</tr>
</tbody>
</table>

Thus, from the above two tables, for an accountant the tax should be ₹ 5,514 in all cases as per the accounting profit. The results are distorted. You will observe that in year 3, in books, the amount of tax provision is higher by ₹ 54 (5,568 – 5,514) and in year 4, it is higher by ₹ 227 (5,741 - 5,514). This is so because in year 1 & 2, these figures are lower by ₹ 714 (5,514 – 4,800) & ₹ 234 (5,514 – 5,280). Thus, the liability that was incurred in year 1 & 2 is paid year 3 onwards. However, no provision of the differential (₹ 714 in year 1 & ₹ 234 in year 2) is made.

The provision of differential should have been made by the entity following three major accounting concepts and convention of periodicity, matching and accrual. The entity has merely deferred the payment of tax to subsequent year. This understanding and appreciation of situation gave rise to the concept of deferred tax liabilities or deferred tax assets.

In earlier years, deferred tax was recognised based on concepts of timing differences and permanent differences based on differences in accounting profits and taxable profits known as income tax liability method. This concept stands revised with this Accounting Standard which recognised deferred tax based on temporary differences that arises due to difference in the carrying value of an item of asset or liability as per books of accounts with the carrying value of that item as per income tax provisions, known as tax base. This method is known as balance sheet approach.

This Accounting Standard though titled as ‘income taxes’ primarily deals with deferred tax though guidance is provided on current tax.
1.2 SCOPE

The objective of this Standard is to prescribe the accounting treatment for income taxes. Income taxes for the purpose of this Standard includes:

(a) all domestic and foreign taxes which are based on taxable profits;

(b) taxes, such as withholding taxes (Tax Deducted at Source), which are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.

Further, the income-tax for the purpose of this Standard could be classified as:

(a) **Current tax** being current tax consequence that arises due to transactions and other events of the current period that are recognised in an entity’s financial statements.

(b) **Deferred tax** being future tax consequence that arises due to the future (i) recovery of the carrying amount of assets or (ii) settlement of carrying amount of the liabilities that are recognised in an entity’s balance sheet. For example: Recovery of fixed assets means by way of depreciation or sale and for other assets by way of realization.

Before we proceed further, it is essential to understand the fundamental principle in recognising deferred tax. This is enunciated in the Standard as under:
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).

**Let us try to understand the aforesaid principle with the help of an example:**

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

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

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

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

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

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

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

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

- The Standard also provides guidance as to where the current tax or deferred tax should be recognised, accounted and presented.
- An entity may incur a loss in the current period and set off against a profit in the earlier period. As the entity would recover a tax paid in the earlier year, the entity should recognize the benefit of tax recoverable as an asset.
• Items of current tax or defer tax recognized in profit and loss are subject to two exceptions:
  1. An item of current tax or defer tax pertaining to other comprehensive income should be recognized in other comprehensive income
  2. An item of current tax or defer tax pertaining to direct equity should be recognized in direct equity

• In addition, the Standard deals with the:
  (a) recognition of deferred tax assets arising from unused tax losses or unused tax credits;
  (b) presentation of income taxes in the financial statements; and
  (c) disclosure of information relating to income taxes.
The Standard however, 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, it deals with the accounting for temporary differences that may arise from such grants or investment tax credits.

1.3 DEFINITIONS

Having understood, the basic concepts of current tax and deferred tax, the following definitions needs to be appreciated:

(a) **Accounting profit** is profit or loss for a period before deducting tax expense.

(b) **Taxable profit (tax loss)** is the profit (loss) for a period, computed as per the income tax act, upon which income taxes are payable (recoverable).

(c) **Tax expense (tax income)** is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

(d) **Current tax** is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

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

(f) **Deferred tax assets** are the amounts of income taxes recoverable in future periods in respect of:
   ♦ **deductible temporary differences**;
the carry forward of unused tax losses; and

the carry forward of unused tax credits.

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

(h) **Temporary differences** may be either:

- **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

- **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.

(i) The **tax base** of an asset or liability is the carrying amount to that asset or liability for tax purposes.

To facilitate, easy understanding, this chapter has been divided as under:

(a) Part A : Tax Expense

(b) Part B : Current Tax, its Recognition, Measurement and Presentation

(c) Part C : Deferred Tax, its Recognition, Measurement and Presentation

(d) Part D : Practical Application

(e) Part E : Disclosures

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### 1.4 PART A: TAX EXPENSE (TAX INCOME)

- Tax expense or tax income is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

- The following needs to be appreciated:

  (a) Tax expense could be positive or negative. Thus, there could be a tax income.

  (b) Tax expense is the aggregate of:

     - **current tax;** and

     - **deferred** tax.
1.5 PART B: CURRENT TAX, ITS RECOGNITION, MEASUREMENT AND PRESENTATION

1.5.1 Current Tax

Current tax is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.

1.5.2 Recognition

(a) Current tax liability

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

(b) Current tax assets

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

Example

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

- Thus, 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.
1.5.3 Measurement

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

(b) Uncertain tax position interpretations

♦ An entity computes its current income-taxes in accordance with the provisions contained in the taxation laws. Taxation laws provide certain benefits or require enhancements in accordance with the fiscal, economic and other policies of the country. These at times are prone to varying interpretations and settled by the appellate authorities after a considerable period from the reporting period. The taxability remains uncertain.

♦ Ind AS 12 requires that current tax liabilities or assets for the current period or the period should be computed based on the amount it expects to pay. It is suggested that statistical tools may be used in computing the current tax with respect to the uncertain tax interpretations.

♦ Thus, computation of current tax at best is an estimate. Any change in this estimate based on subsequent developments should be treated as a change in estimate in accordance with Ind AS 8.

(c) Enacted or substantively enacted

♦ The tax rates in computing the current tax should be based on taxation laws that have enacted or substantively enacted.

♦ A proposed legislation is enacted when all the formalities with respect to the legislation is completed. In India, the enactment occurs when the legislation is notified in the gazette on and from the date it comes into force as mentioned in the said gazette notification.

♦ Implicit in the word ‘substantively enacted’ is the emphasis that in the relevant situation the enactment process is not fully completed. The process of enactment of a taxation laws in India is as under:
  — Finance bill is presented in Lok Sabha of Indian Parliament.
  — It is discussed and passed by the Lok Sabha.
  — It then moves to Rajya Sabha of Indian Parliament.
  — It is discussed and passed by the Rajya Sabha.
  — It is then presented before the President for assent.
  — It is then notified in the gazette of India.
Now, at which stage an entity should conclude that the legislation is substantively enacted becomes a key consideration. More so, the finance bill in India is normally presented on the last day of February and is enacted by the 3rd week of May. The reporting period of most of the entities ends on 31st March and listed entities attempt to issue their financial statements within 4-6 weeks of the reporting date.

- Ind AS 12 does not provide any guidance.
- It is therefore suggested that the entity should explicitly disclose in its financial statements the accounting policy with respect to the adoption of tax rates based on the principle of ‘substantive enactment’. Needless to add, the policy should be applied consistently. If material, the variation due to adoption of rates based on ‘substantive enactment’ should also be disclosed.

1.5.4 Accounting of Current Tax Effects

(a) The accounting of current tax effects of a transaction of an event is consistent with the accounting for that transaction or event.

(b) The current tax effects of a transaction shall follow its accounting treatment.
- If the item is recognised in statement of profit or loss, its current tax effect will be recognised in statement of profit or loss
- If the item is recognised in statement of comprehensive income, its current tax effect will be recognised in statement of comprehensive income
- If the item is recognised directly in equity its current tax effect will be recognised directly in equity.

(c) For further discussion on this topic, refer Accounting for Deferred Tax.

1.5.5 Offsetting Current Tax Assets and Current Tax Liabilities

(a) 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.

(b) Although current tax assets and liabilities are separately recognised and measured they are offset in the balance sheet subject to criteria similar to those established for financial instruments in Ind AS 32. An entity will normally have a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income taxes levied by the
same taxation authority and the taxation laws permit the entity to make or receive a single net payment.

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

1.6 PART C: DEFERRED TAX, ITS RECOGNITION, MEASUREMENT AND PRESENTATION

The following steps should be followed in the recognition, measurement and presentation of deferred tax liabilities or assets:

Step 1: Compute carrying amounts of assets and liabilities
Step 2: Compute tax base
Step 3: Compute temporary differences
Step 4: Classify temporary differences into either:
   ♦ Taxable temporary difference
   ♦ Deductible temporary difference
Step 5: Identify exceptions
Step 6: Assess deductible temporary differences, tax losses and tax credits
Step 7: Determine the tax rate
Step 8: Calculate and recognise deferred tax
Step 9: Accounting of deferred tax
Step 10: Offsetting of deferred tax liabilities and deferred tax assets

These are now discussed in detail.

1.6.1 Step 1: Compute carrying amount

For the purpose of this Standard, we can define carrying amount at which an asset or liability is recognised in the balance sheet, after making necessary adjustments like depreciation, impairment, etc. In other words carrying amount of the assets and liabilities means balance as per the ledger.
Example
Entity A had acquired an item of plant and machinery for ₹ 1,00,000 on April 1, 20X1. It depreciated this item @ 10% per annum on SLM basis. For the year ended March 31, 20X2, it provides depreciation of ₹ 10,000. The carrying amount of this item of plant and machinery as on March 31, 20X2 is ₹ 90,000.

1.6.2 Step 2: Compute tax base

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

Example
Entity A had acquired an item of plant and machinery for ₹ 1,00,000 on April 1, 20X1. It depreciated this item @ 10% per annum on SLM basis. For the year ended March 31, 20X2, it provides depreciation of ₹ 10,000. The carrying amount of this item of plant and machinery as on March 31, 20X2 is ₹ 90,000. As per taxation laws, this item of plant and machinery has to be depreciated @ 30% per annum on WDV basis. The entity thus for the purposes of taxation computes depreciation of ₹ 30,000. The tax base of this item of plant and machinery is ₹ 70,000 (₹ 1,00,000 – ₹ 30,000).

(b) Four scenarios could be anticipated for computation of the tax base of either an asset or a liability:

- Tax base of an asset.
- Tax base of a liability.
- Items with a tax base but no carrying amount.
- Items of assets and liabilities where tax base is not apparent.

Let us examine and compute tax base under each of the four scenarios:

(i) **Tax base of an asset**

The principle to compute tax base of an asset is as under:

- 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.

- The carrying amount of the asset could be recovered either through sale of the asset or through its use or partly through use and partly through sale. The method of recovery has to be determined at each reporting date.
Example

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

Example

Entity A has acquired an item of asset for ₹ 1,00,000 for production of certain items to be sold by the entity. It is deductible equally over two years in the books of accounts. The carrying amount as the end of first reporting period is ₹ 50,000 (₹ 1,00,000 – ₹ 50,000). In the income tax, ₹ 75,000 is deductible in year 1 and balance is deductible in year 2. We have to compute its tax base as on the last day of the first reporting period. However, in income-tax, it can claim only ₹ 25,000 being 25% of the cost of the asset as 75% has already been claimed in year 1. Thus, the tax base in this case is ₹ 25,000.

Example

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

Example

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

Example

An entity that follows mercantile system of accounting has trade receivables of ₹ 1,000. It creates a specific bad debt of ₹ 50. The carrying amount in the books of accounts of trade receivables is thus ₹ 950. However, in income-tax, specific bad debt provision is deductible in the very year it is created. In the subsequent period, entity is able to recover only ₹ 950. The amount recovered is a taxable economic benefit. For tax purposes, entity will be entitled for a deduction of ₹ 950 against this recovery of trade receivable; ₹ 50 already deducted in the earlier period. The tax base is ₹ 950.
If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

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

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

**Example**
An entity has given a loan of ₹10,000 which is the carrying amount. The repayment of loan has no tax consequences. The tax base is ₹10,000.

(ii) Tax base of a liability

The principle to compute tax base of a liability is as under:

- 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.

**Example**
Current liabilities include accrued expenses with a carrying amount of ₹100. The related expense will be deducted for tax purposes on a cash basis.

*The tax base of the accrued expenses is nil.*

**Example**
Current liabilities include accrued expenses with a carrying amount of ₹100. The related expense has already been deducted for tax purposes.

*The tax base of the accrued expenses is ₹100.*

- If those liabilities are not tax deductible, the tax base of that liability is equal to its carrying amount.

**Example**
Current liabilities include accrued fines and penalties with a carrying amount of ₹100. Fines and penalties are not deductible for tax purposes.

*The tax base of the accrued fines and penalties is ₹100.*
It is an other than temporary difference, as the expenses are not allowable as per income tax.

Example
A loan payable has a carrying amount of ₹ 100. The repayment of the loan will have no tax consequences.

*The tax base of the loan is ₹ 100.*

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.

Example
Current liabilities include interest revenue received in advance, with a carrying amount of ₹ 100. The related interest revenue was taxed on a cash basis.

*The tax base of the interest received in advance is nil.*

(iii) **Items with a tax base but no carrying amount**

There are certain items that have a tax base but no carrying amount. These include items that are charged to revenue statement in the period in which they are incurred but are allowed as a deduction over a number of periods as per the taxation laws.

Example
A Limited has been incorporated recently. It incurred ₹ 1,00,000 on its incorporation. It has been charged to revenue in the very first accounting period. The taxation laws allow deduction over a period of 5 years. The carrying amount at the end of year 1 in ₹ Nil.

*The tax base will be ₹ 80,000 (20,000 x 4) as ₹ 20,000 being 1/5th is allowable as a deduction in taxation laws over 4 years.*

Example
Public issue expenses. The entity may have written off the public issue expenses in the very first year. But since tax laws permit deduction over 5 years, the temporary differences will exist till complete deduction is claimed in taxation laws.

(iv) **Items of assets and liabilities where tax base is not apparent**

There could be situations where it may be difficult to compute the tax base of an item. One however, knows the carrying amount. This is because of the provisions
of taxation laws. Whereas in books of accounts, all or most of the revenue and gains are included as part of one single performance statement, in the taxation laws they are charged under different head. The taxable amount amongst other things depends under which head an item at the time of recovery may be charged. In India, income or gains are charged either as ‘Salaries’, ‘Income from house property’, ‘Profits and gains of business’, ‘Capital Gain’ & ‘Income from other sources’. Further certain specific or weighted deductions are also permissible. For example rental income is subject to a flat deduction. So how will you compute the rental income received in advance? Moreover, there are cases depending upon the substance of the transaction, the rental income is to be charged as business income. At times, reverse may be the case. Many more similar situations could be anticipated.

Example
Entity A has an industrial undertaking that consists of land, building, plant and machinery. It is contemplating disposing the entity. It has the option to recover the carrying amount of the entity either by disposing the entire entity as a slump sale or dispose of each asset on a piecemeal basis. Depending upon the manner of recovery and period of holding, the carrying amount may be subject to indexation benefit, the recovery may be charged either as a business profit or capital gains. Again it could be long term gain capital gain or short term capital gain. As at the end of the reporting period, the entity is not sure of the manner and time of recovery.

- So, how should one proceed with the determination of the tax base? It is a matter of judgment. The Standard states that one should refer the fundamental principle as enumerated in the Standard. The principle is reproduced hereunder:

   *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)*

- It is recommended, if material, the basis of judgment and related uncertainties should be disclosed.

(c) Tax base is determined with reference to the tax returns of each entity. This poses no problems when computing tax base of a standalone entity. In some jurisdiction, taxation
laws, in the case of a group permits a consolidated tax return. In such cases, tax bases should be determined based on a consolidated tax returns. If this is not so, then the basis should be individual tax returns. The carrying amount in both the cases shall be determined on the basis of consolidated financial statements.

### 1.6.3 Step 3: Compute temporary differences

#### (a)
Hitherto, in India, entities have been determining deferred tax based on Accounting Standard (AS) 22, *Accounting for Taxes on Income*, as notified in Companies (Accounting Standards) Rules, 2006. The concept there is of ‘timing difference’ and ‘permanent difference’. Based upon the nature of difference, deferred tax liabilities or assets are recognised. The Ind AS 12 is based on the concept of temporary difference. As per Ind AS 12, there are only temporary differences, no permanent differences and timing differences are a component of temporary differences. The concept of ‘temporary differences’ is core of this Ind AS.

#### (b)
The term temporary difference is defined as the difference between the carrying amount of an asset or liability in the balance sheet and its tax base.

**Example**
An entity has an item of plant and machinery acquired on the first day of the reporting period for ₹ 1,00,000. It depreciates it @ 20% p.a on SLM basis. The carrying amount in balance sheet is ₹ 80,000. The taxation laws require depreciation @ 30% on WDV basis. The tax base at the end of the reporting period is ₹ 70,000. The temporary difference is ₹ 10,000 (₹ 80,000 – ₹ 70,000).
(c) The contention in favor of temporary difference is that at the end of the day, all differences between the carrying amount and tax base of an asset or liability will reverse. At most the entity may be able to delay the timing of reversal but the difference will ultimately reversed, therefore the term ‘temporary difference’ is used. The cumulative impact is ‘zero’.

**Example**

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

The following computations are performed.

### Financial Statements

<table>
<thead>
<tr>
<th>Year</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Block</td>
<td>120</td>
<td>120</td>
<td>120</td>
<td>120</td>
<td>120</td>
<td>120</td>
</tr>
<tr>
<td>Cumulative Depreciation</td>
<td>20</td>
<td>40</td>
<td>60</td>
<td>80</td>
<td>100</td>
<td>120</td>
</tr>
<tr>
<td>Carrying Amount</td>
<td>100</td>
<td>80</td>
<td>60</td>
<td>40</td>
<td>20</td>
<td>0</td>
</tr>
</tbody>
</table>

### Tax Computation

<table>
<thead>
<tr>
<th>Year</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax base brought forward</td>
<td>120</td>
<td>30</td>
<td>20</td>
<td>13</td>
<td>8</td>
<td>3</td>
</tr>
<tr>
<td>Depreciation charge (assumed)</td>
<td>90</td>
<td>10</td>
<td>7</td>
<td>5</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Tax base carried forward</td>
<td>30</td>
<td>20</td>
<td>13</td>
<td>8</td>
<td>3</td>
<td>0</td>
</tr>
</tbody>
</table>

### Temporary Difference

<table>
<thead>
<tr>
<th>Year</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying Amount</td>
<td>100</td>
<td>80</td>
<td>60</td>
<td>40</td>
<td>20</td>
<td>0</td>
</tr>
<tr>
<td>Tax base carried forward</td>
<td>30</td>
<td>20</td>
<td>13</td>
<td>8</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Temporary difference</td>
<td>70</td>
<td>60</td>
<td>47</td>
<td>32</td>
<td>17</td>
<td>0</td>
</tr>
</tbody>
</table>

+70 –70
To some, it may appear that temporary differences and timing differences are one and the same term. It is not so. It can however, be said that temporary difference includes timing differences. Timing differences arise when income or expense is included in accounting profit in one period but is included in taxable profit in a different period.

Examples of temporary differences in the nature of timing differences are as under:

**Example**
Interest income recognized in income statement on a time proportion basis but recognized in taxable profit on cash basis as and when income is received.

**Example**
Depreciation used in determining taxable income may differ from that used in determining accounting profit.

**Example**
Development costs may be capitalized and amortize over future periods in determining accounting profit but deducted in determining taxable profit in the period in which they are incurred.

Examples of temporary differences other than in the nature of timing differences are as under:

**Example : Business combinations**
The identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values in accordance with Ind AS 103, Business Combinations, but no equivalent adjustment is made for tax purposes.

With limited exceptions, the identifiable assets acquired and liabilities assumed in a business combination are recognised at their fair values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the business combination or are affected differently.
For example, when the carrying amount of an asset is increased to fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability. However, it may be noted that the resulting deferred tax liability affects goodwill.

**Example:** *Revaluation: assets are revalued and no equivalent adjustment is made for tax purposes.*

Indian Accounting Standards permit or require certain assets to be carried at fair value or to be revalued (see, for example, Ind AS 16, *Property, Plant and Equipment*, Ind AS 38, *Intangible Assets* and Ind AS 109, *Financial Instruments*).

In some jurisdictions, the revaluation or other restatement of an asset to fair value affects taxable profit (tax loss) for the current period. As a result, the tax base of the asset is adjusted and no temporary difference arises.

In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted.

Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the entity and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset.

This is true even if:

(a) the entity does not intend to dispose of the asset. In such cases, the revalued carrying amount of the asset will be recovered through use and this will generate taxable income which exceeds the depreciation that will be allowable for tax purposes in future periods; or

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

### 1.6.4 Step 4: Classify temporary differences

(a) Temporary differences are to be classified into:

- Taxable temporary differences
- Deductible temporary differences
(b) Taxable temporary differences are those temporary differences that results 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.

As the name ‘taxable temporary difference’ suggests, these are the temporary differences that will be taxed in future. These taxable temporary differences will increase tax liabilities. All taxable temporary differences, subject to limited exceptions, give rise to deferred tax liability.

Taxable temporary difference arises where the:

- carrying amount of an asset exceeds its tax base; or
- tax base of a liability exceeds its carrying amount.

**Example**

An asset which costs ₹150 has a carrying amount of ₹100. Cumulative depreciation for tax purposes is ₹90 and the tax rate is 25%.

The tax base of the asset is ₹60 (cost of ₹150 less cumulative tax depreciation of ₹90). To recover the carrying amount of ₹100, the entity must earn taxable income of ₹100, but will only be able to deduct tax depreciation of ₹60. Consequently, the entity will pay income taxes of ₹10 (₹40 at 25%) when it recovers the carrying amount of the asset. The difference between the carrying amount of ₹100 and the tax base of ₹60 is a taxable temporary difference of ₹40.

(c) Deductible temporary differences are those temporary differences that results 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.

Again, it should be noted, the name ‘deductible temporary difference’ suggests, these are the temporary differences that will be deducted in future when computing the tax liability. These deductible temporary differences will reduce tax liabilities. All deductible temporary differences, subject to exceptions/recognition criteria, give rise to deferred tax assets.

Deductible temporary difference arises where the:

- carrying amount of a liability exceeds its tax base; or
- tax base of an asset exceeds its carrying amount.

**Example**

An entity recognises a liability of ₹100 for gratuity and leave encashment expenses by creating a provision for gratuity and leave encashment. For tax purposes, any amount with regard to gratuity and leave encashment will not be deductible until the entity pays the same. The tax rate is 25%.
The tax base of the liability is nil (carrying amount of ₹100, less the amount that will be deductible for tax purposes in respect of that liability in future periods). In settling the liability for its carrying amount, the entity will reduce its future taxable profit by an amount of ₹100 and, consequently, reduce its future tax payments by ₹25 (₹100 at 25%). The difference between the carrying amount of ₹100 and the tax base of nil is a deductible temporary difference of ₹100.

(d) Based on the above discussions, a matrix as under may be drawn:

<table>
<thead>
<tr>
<th>For Assets</th>
<th>For Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>If carrying amount &gt; tax base</td>
<td>Taxable Temporary Difference ↓ Deferred Tax Liability</td>
</tr>
<tr>
<td>If carrying amount &lt; tax base</td>
<td>Deductible Temporary Difference ↓ Deferred Tax Asset</td>
</tr>
<tr>
<td>If carrying amount = tax base</td>
<td>No temporary difference</td>
</tr>
</tbody>
</table>

(e) Further examples of taxable temporary differences:

- **Transactions that affect profit or loss**
  
  **Example**
  Interest revenue is received in arrears and is included in accounting profit on a time apportionment basis but is included in taxable profit on a cash basis.
  
  **Example**
  Revenue from the sale of goods is included in accounting profit when goods are delivered but is included in taxable profit when cash is collected.
  
  *In this case, there is also a deductible temporary difference associated with any related inventory.*
  
  **Example**
  Depreciation of an asset is accelerated for tax purposes.
  
  **Example**
  Development costs have been capitalised and will be amortised to the statement of profit and loss but were deducted in determining taxable profit in the period in which they were incurred.
Example
Prepaid expenses have already been deducted on a cash basis in determining the taxable profit of the current or previous periods.

• Transactions that affect the balance sheet

Example
Depreciation of an asset is not deductible for tax purposes and no deduction will be available for tax purposes when the asset is sold or scrapped.

Example
A borrower records a loan at the proceeds received (which equal the amount due at maturity), less transaction costs. Subsequently, the carrying amount of the loan is increased by amortisation of the transaction costs to accounting profit. The transaction costs were deducted for tax purposes in the period when the loan was first recognised.

Example
A loan payable was measured on initial recognition at the amount of the net proceeds, net of transaction costs. The transaction costs are amortised to accounting profit over the life of the loan. Those transaction costs are not deductible in determining the taxable profit of future, current or prior periods.

Example
The liability component of a compound financial instrument (for example a convertible bond) is measured at a discount to the amount repayable on maturity (see Ind AS 32, Financial Instruments: Presentation). The discount is not deductible in determining taxable profit (tax loss).

• Fair value adjustments and revaluation

Example
Financial assets are carried at fair value which exceeds cost but no equivalent adjustment is made for tax purposes.

Example
An entity revalues property, plant and equipment (under the revaluation model treatment in Ind AS 16, Property, Plant and Equipment) but no equivalent adjustment is made for tax purposes.
• **Business combinations and consolidation**

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

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

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

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

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

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

• **Hyperinflation**

**Example**
Non-monetary assets are restated in terms of the measuring unit current at the end of the reporting period (see Ind AS 29, *Financial Reporting in Hyperinflationary Economies*) and no equivalent adjustment is made for tax purposes.
(f) Further examples of deductible temporary differences:

- **Transactions that affect profit or loss**

  **Example**
  
  Retirement benefit costs are deducted in determining accounting profit as service is provided by the employee, but are not deducted in determining taxable profit until the entity pays either retirement benefits or contributions to a fund. *(Note: similar deductible temporary differences arise where other expenses, such as gratuity and leave encashment or interest, are deductible on a cash basis in determining taxable profit.)*

  **Example**
  
  Accumulated depreciation of an asset in the financial statements is greater than the cumulative depreciation allowed up to the end of the reporting period for tax purposes.

  **Example**
  
  The cost of inventories sold before the end of the reporting period is deducted in determining accounting profit when goods or services are delivered but is deducted in determining taxable profit when cash is collected. *(It may be noted, there is also a taxable temporary difference associated with the related trade receivable.)*

  **Example**
  
  The net realisable value of an item of inventory, or the recoverable amount of an item of property, plant or equipment, is less than the previous carrying amount and an entity therefore reduces the carrying amount of the asset, but that reduction is ignored for tax purposes until the asset is sold.

  **Example**
  
  Preliminary expenses (or organisation or other start up costs) are recognised as an expense in determining accounting profit but are not permitted as a deduction in determining taxable profit until a later period.

  **Example**
  
  Income is deferred in the balance sheet but has already been included in taxable profit in current or prior periods.

  **Example**
  
  A government grant which is included in the balance sheet as deferred income will not be taxable in future periods.
• Fair value adjustments and revaluation

Example
Financial assets are carried at fair value which is less than cost, but no equivalent adjustment is made for tax purposes.

• Business combinations and consolidation

Example
A liability is recognised at its fair value in a business combination, but none of the related expense is deducted in determining taxable profit until a later period.

Example
Unrealised profits resulting from intragroup transactions are eliminated from the carrying amount of assets, such as inventory or property, plant or equipment, but no equivalent adjustment is made for tax purposes.

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

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

Deferred tax liabilities are created for all taxable temporary differences with limited exceptions. Similarly, deferred tax assets are created for all deductible temporary differences subject to limited exceptions and recognition criteria. In Step 5 we will discuss the exceptions with respect to creation to deferred tax and in Step 6 we will discuss the recognition criteria area for deferred tax assets. However, before we proceed further, let’s discuss the principle in recognising deferred tax liabilities or deferred tax asset.
These are:

(a) **Deferred tax liability**

- A deferred tax liability shall be recognized 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; and
      
      (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss)
  
- However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax liability shall be recognised in accordance with paragraph 39 of Ind AS 12.

(b) **Deferred tax asset**

- A deferred tax asset shall be recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be 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; and
  
  (b) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).
  
- However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax asset shall be recognised in accordance with paragraph 44 of Ind AS 12.

From a reading of the aforesaid principles, deferred tax liabilities and deferred tax assets needs to be recognised in most of the cases. But the recognition of deferred tax liabilities or deferred tax assets are subject to exceptions with respect to the following items:

(a) the initial recognition of goodwill arising in a business combination (exception 1);

(b) the initial recognition of an asset or liability in a transaction which:
   
   (i) is not a business combination; and
(ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss) (exception 2);

(c) temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures (exception 3).

These exceptions are discussed in Step 5.

Also deferred tax assets should be created only to the extent of the probability of availability of taxable profits. In case, this probability of availability of taxable profits is missing, deferred tax assets should not be created. The profit probability recognition criterion is discussed in Step 6.

1.6.5 Step 5: Identify exceptions

(a) Exception 1: The initial recognition of goodwill in the case of a business combination

- In the case of a business combination, when the consideration paid exceeds the net identifiable assets, goodwill is created.

- Technically speaking, goodwill arising in a business combination is measured as the excess of (a) over (b) below:

  (a) the aggregate of:

    (i) the consideration transferred measured in accordance with Ind AS 103, which generally requires acquisition date fair value;

    (ii) the amount of any non-controlling interest in the acquiree recognized in accordance with Ind AS 103; and

    (iii) in a business combination achieved in stages, the acquisition-date fair value of the acquirer’s previously held equity interest in the acquiree.

  (b) the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed measured in accordance with Ind AS 103.

- As per principles enunciated in this Ind AS 12, the entity has to determine the tax base of this goodwill to compute the temporary difference, either taxable or deductible, at the time of recognition and subsequently when impairment takes place. The Standard provides separate guidance for taxable temporary difference (Situation A) and deductible temporary difference (Situation B).

- Situation A: Where the temporary difference is in the nature of taxable temporary difference. Again in this case, the prescribed treatment is different where good will is not tax deductible (Situation A1) and where it is tax deductible (Situation A2).
(Situation A1: Where it is not tax deductible)

(a) At the time of initial recognition of goodwill:

(i) Quite a few tax jurisdictions do not permit this goodwill as a tax deductible expense. Also, the cost of goodwill is often not deductible when a subsidiary disposes of its underlying business. Put simply, the tax base of goodwill is Nil. But the entity has a taxable temporary difference as the goodwill (an asset) has a carrying amount leading to a deferred tax liability.

(ii) The Standard does not permit the recognition of the resulting deferred tax liability as goodwill is measured as a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill, resulting into a circular type of computation.

Example

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

Entry 1:

<table>
<thead>
<tr>
<th>Goodwill</th>
<th>Dr. 35,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Assets</td>
<td>Dr. 65,000</td>
</tr>
<tr>
<td>To Consideration</td>
<td>1,00,000</td>
</tr>
</tbody>
</table>

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

Entry 2:

<table>
<thead>
<tr>
<th>Goodwill</th>
<th>Dr. 45,500</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net assets</td>
<td>Dr. 65,000</td>
</tr>
<tr>
<td>To Consideration</td>
<td>1,00,000</td>
</tr>
<tr>
<td>To Deferred tax liability</td>
<td>10,500</td>
</tr>
</tbody>
</table>

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

(b) Subsequently at the time of impairment, if required, in the carrying amount:

(i) This goodwill as per Ind AS 103 is not amortised though tested for impairment.

(ii) Subsequent reduction in a deferred tax liability that is unrecognised because it arises from the initial recognition of goodwill is also regarded as arising from the initial recognition of goodwill and is therefore not recognised.

For example in the aforesaid Example, after 2 years goodwill is tested for impairment and the entity recognises an impairment loss of ₹10,000, the amount of the taxable temporary difference relating to the goodwill is reduced from ₹35,000 to ₹25,000, with a resulting decrease in the value of the unrecognised deferred tax liability. That decrease in the value of the unrecognised deferred tax liability is also regarded as relating to the initial recognition of the goodwill and is therefore prohibited from being recognised as per this Ind AS 12.

- **Situation A2: Where it is tax deductible**
  
  In tax jurisdiction, where goodwill is tax deductible, deferred tax liability should be recognised for the taxable temporary difference.

- **Situation B: Where the difference is in the nature of deductible difference**
  
  In all cases, deferred tax asset, subject to recognition criteria discussed in step 6 below, should be recognised.

- **Summary of Exception 1**
  
  No deferred tax liability is to be recognised for taxable temporary difference arising on goodwill arising in a business combination in tax jurisdictions where such goodwill is not tax deductible.

  In all other cases of temporary difference, either taxable or deferred, either deferred tax liability or deferred tax asset should be recognised in accordance with other provisions of this Ind AS.
Exception 2: The initial recognition of an asset or liability in a transaction which: (i) is not a business combination; and (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss)

- The Standard prohibits recognition of deferred tax liability or deferred tax assets in cases of either taxable or deductible temporary difference arising in a transaction:
  
  (a) is not a business combination; and
  
  (b) does not affect neither the accounting profit nor the taxable profit.

- As per the Standard, three types of transactions of assets or liabilities could be anticipated:

  **Type 1: In the nature of business combination**

  In such a case, recognise deferred tax liabilities or deferred tax assets on temporary differences between the carrying amount and respective tax base of assets or liabilities except on goodwill (in certain circumstances)

  **Type 2: Where the transaction impacts accounting profit (i.e. statement of profit or loss) (like sale of goods, recognition of debtors)**

  In such a case, recognise any deferred tax in statement of profit or loss:

  **Type 3: Where the transaction is not a business combination & does not impact accounting profit nor taxable profit, such as purchase of assets or receipt of government grants.**

  This exception relates to the transaction of the third type.

**Example**

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

- The Standard implies that if the carrying amount of any asset or liability is not equal to its tax base at the time of its transaction where the transaction is:
  
  (i) Not in the nature of business combination.
  
  (ii) Not impacting either the accounting profit or the taxable profit.
  
  (iii) Neither deferred tax liability nor deferred tax asset should be recognised.
The following is a brief checklist:

(i) Is the transaction in the nature of business combination?
(ii) Whether the transaction impacts accounting profit?
(iii) Whether the transaction impacts taxable profits?
(iv) Whether the carrying amount is equal to tax base?

Depending on the answers to the checklist, deferred tax asset or liability needs to be determined in accordance with the guidance under this exception.

Furthermore, an entity does not recognise subsequent changes in unrecognised deferred tax liability or asset as the asset is depreciated.

(c) Exception 3: Temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures

Temporary differences arise when the carrying amount of investments in subsidiaries, branches and associates or interests in joint ventures (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:

(i) the existence of undistributed profits of subsidiaries, branches, associates and joint ventures;
(ii) changes in foreign exchange rates when a parent and its subsidiary are based in different countries; and
(iii) 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.

Should an entity recognise a deferred tax liability in these cases? The guiding principle is:

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:
(i) the parent, investor or venturer is able to control the timing of the reversal of the temporary difference; and

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

- Now let us examine where the parent, investor or venture is able to control the timing of reversal of taxable temporary difference. Generally, the taxable temporary difference will get reversed on distribution of dividends.

- **Subsidiary/branches:** 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.

- The non-monetary assets and liabilities of an entity are measured in its functional currency (see Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*) in the exchange rate which give rise to temporary differences that result in a recognised deferred tax liability or (subject to recognition criteria) asset. The resulting deferred tax is charged or credited to profit or loss.

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

- **Joint Venture:** The arrangement between the parties to a joint venture usually deals with the sharing of the profits and identifies whether decisions on such matters require the consent of all the venturers or a specified majority of the venturers. When the venturer can control the sharing of profits and it is probable that the profits will not be distributed in the foreseeable future, a deferred tax liability is not recognised.

- The aforesaid discussion related to recognition of deferred tax liability on taxable temporary difference. But there could be deductible temporary differences. So what is the guiding principle for recognition of deferred tax assets on deductible temporary differences?
• The principle is:

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 ventures, to the extent that, and only to the extent that, it is probable that:

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

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

• Both the conditions have to be satisfied.

• In deciding whether a deferred tax asset is recognised for deductible temporary differences associated with its investments in subsidiaries, branches and associates, and its interests in joint ventures, an entity considers the guidance set out in Step 6 below.

1.6.6 Step 6: Assess (also reassess) deductible temporary differences, tax losses and tax credits

(a) As we are aware that deductible temporary differences reduces the taxable profits of future periods. It signifies that future tax payments will be smaller by a particular amount. However economic benefits will flow to the entity in the form of lower tax liability in future only in case it has future profits. If there are no future profits, it means there are no tax payments which in turn mean that deductible temporary differences are of no benefit.

Example:

Entity A has deductible temporary difference of ₹1,00,000 for the financial year ended March 31, 2012. It anticipates a future profit of ₹3,00,000 in next year against which the said deductible temporary differences could be set off. The tax rate is 30%. Thus, in future the entity will pay tax on ₹2,00,000 (₹300,000 – ₹1,00,000). The tax liability is ₹60,000 @ 30% tax rate.

Had there been no deductible temporary difference, the tax liability would be ₹90,000 @ 30% on ₹300,000. Thus, there is an inflow of economic benefit of ₹30,000 through a lower cash outflow.

However, if there is no probability of taxable profits in future, the entity is not able to derive any economic benefit (by way of lower cash outflow in future) because of the existing of deductible temporary difference.

(b) Therefore, an entity should recognise deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised. This is based on the principle of prudence and conservatism. It should be noted that the entity has to make sufficient taxable profits in future. Not making losses will not suffice.
(c) Probable means more likely than not. The Standard provides a three step criteria to be applied in a serial order. The criterion is applied in the case of the same taxable entity assessed by the same taxation authority.

**Criteria No. 1: Existence of taxable temporary differences**

The entity at the balance sheet should see whether there are sufficient taxable temporary differences whose reversal pattern matches with the reversal profile of deductible temporary differences.

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Year (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Taxable temporary difference</td>
<td></td>
</tr>
<tr>
<td>Opening balance</td>
<td>10,000</td>
</tr>
<tr>
<td>Recognised in taxable income</td>
<td>5,000</td>
</tr>
<tr>
<td>Closing balance</td>
<td>5,000</td>
</tr>
<tr>
<td>Deductible temporary difference</td>
<td></td>
</tr>
<tr>
<td>Opening balance</td>
<td>8,000</td>
</tr>
<tr>
<td>Recognised in taxable income</td>
<td>4,000</td>
</tr>
<tr>
<td>Closing balance</td>
<td>4,000</td>
</tr>
<tr>
<td>Statement of taxable income</td>
<td></td>
</tr>
<tr>
<td>Taxable temporary difference</td>
<td></td>
</tr>
<tr>
<td>Deductible temporary difference</td>
<td></td>
</tr>
</tbody>
</table>

The entity can recognise deferred tax assets for the entire deductible temporary differences.

**Example**

As at March 31, 2012, an entity has both taxable temporary differences and deductible temporary difference with the following reversal pattern. Deductible temporary differences cannot be carried forward.
The entity can recognize deferred tax assets for the deductible temporary differences up to ₹ 7,000 (₹ 4,000 for year 1 & ₹ 3,000 for year 2) as a taxable temporary difference of that amount is available.

**Criteria No. 2: Probability of future profits**

The entity has to apply probability criteria on its future profitability. If it is probable that there will be sufficient taxable profits, then to the extent of available profits, deductible temporary differences should be applied for recognition of deferred tax assets.

**Example**

If in the aforesaid example, the entity expects a profit of ₹ 750 in year 2, then deferred tax asset should be created on ₹ 7,750 (4,000 + ₹ 3,000 + ₹ 750).

However, taxable profits arising in future from future origination of deductible temporary differences should not be considered as deductible temporary differences will require future taxable profits for utilisation.

**Example**

An entity has unutilised deductible temporary difference of ₹ 1,000 at the end of year 1 that is going to be reversed in the year 2. In year 2, taxable profits are computed because of tax disallowances of unpaid statutory liabilities of ₹ 1,000 which can be claimed as deduction only in year 3, if paid, but cannot be carried forward. The entity expects nil taxable profit in year 3. In this case, no deferred tax asset will be created.

**Example**

An entity has unutilised deductible temporary difference of ₹ 1,000 at the end of year 1 that is going to be reversed in the year 2. In year 2, taxable profits are computed because of tax disallowances of unpaid statutory liabilities of ₹ 1,000 which can be claimed as deduction only in year 3, if paid, but cannot be carried forward. The entity expects taxable profit of ₹ 450 in year 3. In this case, deferred tax asset will be created at appropriate rate on deductible temporary difference of ₹ 450 only.
Criteria No. 3: Availability of tax planning opportunities

If even after applying criteria no. 2, still there are unrecognised deductible temporary differences, the entity endeavor to see whether any tax planning opportunities are available.

Tax planning opportunities are actions that the entity would take in order to create or increase taxable income in a particular period before the expiry of a tax loss or tax credit carry forward.

For example, in some jurisdictions, taxable profit may be created or increased by:

(i) electing to have interest income taxed on either a received or receivable basis;
(ii) deferring the claim for certain deductions from taxable profit;
(iii) selling, and perhaps leasing back, assets that have appreciated but for which the tax base has not been adjusted to reflect such appreciation; and
(iv) selling an asset that generates non-taxable income (such as, in some jurisdictions, a government bond) in order to purchase another investment that generates taxable income.

Where tax planning opportunities advance taxable profit from a later period to an earlier period, the utilisation of a tax loss or tax credit carry forward still depends on the existence of future taxable profit from sources other than future originating temporary differences.

(d) Unused tax losses and unused tax credits:

- 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.
- The criteria for recognising deferred tax assets arising from the carry forward of unused tax losses and tax credits are the same as the criteria 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. In such circumstances, paragraph 82 of Ind AS 12 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.

(e) When an entity has a history of recent losses, the entity should consider the following guidance:

- The criteria for recognising deferred tax assets arising from the carry forward of unused tax losses and tax credits are the same as the criteria 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.

• In such circumstances, this Ind AS requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition.

• To assess the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, the entity should consider the following:
  (i) whether the entity has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;
  (ii) whether it is probable that the entity will have taxable profits before the unused tax losses or unused tax credits expire;
  (iii) whether the unused tax losses result from identifiable causes which are unlikely to recur; and
  (iv) whether tax planning opportunities are available to the entity that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

• 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 to be recognised.

(f) Reassessment of unrecognised Deferred Tax Assets:

• At the end of each reporting period, the entity should reassess unrecognised deferred tax assets. It may need to recognise a previously unrecognised deferred tax asset to the extent it has now become probable that future taxable profits will be available for deferred tax assets to be recovered. For example, improvement in trading conditions may make it probable for an entity to generate sufficient taxable profits in future years to enable it to meet the recognition criteria laid down above.

1.6.7 Step 7: Determine the tax rate (law)

(a) Having determined the taxable temporary differences and deductible temporary difference that needs to be considered for recognition of deferred tax liabilities or assets respectively, we now need to determine the tax for creation to deferred tax liabilities or assets. The principal is:
Deferred tax assets and liabilities shall be measured:

(i) at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled;

(ii) based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

(b) We have already discussed above the meaning of ‘enacted’ or ‘substantively enacted’.

The same discussion applies here also. But another key word that needs to be understood in the principle is ‘expected to apply’. Please remember, we are dealing in the future. Future is uncertain. We have to measure this uncertainty. This leads to application of judgment. The tax rates or the tax laws that will apply in future depends on various factors such as manner of recovery of asset or settlement of liability, levels of income, distribution of profits among others. These are now discussed below.

It should however be remembered that 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.

(c) Manner of recovery of asset or settlement of liability:

- 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.

**Example**

An asset has a carrying amount of ₹ 100 and a tax base of ₹ 60. A tax rate of 20% would apply if the asset was sold and a tax rate of 30% would apply to other income.

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

**Example**

An asset with a cost of ₹ 100 and a carrying amount of ₹ 80 is revalued to ₹ 150. No equivalent adjustment is made for tax purposes. Cumulative depreciation for tax purposes is ₹ 30 and the tax rate is 30%. If the asset is sold for more than cost, the cumulative tax depreciation of ₹ 30 will be included in taxable income but sale proceeds in excess of cost will not be taxable.
The tax base of the asset is ₹ 70 and there is a taxable temporary difference of ₹ 80 (₹ 150 the revalued amount is the carrying amount).

If the entity expects to recover the carrying amount by using the asset, it must generate taxable income of ₹ 150, but will only be able to deduct depreciation of ₹ 70. On this basis, there is a deferred tax liability of ₹ 24 (₹ 80 at 30%).

If the entity expects to recover the carrying amount by selling the asset immediately for proceeds of ₹ 150, the deferred tax liability is computed as follows:

(i) Sale proceeds                     ₹ 150
(ii) Sale proceeds in excess of cost (₹ 100)  ₹ 50
(iii) Taxable proceeds              ₹ 100
(iv) Tax base                        ₹ 70
(v) Taxable temporary difference    ₹ 30
(vi) Tax rate                        30%
(vii) Deferred tax liability        ₹ 9

Thus, 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.

However, an issue may arise as to how to interpret the term ‘recovery’ in relation to an asset that is not depreciated (non-depreciable asset) and is revalued in accordance with paragraph 31 (revaluation model) of Ind AS 16.

The accounting principle in this case is as under:

♦ The deferred tax liability or asset that arises from the revaluation of a non-depreciable asset in accordance with paragraph 31 of Ind AS 16 shall be measured on the basis of the tax consequences that would follow from recovery of the carrying amount of that 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 (tax rate applicable to the taxable amount derived from the sale of an asset) is applied in measuring the deferred tax liability or asset related to a non-depreciable asset.
(d) Levels of taxable income:

- When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using the average rates that are expected to apply to the taxable profit (tax loss) of the periods in which the temporary differences are expected to reverse.

(e) Distribution of dividends:

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

**Example**

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

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

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

On March 15, 20X2, the entity recognises the recovery of income taxes of ₹1,500 (15% of the dividends recognised as a liability) as a current tax asset and as a reduction of current income tax expense for 20X2.
1.6.8 Step 8: Calculate and recognise deferred tax

(a) This is the simplest of all steps. Having determined the taxable temporary differences and the deductible temporary differences as per Step 6 and the applicable tax rates with reference to tax laws, one has to multiply amount determined in Step 6 with the rates determined in Step 7.

- Taxable temporary differences when multiplied with tax rates will lead to deferred tax liabilities.
- Deductible temporary differences when multiplied with rates will lead to deferred tax assets.

(b) The following should be kept in mind:

- Deferred tax liabilities or assets should 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 that 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.

1.6.9 Step 9: Accounting of deferred tax

(a) The accounting of deferred tax effects of a transaction of an event is consistent with the accounting for that transaction or event.

(b) A transaction and the deferred tax effects of a transaction may be accounted for in:

- Statement of profit and loss;
- Outside profit and loss account:
  (i) In other comprehensive income such as revaluation amount in accordance with Ind AS 16, Property, Plant and Equipment
  (ii) Directly in equity such as correction of an error in accordance with Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

(c) However, the carrying amount of deferred tax assets and liabilities may change even though there is no change in the amount of the related temporary differences.

- This can result, for example, from:
  — a change in tax rates or tax laws;
  — a reassessment of the recoverability of deferred tax assets; or
— a change in the expected manner of recovery of an asset.

- In such cases, the resulting deferred tax is recognised in profit or loss, except to the extent that it relates to items previously recognised outside profit or loss.

(d) In exceptional circumstances, it may be difficult to determine the amount of current and deferred tax that relates to items recognised outside profit or loss (either in other comprehensive income or directly in equity).

- This may be the case, for example, when a change in the tax rate or other tax rules affects a deferred tax asset or liability relating (in whole or in part) to an item that was previously recognised outside profit or loss; or

- In such cases, the current and deferred tax related to items that are recognised outside profit or loss are based on a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction concerned, or other method that achieves a more appropriate allocation in the circumstances.

(e) Ind AS 16 does not specify whether an entity should transfer each year from revaluation surplus to retained earnings an amount equal to the difference between the depreciation or amortisation on a revalued asset and the depreciation or amortisation based on the cost of that asset.

- If an entity makes such a transfer, the amount transferred is net of any related deferred tax.

- Similar considerations apply to transfers made on disposal of an item of property, plant or equipment.

(f) When an asset is revalued for tax purposes and that revaluation is related to an accounting revaluation of an earlier period, or to one that is expected to be carried out in a future period, the tax effects of both the asset revaluation and the adjustment of the tax base are recognised in other comprehensive income in the periods in which they occur.

(g) When an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. In many jurisdictions this amount is referred to as a withholding tax. Such an amount paid or payable to taxation authorities is charged to equity as a part of the dividends.

**1.6.10 Step 10: Offsetting deferred tax assets and deferred tax liabilities**

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

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

- 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.

(b) To avoid the need for detailed scheduling of the timing of the reversal of each temporary difference, this Standard requires an entity to set off a deferred tax asset against a deferred tax liability of the same taxable entity if, and only if, they relate to income taxes levied by the same taxation authority and the entity has a legally enforceable right to set off current tax assets against current tax liabilities.

(c) In rare circumstances, an entity may have a legally enforceable right of set off, and an intention to settle net, for some periods but not for others. In such rare circumstances, detailed scheduling may be required to establish reliably whether the deferred tax liability of one taxable entity will result in increased tax payments in the same period in which a deferred tax asset of another taxable entity will result in decreased payments by that second taxable entity.

1.7 PART D: PRACTICAL APPLICATION

1.7.1 Deferred tax arising from a business combination

(a) As discussed above, temporary differences may arise in a business combination. In accordance with Ind AS 103, an entity recognises any resulting deferred tax assets (to the extent that they meet the recognition criteria) or deferred tax liabilities as identifiable assets and liabilities at the acquisition date. Consequently, those deferred tax assets and deferred tax liabilities affect the amount of goodwill or the bargain purchase gain the entity recognises. However, in accordance with this Ind AS, in certain circumstances, an entity does not recognise deferred tax liabilities arising from the initial recognition of goodwill.

(b) As a result of a business combination, the probability of realising a pre-acquisition deferred tax asset of the acquirer could change. An acquirer may consider it probable that it will recover its own deferred tax asset that was not recognised before the business combination. For example, the acquirer may be able to utilise the benefit of its unused tax losses against the future taxable profit of the acquiree. Alternatively, as a result of the business combination it might no longer be probable that future taxable profit will allow the deferred tax asset to be recovered. In such cases, the acquirer recognises a change in the deferred tax asset in the period of the business combination, but does not include it as part of the accounting for the business combination. Therefore, the acquirer does not take it into account in measuring the goodwill or bargain purchase gain it recognises in the business combination.
(c) The potential benefit of the acquiree’s income tax loss carry forwards or other deferred tax assets might not satisfy the criteria for separate recognition when a business combination is initially accounted for but might be realised subsequently. An entity shall recognise acquired deferred tax benefits that it realises after the business combination as follows:

- Acquired deferred tax benefits recognised within the measurement period that result from new information about facts and circumstances that existed at the acquisition date shall be applied to reduce the carrying amount of any goodwill related to that acquisition. If the carrying amount of that 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, depending on whether paragraph 34 or paragraph 36A of Ind AS 103 would have applied had the measurement period adjustments been known on the date of acquisition itself.

- All other acquired deferred tax benefits realised shall be recognised in profit or loss (or, if this Standard so requires, outside profit or loss).

1.7.2 Current and deferred tax arising from share-based payment transactions

(a) In some tax jurisdictions, an entity receives a tax deduction (i.e., an amount that is deductible in determining taxable profit) that relates to remuneration paid in shares, share options or other equity instruments of the entity. The amount of that tax deduction may differ from the related cumulative remuneration expense, and may arise in a later accounting period. For example, in some jurisdictions, an entity may recognise an expense for the consumption of employee services received as consideration for share options granted, in accordance with Ind AS 102, Share-based Payment, and not receive a tax deduction until the share options are exercised, with the measurement of the tax deduction based on the entity’s share price at the date of exercise.

(b) As with the preliminary expenses, 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.

(c) As noted above, in (a), the amount of the tax deduction or estimated future tax deduction, measured in accordance with paragraph (b) above may differ from the related cumulative remuneration expense. This 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. 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.

1.7.3 Change in tax status of an entity or its shareholders

(a) A change in the tax status of an entity or of its shareholders may have consequences for an entity by increasing or decreasing its tax liabilities or assets. This may, for example, occur upon the public listing of an entity’s equity instruments or upon the restructuring of an entity’s equity. It may also occur upon a controlling shareholder’s move to a foreign country. As a result of such an event, an entity may be taxed differently; it may for example gain or lose tax incentives or become subject to a different rate of tax in the future.

(b) A change in the tax status of an entity or its shareholders may have an immediate effect on the entity’s current tax liabilities or assets. The change may also increase or decrease the deferred tax liabilities and assets recognised by the entity, depending on the effect the change in tax status has on the tax consequences that will arise from recovering or settling the carrying amount of the entity’s assets and liabilities.

(c) The issue is how an entity should account for the tax consequences of a change in its tax status or that of its shareholders.

(d) The accounting principles that should be adopted in this situation are as under:

♦ 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.
1.8 PART E: DISCLOSURES

This Ind AS not only deals with recognition and measurement of income-taxes but also requires quite a few disclosures with respect to these income tax. These are discussed as under.

1.8.1 Disclosure 1: Disclose components of tax expenses (income)

(a) Each of the major components of tax expense (income) is to be disclosed separately.

(b) As we know, tax expense (tax income) is the aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax. The tax expense (income) related to profit or loss or loss from ordinary activities shall be presented in statement of profit or loss.

(c) The components of tax expense (income) include:
   - current tax expense (income);
   - any adjustments recognised in the period for current tax of prior periods;
   - the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;
   - the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;
   - the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce current tax expense;
   - the amount of the benefit from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce deferred tax expense;
   - deferred tax expense arising from the write-down, or reversal of a previous write-down, of a deferred tax asset; and
   - the amount of tax expense (income) relating to those changes in accounting policies and errors that are included in profit or loss in accordance with Ind AS 8, because they cannot be accounted for retrospectively.

1.8.2 Disclosure 2: Tax related to items charged directly to equity

(a) Indian Accounting Standards require or permit particular items to be credited or charged directly to equity.

(b) Examples of such items are:
   - 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
(see Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors); and

- amounts arising on initial recognition of the equity component of a compound financial instrument (see paragraph 23).

(c) The current and deferred tax relating to these items have to be recognised and accounted for directly in equity.

(d) This Ind AS requires disclosure of the aggregate current and deferred tax relating to items that are charged or credited directly to equity.

1.8.3 Disclosure 3: Tax related to items recognised in statement of other comprehensive income

(a) Indian Accounting Standards require or permit particular items to be recognised in other comprehensive income.

(b) Examples of such items are:

- a change in carrying amount arising from the revaluation of property, plant and equipment (see Ind AS 16); and

- exchange differences arising on the translation of the financial statements of a foreign operation (see Ind AS 21).

(c) The current and deferred tax relating to these items have to be recognised and accounted for in the statement of other comprehensive income.

(d) This Ind AS requires disclosure of the amount of income tax relating to each component of other comprehensive income.

1.8.4 Disclosure 4: Explanation of the relationship between tax expense (income) and accounting profit

(a) In ideal situation, if accounting profit is say ₹ 100 and tax rate is 30%, the tax expense should be ₹ 30. But this is seldom the case due to differences in accounting principles and standards vis–a–vis tax laws.

(b) Therefore, this Standard requires an explanation to be disclosed of the relationship between tax expense (income) and accounting profit in either or both of the following forms:

- a numerical reconciliation between tax expense (income) and the product of accounting profit multiplied by the applicable tax rate(s), disclosing also the basis on which the applicable tax rate(s) is (are) computed; or

- a numerical reconciliation between the average effective tax rate (tax expense divided
by the accounting profit) and the applicable tax rate, disclosing also the basis on which the applicable tax rate is computed.

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

The two types of disclosures are as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting profit</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Tax at the applicable tax rate of 30%</td>
<td>30,000</td>
</tr>
<tr>
<td>Tax effect of expenses that are not deductible in determining taxable profits:-</td>
<td>3,000</td>
</tr>
<tr>
<td>Penalties</td>
<td></td>
</tr>
<tr>
<td>Tax expense</td>
<td>33,000</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Particulars</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applicable tax rate</td>
<td>30</td>
</tr>
<tr>
<td>Tax effect of expenses that are not deductible in determining taxable profits:- Penalties</td>
<td>3</td>
</tr>
<tr>
<td>Average effective tax rate</td>
<td>33</td>
</tr>
</tbody>
</table>

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

(c) These disclosures enable users of financial statements to understand whether the relationship between tax expense (income) and accounting profit is unusual and to understand the significant factors that could affect that relationship in the future. The relationship between tax expense (income) and accounting profit may be affected by such factors as revenue that is exempt from taxation, expenses that are not deductible in determining taxable profit (tax loss), the effect of tax losses and the effect of foreign tax rates.

(d) In explaining the relationship between tax expense (income) and accounting profit, an entity uses an applicable tax rate that provides the most meaningful information to the users of its financial statements. Often, the most meaningful rate is the domestic rate of tax in the country in which the entity is domiciled, aggregating the tax rate applied for national taxes with the rates applied for any local taxes which are computed on a substantially similar level of taxable profit (tax loss).
However, for an entity operating in several jurisdictions, it may be more meaningful to aggregate separate reconciliations prepared using the domestic rate in each individual jurisdiction. The following example illustrates how the selection of the applicable tax rate affects the presentation of the numerical reconciliation.

**Example**

In 20X2, an entity has accounting profit in its own jurisdiction (country A) of ₹ 1,500 (20X1: ₹ 2,000) and in country B of ₹ 1,500 (20X1: ₹ 500). The tax rate is 30% in country A and 20% in country B. In country A, expenses of ₹ 100 (20X1: ₹ 200) are not deductible for tax purposes.

The following reconciliation will be prepared:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>20X2</td>
</tr>
<tr>
<td>Accounting profit</td>
<td>3,000</td>
</tr>
<tr>
<td>Tax at the domestic rate of 30%</td>
<td>900</td>
</tr>
<tr>
<td>Tax effect of expenses that are not deductible for tax purposes</td>
<td>30</td>
</tr>
<tr>
<td>Effect of lower tax rates in country B</td>
<td>(150)</td>
</tr>
<tr>
<td>Tax expense</td>
<td>780</td>
</tr>
</tbody>
</table>

### 1.8.5 Disclosure 5: Change in tax rates

(a) The applicable tax rates may change due to variety of reasons. There could be a change in the manner of recovery of the asset. The tax laws may have changed. There could be a change in the structure of the entity.

(b) In case there are changes in the applicable tax rate(s) compared to the previous accounting period, an explanation has to be provided.

### 1.8.6 Disclosure 6: Unrecognised deductible temporary differences, unused tax losses and unused tax credits

(a) The Standard lays down criteria for recognising deferred tax assets on deductible temporary differences, unused tax losses and unused tax credits. For example, whether a sufficient
taxable temporary difference are available, is there a probability of future profits and are there any tax planning opportunities.

(b) If the laid down recognition criteria could not be met, no deferred tax asset is recognised on these deductible temporary differences, unused tax losses and unused tax credits.

(c) The Standard requires the amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised in the balance sheet, to be disclosed.

1.8.7 Disclosure 7: Temporary differences associated with investments in subsidiaries etc.

(a) The 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 should be disclosed.

(b) It would often be impracticable to compute the amount of unrecognised deferred tax liabilities arising from investments in subsidiaries, branches and associates and interests in joint ventures. Therefore, this Standard requires an entity to disclose the aggregate amount of the underlying temporary differences but does not require disclosure of the deferred tax liabilities.

(c) Nevertheless, where practicable, entities are encouraged to disclose the amounts of the unrecognised deferred tax liabilities because financial statement users may find such information useful.

1.8.8 Disclosure 8: Amount of deferred tax liabilities (assets) or income (expense)

(a) As per the criteria laid down in the Standard, deferred tax liabilities have to be recognised for taxable temporary differences and deferred tax assets have to be recognised for deductible temporary differences, unused tax losses and unused tax credits.

(b) Where deferred taxes have been recognised, the following should be disclosed 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.
1.8.9 Disclosure 9: Discontinued operations

The following should be disclosed in respect of discontinued operations, the tax expense relating to:

(i) the gain or loss on discontinuance; and

(ii) the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented.

1.8.10 Disclosure 10: Dividend tax

(a) At times dividends relating to the reporting period are proposed or declared after the reporting date but before the financial statements are approved for issue. These are disclosed but not recognised in financial statements.

(b) In such a situation, an entity should disclose 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.

1.8.11 Disclosures 11: In case of business combination

The following should be disclosed:

- if a business combination in which the entity is the acquirer causes a change in the amount recognised for its pre-acquisition deferred tax asset, the amount of that change; and

- if the deferred tax benefits acquired in a business combination are not recognised at the acquisition date but are recognised after the acquisition date, a description of the event or change in circumstances that caused the deferred tax benefits to be recognised.

1.8.12 Disclosure 12: Deferred tax asset and evidence thereto where based on future taxable profits

An entity shall disclose the amount of a deferred tax asset and the nature of the 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 in the tax jurisdiction to which the deferred tax asset relates.
1.8.13 Disclosure 13: Tax consequences of distribution of dividends

(a) As discussed above, in some tax jurisdiction tax rates depend on the fact whether dividend is distributed or not.

(b) In these circumstances, an entity shall disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. In addition, the entity shall disclose the amounts of the potential income tax consequences practicably determinable and whether there are any potential income tax consequences not practicably determinable.

(c) The aforesaid disclosure requirement requires an entity to disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. An entity also discloses the important features of the income tax systems and the factors that will affect the amount of the potential income tax consequences of dividends.

(d) However, it would sometimes not be practicable to compute the total amount of the of the total amount may be easily determinable. For example, in a consolidated group, a parent and some of its subsidiaries may have paid income taxes at a higher rate on undistributed profits and be aware of the amount that would be refunded on the payment of future dividends to shareholders from consolidated retained earnings. In this case, that refundable amount is disclosed.

(e) If applicable, the entity also discloses that there are additional potential income tax consequences not practicably determinable. In the parent’s separate financial statements, if any, the disclosure of the potential income tax consequences relates to the parent’s retained earnings.

(f) An entity required to provide the disclosures referred above is also required to provide disclosures related to temporary differences associated with investments in subsidiaries, branches and associates or interests in joint ventures. In such cases, an entity considers this in determining the information to be disclosed under this requirement. For example, an entity may be required to disclose the aggregate amount of temporary differences associated with investments in subsidiaries for which no deferred tax liabilities have been recognised. If it is impracticable to compute the amounts of unrecognised deferred tax liabilities there may be amounts of potential income tax consequences of dividends not practicably determinable related to these subsidiaries.
1.8.14 Disclosure 14: Tax related contingencies

An entity discloses any tax-related contingent liabilities and contingent assets in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets. Contingent liabilities and contingent assets may arise, for example, from unresolved disputes with the taxation authorities.

1.8.15 Disclosure 15: Change in tax rates or tax laws

Where changes in tax rates or tax laws are enacted or announced after the reporting period, an entity discloses any significant effect of those changes on its current and deferred tax assets and liabilities (see Ind AS 10, Events after the Reporting Period).

Illustration 1

An entity has a deductible temporary difference of ₹50,000. It has no taxable temporary differences against which it can be offset. The entity is also not anticipating any future profits. However, it can implement a tax planning strategy which can generate profits up to ₹60,000. The cost of implementing this tax planning strategy is ₹12,000. The tax rate is 30%. Compute the deferred tax asset that should be recognised.

Solution

The entity should recognise a deferred tax asset of ₹14,400 @ 30% of ₹48,000 (₹60,000 – ₹12,000).

The balance deferred tax asset of ₹600 @ 30% on ₹2,000 (₹50,000 – ₹48,000) shall remain unrecognised.

Illustration 2

A Limited recognises interest income in its books on accrual basis. However, for income tax purposes the method is ‘cash basis’. On December 31, 20X1, it has interest receivable of ₹10,000 and the tax rate was 25%. On February 28, 20X1, the finance bill is introduced in the legislation that changes the tax rate to 30%. The finance bill is enacted as Act on May 21, 20X2. Discuss the treatment of deferred tax in case the reporting date of A Limited’s financial statement is December 31, 20X1 and these are approved for issued on May 31, 20X2.

Solution

The difference of ₹10,000 between the carrying value of interest receivable of ₹10,000 and its tax base of NIL is a taxable temporary difference.

A Limited has to recognise a deferred tax liability of ₹2,500 (₹10,000 x 25%) in its financial statements for the reporting period ended on December 31, 20X1.
It will not recognise the deferred tax liability @ 30% because as on December 31, 20X1, this tax rate was neither substantively enacted or enacted on the reporting date. However, if the effect of this change is material, A Limited should disclose this difference in its financial statements.

### 1.9 SIGNIFICANT CHANGES IN IND AS 12 VIS-À-VIS AS 22

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particulars</th>
<th>Ind AS 12</th>
<th>AS 22</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Approach for creating Deferred Tax</td>
<td>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.</td>
<td>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.</td>
</tr>
<tr>
<td></td>
<td>Limited Exceptions for Recognition of Deferred Tax Asset</td>
<td>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</td>
<td>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.</td>
</tr>
<tr>
<td>Recognition of Current and Deferred Tax</td>
<td>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.</td>
<td>AS 22 does not specifically deal with this aspect.</td>
<td></td>
</tr>
<tr>
<td>Disclosure of DTA and DTL in Balance Sheet:</td>
<td>Ind AS 12 does not deal with this aspect except that it requires that income tax relating to each component of other comprehensive income shall be disclosed as current or non-current asset/liability in accordance with the requirements of Ind AS 1.</td>
<td>AS 22 deals with disclosure of deferred tax assets and deferred tax liabilities in the balance sheet.</td>
<td></td>
</tr>
<tr>
<td>Disclosure Requirements:</td>
<td>Disclosure requirements given in the Ind AS 12 are more detailed as compared to existing AS 22.</td>
<td>Less disclosure are required</td>
<td></td>
</tr>
<tr>
<td>--------------------------</td>
<td>---------------------------------------------------------------------------------</td>
<td>---------------------------</td>
<td></td>
</tr>
<tr>
<td>DTA/DTL arising out of Revaluation of Assets:</td>
<td>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.</td>
<td>AS 22 does not deal with this aspect.</td>
<td></td>
</tr>
<tr>
<td>Changes in Entities Tax Status or that of its Shareholders</td>
<td>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.</td>
<td>AS 22 does not deal with this aspect.</td>
<td></td>
</tr>
<tr>
<td>Virtual Certainty:</td>
<td>Since the concept of virtual certainty does not exist in Ind AS 12, this explanation is not included.</td>
<td>AS 22 explains virtual certainty supported by convincing evidence.</td>
<td></td>
</tr>
<tr>
<td>Guidance for Recognition of Deferred Tax in a Tax Holiday Period:</td>
<td>Ind AS 12 does not specifically deal with these situations.</td>
<td>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’.</td>
<td></td>
</tr>
<tr>
<td>Guidance on Certain Issues:</td>
<td>Ind AS 12 does not specifically deal with this aspect.</td>
<td>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.</td>
<td></td>
</tr>
</tbody>
</table>
TEST YOUR KNOWLEDGE

Practical Questions

1. An asset which cost ₹ 150 has a carrying amount of ₹ 100. Cumulative depreciation for tax purposes is ₹ 90 and the tax rate is 25%. Calculate the tax base.

2. A company had purchased an asset at ₹ 1,00,000. Estimated useful life of the asset is 5 years and depreciation rate is 20%. (Depreciation rate for Tax purposes is 25%). The operating profit is ₹ 1,00,000 for all the 5 years. Tax rate is 30% for the next 5 years. Calculate the Book Value as per financial and tax purposes and then DTL.

3. A Ltd. Acquired B Ltd. The following assets and liabilities are acquired in a business combination:

<table>
<thead>
<tr>
<th>₹ 000’s</th>
<th>Fair Value</th>
<th>Carrying amount</th>
<th>Temporary Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant and Equipment</td>
<td>250</td>
<td>260</td>
<td>(10)</td>
</tr>
<tr>
<td>Inventory</td>
<td>120</td>
<td>125</td>
<td>(5)</td>
</tr>
<tr>
<td>Debtors</td>
<td>200</td>
<td>210</td>
<td>(10)</td>
</tr>
<tr>
<td></td>
<td>570</td>
<td>595</td>
<td>(25)</td>
</tr>
<tr>
<td>9% Debentures</td>
<td>(100)</td>
<td>(100)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>470</td>
<td>495</td>
<td></td>
</tr>
<tr>
<td>Consideration paid</td>
<td>500</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>Goodwill</td>
<td>30</td>
<td>5</td>
<td>(25)</td>
</tr>
</tbody>
</table>

Calculate Deferred Tax Asset.

4. XYZ Ltd. proposes to issue 1000 shares to its 200 employees under ESOP. (Vesting condition: Continuous employment for 3 years). 10% labour turnover is observed and value of option is ₹ 40. Calculate Deferred Tax Asset. What is if the entity gets a deduction of ₹ 19,00,000 (say as per tax law the share based payment is measured differently) instead of ₹ 17,49,600?
5. B Limited is a newly incorporated entity. Its first financial period ends on March 31, 20X1. As on the said date, the following temporary differences exist:

(a) Taxable temporary differences relating to accelerated depreciation of ₹ 9,000. These are expected to reverse equally over next 3 years.

(b) Deductible temporary differences of ₹ 4,000 expected to reverse equally over next 4 years.

It is expected that B Limited will continue to make losses for next 5 years. Tax rate is 30%. Losses can be carried forward but not backwards.

Discuss the treatment of deferred tax as on March 31, 20X1.

Answers to Practical Questions

1. The tax base of the asset is ₹ 60 (cost of ₹ 150 less cumulative tax depreciation of ₹ 90). To recover the carrying amount of ₹ 100, the entity must earn taxable income of ₹ 100, but will only be able to deduct tax depreciation of ₹ 60. Consequently, the entity will pay income taxes of ₹ 10 (₹ 40 at 25%) when it recovers the carrying amount of the asset. The difference between the carrying amount of ₹ 100 and the tax base of ₹ 60 is a taxable temporary difference of ₹ 40. Therefore, the entity recognises a deferred tax liability of ₹ 10 (₹ 40 at 25%) representing the income taxes that it will pay when it recovers the carrying amount of the asset.

2. Let us first of all calculate the Book Value as per financial and tax purposes.

<table>
<thead>
<tr>
<th>Year</th>
<th>Financial Accounting: ₹ 000’s</th>
<th>Tax Accounting: ₹ 000’s</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross Block</td>
<td>Accumulated Depreciation</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>60</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>80</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

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Calculation of DTL:

<table>
<thead>
<tr>
<th>Year</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carrying Amount</td>
<td>80</td>
<td>60</td>
<td>40</td>
<td>20</td>
<td>0</td>
</tr>
<tr>
<td>Tax Base</td>
<td>75</td>
<td>50</td>
<td>25</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Difference</td>
<td>5</td>
<td>10</td>
<td>15</td>
<td>20</td>
<td>0</td>
</tr>
<tr>
<td>Deferred Tax Liability (Difference x 30%)</td>
<td>1.5</td>
<td>3</td>
<td>4.5</td>
<td>6</td>
<td>0</td>
</tr>
</tbody>
</table>

3. In this case there is a Deferred Tax Asset as the Tax base of assets acquired is higher by 25,000. DTA would be ₹ 7,500 (25,000 x 30%)

Journal entry:

- Plant and equipment ----------------------------------- Dr 250
- Inventory ----------------------------------------------- --Dr 120
- Debtors ------------------------------------------------- --Dr 200
- Goodwill ----------------------------------------------- --Dr 22.5 (30- 7.5)
- DTA ---------------------------------------------------------Dr 7.5
  
To 9% Debentures 100
To Bank 500

4. Value of the award:

1000 x 200 x 40 x 0.9 x 0.9 x 0.9 = 58,32,000

Annual amortisation = 58,32,000/3 = 19,44,000

DTA = 19,44,000 x 30% = 5,83,200

Journal Entries:

- Employee benefit expense Dr 19,44,000
  To Equity Suspense A/c 19,44,000
- Deferred Tax Income Dr 5,83,200
  To Comprehensive Income 5,83,200
- Deferred Tax Asset Dr 5,83,200
  To Deferred Tax Asset 5,83,200
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.

If the entity gets a deduction of ₹19,00,000 (say as per tax law the share based payment is measured differently) instead of ₹17,49,600.

Then an additional entry shall be passed:

Deferred Tax Asset Dr 1,50,400
To Retained earnings 1,50,400

5. The year-wise anticipated reversal of temporary differences is as under:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Year ending on March 31, 20X2</th>
<th>Year ending on March 31, 20X3</th>
<th>Year ending on March 31, 20X4</th>
<th>Year ending on March 31, 20X5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reversal of taxable temporary difference relating to accelerated depreciation over next 3 years (₹9,000/3)</td>
<td>3,000</td>
<td>3,000</td>
<td>3,000</td>
<td>Nil</td>
</tr>
<tr>
<td>Reversal of deductible temporary difference relating to preliminary expenses over next 4 years (₹4,000/4)</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
</tr>
</tbody>
</table>

B Limited will recognise a deferred tax liability of ₹2,700 on taxable temporary difference relating to accelerated depreciation of ₹9,000 @ 30%.

However, it will limit and recognise a deferred tax asset on reversal of deductible temporary difference relating to preliminary expenses reversing up to year ending March 31, 20X4 amounting to ₹900 (₹3,000 @ 30%). No deferred tax asset shall be recognized for the reversal of deductible temporary difference for the year ending on March 31, 20X5 as there are no taxable temporary differences. Further, the outlook is also a loss. However, if there are tax planning opportunities that could be identified for the year ending on March 31, 20X5 deferred tax asset on the remainder of ₹1,000 (₹4,000 – ₹3,000) of deductible temporary difference could be recognised at the 30% tax rate.