CHAPTER 7

# IND AS ON ITEMS IMPACTING THE FINANCIAL STATEMENTS



## UNIT 1:
## INDIAN ACCOUNTING STANDARD 12 : INCOME TAXES

### LEARNING OUTCOMES

**After studying this unit, you will be able to:**

- List 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
- Demonstrate when Ind AS 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

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- 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.

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# UNIT OVERVIEW

| | |
|---|---|
| Definition | • Accounting profit<br>• Taxable profit (tax loss)<br>• Tax expense (tax income)<br>• Current tax<br>• Deferred tax liabilities<br>• Deferred tax assets<br>• Temporary differences<br>• Taxable temporary differences<br>• Deductible temporary differences<br>• Tax base |
| Tax Expense | • Current Tax<br>• Deferred Tax |
| Current tax | • Recognition<br>• Measurement<br>• Accounting of Current Tax Effects<br>• Offsetting Current Tax Assets and Current Tax Liabilities |
| Deferred Tax | • Compute carrying amount<br>• Compute tax base<br>• Compute temporary differences<br>• Classify temporary differences<br>• Identify exceptions<br>• Assess (also reassess) deductible temporary differences, tax losses and tax credits<br>• Determine the tax rate (law)<br>• Calculate and recognise deferred tax<br>• Accounting of deferred tax<br>• Offsetting deferred tax assets and deferred tax liabilities |
| Practical Application | • Deferred tax arising from a business combination<br>• Current and deferred tax arising from share-based payment transactions<br>• Change in tax status of an entity or its shareholders |
| Disclosure | • Disclose components of tax expenses (income)<br>• Tax related to items charged directly to equity<br>• Tax related to items recognised in statement of other comprehensive income<br>• Explanation of the relationship between tax expense (income) and accounting profit<br>• Change in tax rates<br>• Unrecognised deductible temporary differences, unused tax losses and unused tax credits<br>• Temporary differences associated with investments in subsidiaries etc.<br>• Amount of deferred tax liabilities (assets) or income (expense) |

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## 1.1 OBJECTIVE

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:

| Year | 1 | 2 | 3 | 4 |
|---|---|---|---|---|
| Cost of the asset | 10,000 | 10,000 | 10,000 | 10,000 |
| Depreciation rate – WDV | 40% | 40% | 40% | 40% |
| Depreciation amount – WDV | 4,000 | 2,400 | 1,440 | 864 |
| Taxable profits before depreciation | 20,000 | 20,000 | 20,000 | 20,000 |
| Less: Depreciation | (4,000) | (2,400) | (1,440) | (864) |
| Taxable profits after depreciation | 16,000 | 17,600 | 18,560 | 19,136 |
| Tax rate | 30% | 30% | 30% | 30% |
| Tax amount | 4,800 | 5,280 | 5,568 | 5,741 |

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| However, in the books of accounts, the situation will be as under: | | | | |
|---|---|---|---|---|
| **Year** | **1** | **2** | **3** | **4** |
| (a) Cost of the asset | 10,000 | 10,000 | 10,000 | 10,000 |
| (b) Depreciation rate – SLM | 16.21% | 16.21% | 16.21% | 16.21% |
| (c) Depreciation amount – SLM | 1,621 | 1,621 | 1,621 | 1,621 |
| (d) Accounting profits before depreciation | 20,000 | 20,000 | 20,000 | 20,000 |
| (e) Less: Depreciation | (1,621) | (1,621) | (1,621) | (1,621) |
| (f) Accounting profits after depreciation | 18,379 | 18,379 | 18,379 | 18,379 |
| (g) Tax amount – as above | 4,800 | 5,280 | 5,568 | 5,741 |
| (h) Effective tax rate=(g)/(f) | 26.12% | 28.73% | 30.30% | 31.24% |
| (i) Tax @ 30% tax rate {30%*(f)} | 5,514 | 5,514 | 5,514 | 5,514 |

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.

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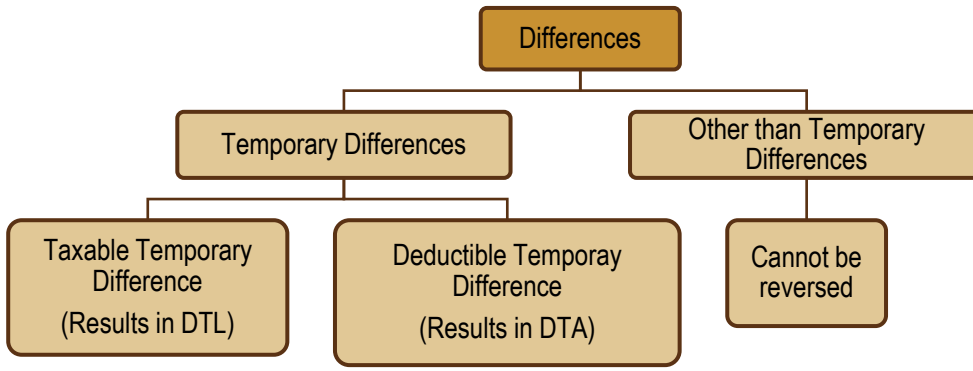


## 1.2 SCOPE

- 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.

| | |
|---|---|
| Domestic and Foreign Taxes; Including withholding taxes which are payable by a subsidiary, Associate or Joint Arrangements on distributions to the Reporting Entity | Methods of Accounting for Government Grants or Investment tax credits (But it deals with accounting for temporary differences arising from such grants and investment tax credits) |

- 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

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(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:

**Example 2**

(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 the future.

(b) Assume that under the income tax provisions, if this piece of land is sold after holding it for more than 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 21,000 (1,21,000-1,00,000). For instance, if after two and half years, the 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).

(e) In view of the above savings, the entity should recognise a deferred tax asset of ₹ 6,300 in this case in Year 1.

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

**Note:** There are controversial views 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.

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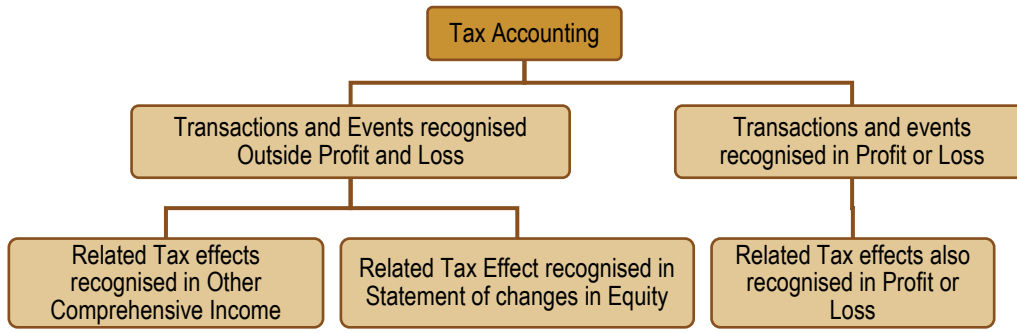
- The Standard also provides guidance as to where the current tax or deferred tax should be recognised, accounted and presented.
- An entity may incur a loss in the current period and set off against a profit in the earlier period. As the entity would recover a tax paid in the earlier year, the entity 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

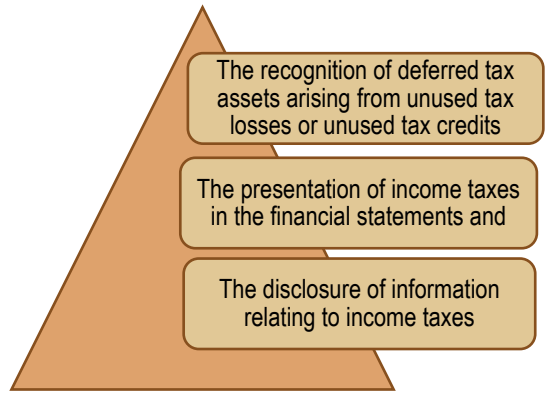



- In addition, the Standard deals with the:

  (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.

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- 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.
- ***This Standard applies to income taxes arising from tax law enacted or substantively enacted to implement the Pillar Two model rules published by the Organisation for Economic Co-operation and Development (OECD), including tax law that implements qualified domestic minimum top-up taxes described in those rules. As an exception to the requirements in this Standard, an entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.***

## 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.

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**(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.

***Comparison with AS 22:***

- **Timing differences** are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods.
- Thus, it can be seen that while AS 22 spoke of timing differences with reference to income, Ind AS 12 speaks of temporary differences with reference to carrying amounts and tax bases of assets and liabilities. In other words, AS 22 adopts a P/L approach, whereas Ind AS 12 adopts a balance sheet approach towards accounting for taxes on income.

**(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

## 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:

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(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.

## 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.

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**(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 substantive 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 law 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 in the Rajya Sabha.
  - It is then presented before the President for assent.
  - It is then notified in the gazette of India.

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- 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.

(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.

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(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.

**Illustration 1A**

*H Ltd. is a manufacturing company, wanting to calculate its taxable profit or loss for the year ended 31 March 20X8. The statement of profit and loss and other comprehensive income, the balance sheet and the notes are given below.*

*Tax rate for the financial year 20X7-20X8 is 30%, but the new tax rate of 32%, for the year 20X8-20X9 and beyond, has already been enacted before the year end.*

*Calculate taxable profit for the financial year 20X7-20X8 and the related current tax expense.*

***Balance Sheet as of 31 March 20X8***

| | ₹ |
|---|---|
| ***ASSETS*** | |
| ***Non-current assets*** | |
| *Property, plant and equipment* | *4,20,00,000* |
| *Product development costs* | *21,00,000* |
| *Investment in subsidiary – S Ltd.* | *1,54,00,000* |
| ***Current assets*** | |
| *Trading investments* | *72,80,000* |
| *Trade receivables* | *2,19,10,000* |
| *Inventories* | *1,06,40,000* |
| *Cash and cash equivalents* | *63,00,000* |
| ***TOTAL ASSETS*** | *10,56,30,000* |
| ***EQUITY & LIABILITIES*** | |
| ***Equity*** | |
| *Share capital* | *4,20,00,000* |
| *Accumulated profits* | *2,86,24,330* |
| *Revaluation surplus* | *30,80,000* |
| ***Non-current liabilities*** | |
| *Deferred income - government grants* | *14,00,000* |
| *Liability for product warranty costs* | *5,60,000* |
| *Deferred tax liability (from 20X6-20X7)* | *7,75,670* |

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| | |
|---|---|
| ***Current liabilities*** | |
| *Trade payables* | *2,67,40,000* |
| *Medical benefits for employees* | *24,50,000* |
| ***TOTAL EQUITY & LIABILITIES*** | *10,56,30,000* |

***Extract of Statement of profit and loss for the year ended 31 March 20X8***

| | |
|---|---|
| *Revenue* | *16,81,40,000* |
| *Cost of sales* | *(13,44,00,000)* |
| *Gross profit* | *3,37,40,000* |
| *Operating costs* | *(2,68,80,000)* |
| *Profit from operations* | *68,60,000* |
| *Finance costs* | *(9,10,000)* |
| *Profit before taxation* | *59,50,000* |

***Notes:***

1. *Depreciation expense for the year financial year 20X7-20X8 allowable as per the Income Tax Rules is ₹72,10,000. Depreciation as allowed for the purposes of financial reporting included in operating costs is ₹ 59,50,000. Cost of PPE is ₹ 5,60,00,000 and H Ltd. deducted expenses of ₹1,45,60,000 in its tax returns prior to financial year 20X7-20X8. Further, as of 31 March 20X8, H Ltd. for the first time revalued its property, plant and equipment to market value of ₹4,20,00,000 (revaluation surplus = ₹30,80,000).*

2. *In 20X4-20X5, H Ltd. incurred product development costs of ₹35,00,000. These costs were recognized as an asset and amortized over period of 10 years. For tax purposes, H Ltd. deducted full product development costs when they were in 20X4-20X5.*

3. *Trading investments were acquired in the preceding year at a cost of ₹80,50,000. These investments are classified as at fair value through profit or loss and thus recognized in their fair value. Fair value adjustments are not allowable by the tax authorities.*

4. *Bad debt provision amounts to ₹45,50,000 and relates to 2 debtors: debtor A – ₹28,00,000 (receivable originates in 20X5-20X6 and 100% provision was recognized in the preceding year) and debtor B – ₹17,50,000 (receivable originates in 20X6-20X7 and 100% provision was recognized in F.Y. 20X7-20X8). Tax law allows deduction of 20% of provision for debtors overdue for more than 1 year, another 30% for debtors overdue for more than 2 years and remaining 50% for debtors overdue for more than 3 years.*

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5. *H Ltd. created a provision for inventory obsolescence in accordance with Ind AS 2 requirements. New provision created in 20X7-20X8 was ₹ 3,78,000 (total provision: ₹ 6,30,000). Being a general provision, this provision is not tax deductible.*

6. *Government grants are not taxable. Full government grant received in 20X7-20X8 is included in the balance sheet.*

7. *In 20X7-20X8, H Ltd. increased a liability for product warranty costs by ₹ 1,75,000. Product warranty costs are not tax deductible until the company pays claims. Claims paid in 20X7-20X8 amounted to ₹ 2,17,000.*

8. *During the year, H Ltd. introduced health care benefits for employees. The expenses are allowable for tax purposes only when benefits are paid but in line with Ind AS 19, recognized in profit or loss when employees provide service.*

9. *Penalties towards violation of laws included in operating expenses amount to ₹ 63,000. These are not deductible for tax purposes.*

10. *Tax law allows to deduct expenses for petrol only up to ₹ 1,40,000 per vehicle per year. H Ltd. had 4 vehicles in 20X7-20X8 and its total petrol expenses amounted to ₹ 7,21,000.*

*Note: This illustration is prepared for the purposes of understanding the computation of current tax and is in no way based on the provisions of the Income Tax Act, 1961. For the purposes of Financial Reporting, the tax treatments will be given in the question.*

**Solution:**

**Calculation of current tax expense**

| | | |
|---|---|---|
| Accounting profit | (A) | 59,50,000 |
| Add back: | | |
| Accounting depreciation | | 59,50,000 |
| Amortization of product development costs (W.N.1) | | 3,50,000 |
| Revaluation of trading investments | | 7,70,000 |
| Bad debt provisions - 20X7-20X8 | | 17,50,000 |
| Inventory obsolescence provision | | 3,78,000 |
| Product warranty costs provision - 20X7-20X8 | | 1,75,000 |
| Provision for health care benefit costs | | 24,50,000 |
| Fines and Penalties disallowed for tax purposes | | 63,000 |

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| | | |
|---|---|---|
| Petrol over limit (W.N.3) | | 1,61,000 |
| Total | (B) | 120,47,000 |
| Deduct: | | |
| Tax depreciation | | (72,10,000) |
| Tax allowance for bad debt provisions (W.N.2) | | (11,90,000) |
| Product warranty costs provision - claims paid | | (2,17,000) |
| Total | (C) | (86,17,000) |
| Taxable profit / loss: | (A+B-C) | 93,80,000 |
| Tax rate is 30% | | |
| Current income tax (93,80,000 x 30%) | | 28,14,000 |

**Journal Entry**

| | | | |
|---|---|---|---|
| Profit or loss - Current income tax expense | Dr. | 28,14,000 | |
| To Credit Current income tax liabilities | | | 28,14,000 |

**Working Notes:**

**1. Product development costs:**

| | |
|---|---|
| Annual amortization (₹ 35,00,000/ 10) | 3,50,000 |

**2. Bad debt provisions:**

| | |
|---|---|
| Debtor A - ₹ 28,00,000 from 20X5-20X6 | |
| > 2 years - 30% deductible in 20X7-20X8 | 8,40,000 |
| Debtor B - ₹ 17,50,000 from 20X6-20X7 | |
| > 1 year - 20% deductible in 20X7-20X8 | 3,50,000 |
| Total - tax deductible in 20X7-20X8 | 11,90,000 |

**3. Petrol expenses**

| | |
|---|---|
| Actual expenses | 7,21,000 |
| Tax deductible (4 x 140,000) | 5,60,000 |
| Excess | 1,61,000 |

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# 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 3**

Entity A had acquired an item of plant and machinery for ₹ 1,00,000 on 1st April, 20X1. It depreciated this item @ 10% per annum on SLM basis. For the year ended 31st March, 20X2, it provides depreciation of ₹ 10,000. The carrying amount of this item of plant and machinery as on 31st March, 20X2 is ₹ 90,000.

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## 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 4**

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

In the above scenario, if Entity A decides to revalue the item of plant and machinery and measures it at ₹ 1,50,000, the carrying value of the item of plant and machinery will be ₹ 1,50,000. For tax purposes, if the revaluation is ignored, the tax base remains ₹ 70,000 (Initial cost ₹ 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.

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**Examples 5-9**

5. 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.

6. 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.

7. Interest receivable has 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.

8. 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 in the current year is ₹ 1,000.

9. 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. In the subsequent period, entity is able to recover only ₹ 950. Further, in income-tax, specific bad debt provision is deductible in the

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very year it is created. 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. 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.

**Examples 10 & 11**

10. 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.

11. 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.

**Examples 12 & 13**

12. 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.*

13. 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.

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**Example 14**

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 15**

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 16**

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.

**Examples 17 & 18**

17. 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 is Nil.

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*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.*

18. 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 19**

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

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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 stand-alone 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 return. 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.

**Illustration 1B (in continuation to Illustration 1A):**

*Based on the balance sheet and notes of H Ltd. from previous example, calculate tax base of its assets and liabilities as of 31 March 20X8. Note that balance sheet has been adjusted by current tax expense and liability.*

***Balance Sheet as of 31 March 20X8***

| ***ASSETS*** | ₹ |
|---|---|
| ***Non-current assets*** | |
| *Property, plant and equipment* | *420,00,000* |
| *Product development costs* | *21,00,000* |
| *Investment in subsidiary – S Ltd.* | *154,00,000* |
| ***Current assets*** | |
| *Trading investments* | *72,80,000* |
| *Trade receivables* | *219,10,000* |
| *Inventories* | *106,40,000* |
| *Cash and cash equivalents* | *63,00,000* |
| ***Total Assets*** | ***10,56,30,000*** |

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| ***EQUITY & LIABILITIES*** | ₹ |
|---|---|
| ***Equity*** | |
| *Share capital* | *420,00,000* |
| *Accumulated profits* | *258,10,330* |
| *Revaluation surplus* | *30,80,000* |
| ***Long-term liabilities*** | |
| *Deferred income - government grants* | *14,00,000* |
| *Liability for product warranty costs* | *5,60,000* |
| *Deferred tax liability (from 20X6-20X7)* | *7,75,670* |
| ***Current liabilities*** | |
| *Trade payables* | *267,40,000* |
| *Medical benefits for employees* | *24,50,000* |
| *Current Tax Liability* | *28,14,000* |
| ***Total Equity & Liabilities*** | ***10,56,30,000*** |

*Remaining information are same as per Illustration 1A.*

**Solution:**

**Determination of Tax Base**

| Item | Carrying amount | Tax base |
|---|---|---|
| Property, plant and equipment | 420,00,000 | 342,30,000 |
| Product development costs | 21,00,000 | 0 |
| Investment in subsidiary | 154,00,000 | 154,00,000 |
| Trading investments | 72,80,000 | 80,50,000 |
| Trade receivables | 219,10,000 | 247,10,000 |
| Inventories | 106,40,000 | 112,70,000 |
| Cash and cash equivalents | 63,00,000 | 63,00,000 |
| Deferred income - government grants | -14,00,000 | 0 |
| Liability for product warranty costs | -5,60,000 | 0 |
| Trade payables | -267,40,000 | -267,40,000 |
| Health care benefits for employees | -24,50,000 | 0 |

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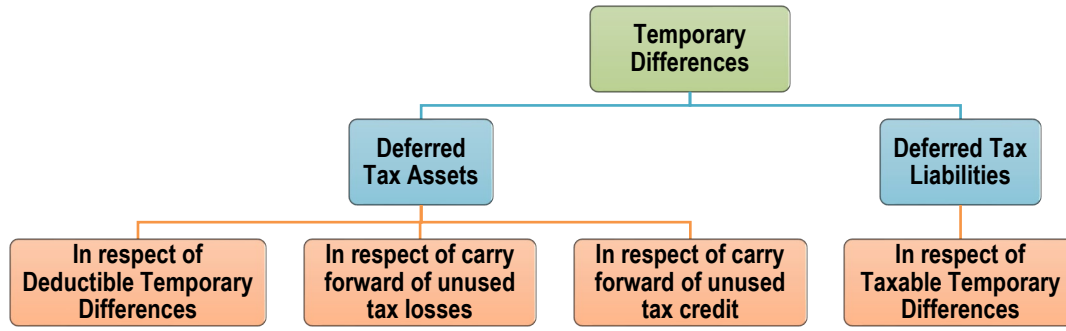
**Working Notes:**

| | | | |
|---|---|---|---|
| **1.** | **Property, plant and equipment** | | |
| | Cost | 560,00,000 | |
| | Less: current tax depreciation | (72,10,000) | |
| | Less: PY tax depreciation | (145,60,000) | |
| | Tax base | **3,42,30,000** | |
| **2.** | **Trade receivables - bad debt provisions:** | | |
| **I** | **Calculation of cost** | | |
| | Carrying amount | 219,10,000 | |
| | Add back: bad debt provision | 45,50,000 | |
| | Cost | **2,64,60,000** | **A** |
| **II** | **Debtor A - ₹ 28,00,000 from 20X5-20X6** | | |
| | > 1 year - 20% deducted in 20X6-20X7 | 5,60,000 | |
| | > 2 years - 30% deducted in 20X7-20X8 | 8,40,000 | |
| | Already deducted for tax: | **14,00,000** | |
| **III** | **Debtor B - ₹ 17,50,000 from 20X6-20X7** | | |
| | > 1 year - 20% deducted in 20X7-20X8 | 3,50,000 | |
| | Total deducted for tax purposes | 17,50,000 | **B** |
| | **Tax base of trade receivables:** | **2,47,10,000** | **A-B** |

*****

## 1.6.3 Step 3: Compute temporary differences

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(a) 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 20**

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).

(b) The contention in favour 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 have reversed, therefore the term 'temporary difference' is used. The cumulative impact is 'zero'.

**Example 21**

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**

| Year | 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|
| Gross Block | 120 | 120 | 120 | 120 | 120 | 120 |
| Cumulative Depreciation | (20) | (40) | (60) | (80) | (100) | (120) |
| Carrying Amount | 100 | 80 | 60 | 40 | 20 | 0 |

**Tax Computation**

| Year | 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|
| Tax base brought forward | 120 | 30 | 20 | 13 | 8 | 3 |
| Depreciation charge (assumed) | (90) | (10) | (7) | (5) | (5) | (3) |
| Tax base carried forward | 30 | 20 | 13 | 8 | 3 | 0 |

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**Temporary Difference**

| Year | 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|
| Carrying Amount | 100 | 80 | 60 | 40 | 20 | 0 |
| Tax base carried forward | (30) | (20) | (13) | (8) | (3) | 0 |
| Temporary difference | 70 | 60 | 47 | 32 | 17 | 0 |
| Cumulative impact | +70 | –10 | –13 | –15 | –15 | –17 |
| | +70 | –70 | | | | |

**Movement in Balance Sheet**

| Year | 1 | 2 | 3 | 4 | 5 | 6 |
|---|---|---|---|---|---|---|
| Temporary difference | 70 | 60 | 47 | 32 | 17 | 0 |
| Deferred tax liability | 21 | 18 | 14 | 10 | 5 | 0 |
| Movement in provision | +21 | -3 | -4 | -4 | -5 | -5 |
| Cumulative | +21 | -21 | | | | |

(c) 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.

(d) Examples of temporary differences in the nature of timing differences are as under.

**Example 22**

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

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

**Example 23: 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 24: *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*, Ind AS 109, *Financial Instruments* and Ind AS 116 *Leases*).

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

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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 25**

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.

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(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 26**

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:

| | For Assets | For Liabilities |
|---|---|---|
| If carrying amount > tax base | Taxable Temporary Difference<br>↓<br>Deferred Tax Liability<br>(e.g. WDV as per books > WDV as per Income Tax) | Deductible Temporary Difference<br>↓<br>Deferred Tax Asset<br>(e.g. Provision for Bonus as per books > Provision for Bonus as per IT) |

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| | | |
|---|---|---|
| If carrying amount < tax base | Deductible Temporary Difference<br>↓<br>Deferred Tax Asset<br>(e.g. WDV as per books < WDV as per Income Tax) | Taxable Temporary Difference<br>↓<br>Deferred Tax Liability<br>(e.g. Loan carrying amount as per books< Loan carrying amounts as per tax) |
| If carrying amount = tax base | No temporary difference | No temporary difference |

(e) Further examples of taxable temporary differences:

➢ **Transactions that affect profit or loss**

**Example 27**

1. 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.
2. 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*.
3. Depreciation of an asset is accelerated for tax purposes.
4. 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.
5. 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 28**

1. 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.
2. 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 using effective rate of interest. The transaction costs were deducted for tax purposes in the period when the loan was first recognised.

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3. 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.

4. 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 29**

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

2. 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 30**

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

2. 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.

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

4. 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.

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

6. 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.

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➢ **Hyperinflation**

**Example 31**

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 32**

1. 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.)*
2. 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.
3. 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.)*
4. 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.
5. 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.
6. Income is deferred in the balance sheet but has already been included in taxable profit in current or prior periods.
7. A government grant which is included in the balance sheet as deferred income will not be taxable in future periods.

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➢ **Fair value adjustments and revaluation**

**Example 33**

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 34**

1. 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.
2. 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.
3. Investments in foreign subsidiaries, branches or associates or interests in foreign joint ventures are affected by changes in foreign exchange rates.
4. 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

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(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)

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

- However, for taxable temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint 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).

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

- However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint 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

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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);

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

(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.

**Illustration 1C (in continuation to Illustration 1A):**

*Based on the data from above illustration 1A of H Ltd., calculate temporary differences and deferred tax. Note from Illustration 1A: Tax rate for 20X7-20X8 is 30%, but the new tax rate of 32% for the year 20X8-20X9 and beyond has already been enacted before the year end.*

**Solution:**

**Calculation of Temporary Differences / Deferred Tax**

| Item | Carrying amount | Tax base | Temporary difference | Taxable / deductible | DTA / DTL at 32% |
|---|---|---|---|---|---|
| Property, plant and equipment | 4,20,00,000 | 3,42,30,000 | 77,70,000 | taxable | (24,86,400) |
| Product development costs | 21,00,000 | 0 | 21,00,000 | taxable | (6,72,000) |
| Investment in subsidiary S Ltd. | 1,54,00,000 | 1,54,00,000 | 0 | | 0 |
| Trading investments | 72,80,000 | 80,50,000 | (7,70,000) | deductible | 2,46,400 |
| Trade receivables | 2,19,10,000 | 2,47,10,000 | (28,00,000) | deductible | 8,96,000 |

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| | | | | | |
|---|---|---|---|---|---|
| Inventories | 1,06,40,000 | 1,12,70,000 | (6,30,000) | deductible | 2,01,600 |
| Cash and cash equivalents | 63,00,000 | 63,00,000 | 0 | | 0 |
| Deferred income - government grants | (14,00,000) | 0 | (14,00,000) | **excluded** | 0 |
| Liability for product warranty costs | (5,60,000) | 0 | (5,60,000) | deductible | 1,79,200 |
| Trade payables | (2,67,40,000) | (2,67,40,000) | 0 | | 0 |
| Medical benefits for employees | (24,50,000) | 0 | (24,50,000) | deductible | 7,84,000 |
| ***Deferred tax asset - total*** | | | | | ***23,07,200*** |
| ***Deferred tax liability - total*** | | | | | ***(31,58,400)*** |
| **Deferred tax total** | | | | | **(8,51,200)** |

*****

## 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).

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- **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 dispose 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.

Deferred tax liability is not recognised for goodwill since the recognition shall be done through goodwill itself. This is going to result in inflating the goodwill amount, and therefore is not permitted.

**Example 35**

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:

| | | | |
|---|---|---|---|
| Goodwill | Dr. | 35,000 | |
| Net Assets | Dr. | 65,000 | |
| To Consideration | | | 1,00,000 |

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:

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| Entry 2: | | | |
|---|---|---|---|
| Goodwill | Dr. | 45,500 | |
| Net assets | Dr. | 65,000 | |
| To Consideration | | | 1,00,000 |
| To Deferred tax liability | | | 10,500 |

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. This is going to inflate the goodwill since the impact is taken in goodwill itself.

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.

**Example 36**

In the aforesaid Example 35, 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.

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➢ **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.

**(B) 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.

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**Example 37**

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) Not giving rise to equal taxable and deductible temporary differences

  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.

- A transaction that is not a business combination may lead to the initial recognition of an asset and a liability and, at the time of the transaction, affect neither accounting profit nor taxable profit.

  **For example,** at the commencement date of a lease, a lessee typically recognises a lease liability and the corresponding amount as part of the cost of a right-of-use asset. Depending on the applicable tax law, equal taxable and deductible temporary differences may arise on initial recognition of the asset and liability in such a transaction. The exemption provided does not apply to such temporary differences and an entity recognises any resulting deferred tax liability and asset.

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**Example 38**

Entity X acquired an intangible asset (a license) for ₹ 10 Cr that has a life of five years. The asset will be solely recovered through use. No tax deductions can be claimed, as the license is amortised or as when the license expires. No tax deductions are available on disposal. Trading profits from using the license will be taxed at 30%.

The tax base of the asset is nil, because the cost of the intangible asset is not deductible for tax purposes (either in use or on disposal). A temporary difference of ₹ 10 Cr arises; prima facie a deferred tax liability of ₹ 3 Cr should be recognized on this amount. However, no deferred tax is recognised on the asset's initial recognition. This is because the temporary difference did not arise from a business combination and did not affect accounting or taxable profit at the time of the recognition.

The asset will have a carrying amount of ₹ 8 Cr at the end of year 1. The entity will pay tax of ₹ 2.40 Cr through recovery of the asset by earning taxable amounts of ₹ 8 Cr. The deferred tax liability is not recognised, because it arises from initial recognition of an asset. Similarly, no deferred tax is recognised in later periods.

### (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

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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.

  Relevant Extracts from Financial Statements of selected Listed Entities are presented below:

*Annual Report of Bharti Airtel Ltd. for the year ending 31 March 2022 (Page 358)*

The Group has not recognised deferred tax liability with respect to unremitted retained earnings and associated foreign currency translation reserve with respect to certain of its subsidiaries and joint ventures where the Group is in a position to control the timing of the distribution of profits and it is probable that the subsidiaries will not distribute the profits in the foreseeable future. The taxable temporary difference associated with respect to unremitted retained earnings and associated foreign currency translation reserve is ₹98,427 and ₹79,800 as of March 31, 2022 and March 31, 2021, respectively. The distribution of the same is expected to attract tax in the range of NIL to 20% depending on the tax rates applicable as of March 31, 2022 in the jurisdiction in which the respective Group entity operates.

***(Source:** Annual report for 2021-2022 of Bharti Airtel Ltd.)*

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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*). If the entity's taxable profit or tax loss (and, hence, the tax base of its non-monetary assets and liabilities) is determined in a different currency, changes, changes in the exchange rate 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.

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- 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 reduce 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.

**Illustration 2**

*The directors of H Ltd. wish to recognise a material deferred tax asset in relation to ₹ 250 Cr of unused trading losses which have accumulated as at 31st March 20X1. H Ltd. has budgeted profits for ₹ 80 Cr for the year ended 31st March 20X2. The directors have forecast that profits will grow by 20% each year thereafter.*

*However, the market is currently depressed and sales orders are at a lower level for the first quarter of 20X2 than they were for the same period in any of the previous five years. On extrapolating the sales order book, it is noted that the improvement in trading results may occur after the next couple of years to come at the position of breakeven and the budgeted profits shared by the directors of H Ltd. do not appear to be in line with the sales order book. H Ltd. operates under a tax jurisdiction which allows for trading losses to be only carried forward for a maximum of two years.*

*Analyse whether a deferred tax asset can be recognized in the financial statements of H Ltd. for the year ended 31st March 20X1?*

**Solution**

In relation to unused trading losses, the carrying amount is zero since the losses have not yet been recognised in the financial statements of H Ltd. A potential deferred tax asset does arise but the determination of the tax base is more problematic.

The tax base of an asset is the amount which will be deductible against taxable economic benefits from recovering the carrying amount of the asset. Where recovery of an asset will

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have no tax consequences, the tax base is equal to the carrying amount. H Ltd. operates under a tax jurisdiction which only allows losses to be carried forward for two years. The maximum the tax base could be is therefore equal to the amount of unused losses for years 20X0 and 20X1 since these only are available to be deducted from future profits. The tax base though needs to be restricted to the extent that there is a probability of sufficient future profits to offset the trading losses. The directors of H Ltd. should base their forecast of the future profitability on reasonable and supportable assumptions. There appears to be evidence that this is not the case.

H Ltd. has accumulated trading losses and there is little evidence that there will be an improvement in trading results within the next couple of years. The market is depressed and sales orders for the first quarter of 20X2 are below levels in any of the previous five years.

The forecast profitability for 20X2 and subsequent growth rate therefore appear to be unrealistically optimistic.

Given that losses can only be carried forward for a maximum of two years, it is unlikely that any deferred tax asset should be recognised.

Hence, the contention of directors to recognized deferred tax assets in relation to ₹ 250 crores is not correct.

*****

**Example 39**

Entity A has deductible temporary difference of ₹ 1,00,000 for the financial year ended 31st March, 20X1. 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 (₹ 3,00,000 – ₹ 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 ₹ 3,00,000. 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.

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(b) 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) If tax law does not impose any restrictions on sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference, an entity assesses a deductible temporary difference in combination with all of its other deductible temporary differences.

(d) If tax law restricts the utilisation of losses to deduction against income of a specific type, a deductible temporary difference is assessed in combination only with other deductible temporary differences.

(e) 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.

| Particulars | Year | | |
|---|---|---|---|
| | 1 | 2 | 3 |
| Taxable temporary difference | | | |
| Opening balance | 10,000 | 5,000 | 2,000 |
| Recognised in taxable income | 5,000 | 3,000 | 2,000 |
| Closing balance | 5,000 | 2,000 | - |
| Deductible temporary difference | | | |
| Opening balance | 8,000 | 4,000 | 1,000 |
| Recognised in taxable income | 4,000 | 3,000 | 1,000 |
| Closing balance | 4,000 | 1,000 | - |
| Statement of taxable income | | | |
| Taxable temporary difference | 5,000 | 3,000 | 2,000 |
| Deductible temporary difference | 4,000 | 3,000 | 1,000 |

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

**Example 40**

As at 31st March, 20X1, an entity has both taxable temporary differences and deductible temporary difference with the following reversal pattern. Deductible temporary differences cannot be carried forward.

| Particulars | Year | | |
|---|---|---|---|
| | 1 | 2 | 3 |
| Taxable temporary difference | | | |
| Opening balance | 10,000 | 5,000 | 2,000 |
| Recognized in taxable income | 5,000 | 3,000 | 2,000 |
| Closing balance | 5,000 | 2,000 | - |
| Deductible temporary difference | | | |
| Opening balance | 8,000 | 4,000 | - |
| Recognized in taxable income | 4,000 | 4,000 | - |
| Closing balance | 4,000 | - | - |
| Statement of taxable income | | | |
| Taxable temporary difference | 5,000 | 3,000 | 2,000 |
| Deductible temporary difference | 4,000 | 4,000 | - |

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.

**Examples 41- 43**

41. If in the aforesaid example 40, 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.

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42. 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.

43. 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 endeavour 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.

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(f) 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.

(g) 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

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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.

(h) 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.

(i) Uncertainty over income tax treatment

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

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

- If an entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment, the entity shall reflect the effect of uncertainty in determining the related taxable profit (tax loss), tax bases, unused tax losses, unused tax credits

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or tax rates. An entity shall reflect the effect of uncertainty for each uncertain tax treatment by using either of the following methods, depending on which method the entity expects to better predict the resolution of the uncertainty:

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

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

- If an uncertain tax treatment affects current tax and deferred tax (for example, if it affects both taxable profit used to determine current tax and tax bases used to determine deferred tax), an entity shall make consistent judgements and estimates for both current tax and deferred tax.

***Comparison to AS 22:***

***Para 15:*** *Except in the situations stated in paragraph 17, deferred tax assets should be 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.*

***Para 16:*** *While recognising the tax effect of timing differences, consideration of prudence cannot be ignored. Therefore, deferred tax assets are recognised and carried forward only to the extent that there is a reasonable certainty of their realisation. This reasonable level of certainty would normally be achieved by examining the past record of the enterprise and by making realistic estimates of profits for the future.*

***Para 17:*** *Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be 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.*

*Ind AS 12 and AS 22 both require exercise of prudence while recognizing deferred tax assets. However, AS 22 emphasizes on virtual certainty supported by convincing evidence for recognizing deferred tax asset, whereas Ind AS 12 requires only probable existence of taxable profit against which deductible temporary differences can be utilized. Thus, the requirement of recognizing*

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*deferred tax asset under AS 22 is very strict (virtual certainty moves towards more than 95% certainty through evidence such as a strong order book for the future, firm orders in hand etc.), whereas under Ind AS 12, the same is more realistic focusing only on probable existence of taxable profits. Ind AS 12 moves to exercise caution only in case of unused tax losses, where it specifies that deferred tax asset arising from unused tax losses or tax credits can be recognized 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.*

### 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'. Since, we are dealing in the future and 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.

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(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.

**Examples 44 & 45**

44. 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.

45. 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. Accumulated depreciation for tax purposes is ₹ 30 and the tax rate is 30%. If the asset's sale proceeds exceeds the cost (₹ 100), a gain of only ₹ 30 (being the cumulative tax depreciation of ₹ 30 claimed) will be included in taxable income but sale proceeds in excess of cost (₹ 100) 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 |

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| | | |
|---|---|---|
| (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*.

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**Example 46**

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, 31st December, 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 15th March, 20X2 the entity recognises dividends of ₹ 10,000 from previous operating profits as a liability.

On 15th March, 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.

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- 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).

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- 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

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(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.

**Illustration 3**

*On 1st April 20X1, S Ltd. leased a machine over a 5 year period. The present value of lease liability is ₹ 120 Cr (discount rate of 8%) and is recognized as lease liability and corresponding Right of Use (RoU) Asset on the same date. The RoU Asset is depreciated under straight line method over the 5 years. The annual lease rentals are ₹ 30 Cr payable starting 31st March 20X2. The tax law permits tax deduction on the basis of payment of rent.*

*Assuming tax rate of 30%, you are required to explain the deferred tax consequences for the above transaction for the year ended 31st March 20X2.*

**Solution**

A temporary difference effectively arises between the value of the machine for accounting purposes and the amount of lease liability, since the rent payment is eligible for tax deduction.

Tax base of the machine is nil as the amount is not eligible for deduction for tax purposes.

Tax base of the lease liability is nil as it is measured at carrying amount less any future tax deductible amount

**Recognition of deferred tax on 31st March 20X2:**

Carrying amount in balance sheet

RoU Asset [120 Cr – 24 Cr (Depreciation)] ₹ 96.00 Dr

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| | |
|---|---|
| Lease Liability [120 Cr + 9.60 Cr (120 Cr x 8%) - 30 Cr] | ₹ 99.60 Cr |
| **Net Amount** | **₹ 3.60 Cr** |
| Tax Base | ₹ 0.00 Cr |
| Temporary Difference (deductible) | ₹ 3.60 Cr |
| Deferred Tax asset to be recognized (₹ 3.60 Cr x 30%) | ₹ 1.08 Cr |

*****

# 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.

**Illustration 4**

*On 1st April 20X1, A Ltd. acquired 12 Cr shares (representing 80% stake) in B Ltd. by means of a cash payment of ₹ 25 Cr. It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in B Ltd. at 1st April 20X1 can be used for this purpose. On 1st April 20X1, the market value of a B Ltd. share was ₹ 2.00*

*On 1st April 20X1, the individual financial statements of B Ltd. showed the net assets at ₹ 23 Cr.*

*The directors of A Ltd. carried out a fair value exercise to measure the identifiable assets and liabilities of B Ltd. at 1st April 20X1. The following matters emerged:*

– *Property having a carrying value of ₹ 15 Cr at 1st April 20X1 had an estimated market value of ₹ 18 Cr at that date.*

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– *Plant and equipment having a carrying value of ₹ 11 Cr at 1st April 20X1 had an estimated market value of ₹ 13 Cr at that date.*

– *Inventory in the books of B Ltd. is shown at a cost of ₹ 2.50 Cr. The fair value of the inventory on the acquisition date is ₹ 3 Cr.*

*The fair value adjustments have not been reflected in the individual financial statements of B Ltd. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.*

*Assume that the current book value (prior to fair valuation exercise under Ind AS 103) equals the tax base.*

*Calculate the deferred tax impact on above and calculate the goodwill arising on acquisition of B Ltd.*

**Solution**

**Computation of Net Assets of B Ltd.**

| | |
|---|---|
| As per books | ₹ 23.00 Cr |
| *Add*: Fair value differences not recognized in books of B Ltd.: | |
| Property (18 Cr – 15 Cr) | ₹ 3.00 Cr |
| Plant and Equipment (13 Cr – 11 Cr) | ₹ 2.00 Cr |
| Inventory (3 Cr – 2.5 Cr) | ₹ 0.50 Cr |
| | ₹ 28.5 Cr |
| *Less:* Deferred tax liability on fair value difference @ 20% | |
| [(3 Cr + 2 Cr + 0.50 Cr) x 20%] | (₹ 1.10 Cr) |
| Total Net Assets at Fair Value | ₹ 27.40 Cr |

**Computation of Goodwill:**

| | |
|---|---|
| Purchase Consideration | ₹ 25.00 Cr |
| *Add*: Non-Controlling Interest [{(12 Cr x (20% / 80%)} x ₹ 2 per share] | ₹ 6.00 Cr |
| | ₹ 31.00 Cr |
| *Less*: Net Assets at Fair Value | (₹ 27.40 Cr) |
| Goodwill on acquisition date | ₹ 3.60 Cr |

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(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

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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.

**Illustration 5**

*On 1st April 20X1, P Ltd. had granted 1 Cr share options worth ₹4 Cr (fair value) subject to a two-year vesting period. The income tax law permits a tax deduction at the exercise date of the intrinsic value of the options. The intrinsic value of the options at 31st March 20X2 was ₹1.60 Cr and at 31st March 20X3 was ₹4.60 Cr. The increase in the fair value of the options on 31st March 20X3 was not foreseeable at 31st March 20X2. The options were exercised at 31st March 20X3.*

*Give the accounting for the above transaction for deferred tax for period ending 31st March, 20X2 and 31st March, 20X3. Assume that there are sufficient taxable profits available in future against any deferred tax assets. Tax rate of 30% is applicable to P Ltd.*

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**Solution:**

**On 31st March 20X2:**

The tax benefit is calculated as under:

| | |
|---|---|
| Carrying amount of Share based payment (₹ 1.60 Cr x ½) | ₹ 0.00 Cr |
| Tax Base of Share based payment | ₹ 0.80 Cr |
| Temporary Difference (Carrying amount – tax base) | ₹ 0.80 Cr |
| Deferred Tax Asset recognized (Temporary Difference x Tax rate) | |
| (0.80 Cr x 30%) | ₹ 0.24 Cr |

**Journal Entry for above:**

| | | | |
|---|---|---|---|
| Deferred Tax Asset | Dr. | ₹ 0.24 Cr | |
| To Tax Expense | | | ₹ 0.24 Cr |

(Being DTA recognized on equity option)

**On 31st March 20X3:**

The options have been exercised and a current tax benefit will be available to the entity on the basis of intrinsic value of ₹ 4.60 Cr. Initially recognized deferred tax asset will no longer be required.

The accounting entry will be done as under:

| | | | |
|---|---|---|---|
| Tax Expense | Dr | ₹ 0.24 Cr | |
| To Deferred Tax Asset | | | ₹ 0.24 Cr |

(Being DTA reversed on the exercise of the option)

*****

## 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

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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

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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.

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(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.

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**Example 47**

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:

| Particulars | Amount (₹ ) |
|---|---|
| Accounting profit | 1,00,000 |
| Tax at the applicable tax rate of 30% | 30,000 |
| Tax effect of expenses that are not deductible in determining taxable profits: | |
| Penalties | 3,000 |
| Tax expense | 33,000 |

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

| Particulars | % |
|---|---|
| Applicable tax rate | 30 |
| Tax effect of expenses that are not deductible in determining taxable profits - Penalties | 3 |
| Average effective tax rate | 33 |

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).

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Relevant Extracts from Financial Statements of selected Listed Entities are presented below:

1. Annual Report of Reliance Industries Ltd. for the year ending 31st March 2022 (Page 335):

(₹ in crore)

| | Year ended 31st March, 2022 | Year ended 31st March, 2021 |
|---|---|---|
| **12. Taxation** | | |
| **Tax Expenses Recognised in Statement of Profit and Loss** | | |
| Current tax | 787 | - |
| Deferred tax | 6,915 | (4,732) |
| **Tax expenses recognised in the current year** | **7,702** | **(4,732)** |

| | Year ended 31st March, 2022 | Year ended 31st March, 2021 |
|---|---|---|
| **Tax expenses for the year can be reconciled to the accounting profit as follows:** | | |
| Profit Before Tax and Exceptional Items | 46,786 | 22,908 |
| Applicable Tax Rate | 34.944% | 34.944% |
| Computed Tax Expense | 16,349 | 8,005 |
| Tax Effect of: | | |
| Exempted income | (1,574) | (133) |
| Expenses disallowed | 5,716 | 4,910 |
| Additional allowances net of MAT Credit | (19,704) | (12,782) |
| **Current Tax Provision (A)** | **787** | **-** |
| Incremental Deferred tax Liability/(Asset) on account of Property, Plant and Equipment and Intangible Assets | 771 | 2,354 |
| Incremental Deferred tax Liability / (Asset) on account of Financial Assets and Other items | 6,144 | (7,086) |
| **Deferred Tax Provision (B)** | **6,915** | **(4,732)** |
| **Tax Expenses Recognised in Statement of Profit and Loss (A+B)** | **7,702** | **(4,732)** |
| **Effective Tax Rate** | **16.46%** | **-** |
| **Tax on Exceptional Item *** | **(6,386)** | **(14,062)** |

* Refer Note 32

(Source Annual report for 2021-2022 of Reliance Industries Ltd.)

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2. *Annual Report of Hindustan Unilever Ltd. for the year ending 31st March 2022 (Page 160)*

**B. Reconciliation of Effective Tax Rate**

The reconciliation between the statutory income tax rate applicable to the Company and the effective income tax rate of the Company is as follows:

| | Year ended 31st March, 2022 | Year ended 31st March, 2021 |
|---|---|---|
| **Statutory income tax rate applicable for the year** | 25.2% | 25.2% |
| Differences due to: | | |
| Expenses not deductible for tax purposes | 1.0% | 1.1% |
| Income exempt from income tax | -0.3% | -0.2% |
| Others* | -1.0% | -1.9% |
| **Effective tax rate** | **24.9%** | **24.2%** |

* Others include prior period adjustment tax refunds and tax on exceptional items.

*(Source: Annual report for 2021-2022 of Hindustan Unilever Ltd.)*

3. Annual Report of Larsen & Toubro Ltd. for the year ending 31st March 2022 (Page 438)

**[NOTE 44]**

Disclosure pursuant to Ind AS 12 "Income Taxes": *(contd.)*

(b) Reconciliation of tax expense and the accounting profit multiplied by domestic tax rate applicable in India:

₹ crore

| Sr. No. | Particulars | 2021-22 | 2020-21 |
|---|---|---|---|
| (1) | Profit before tax from: | | |
| | Continuing Operations (including exceptional items) | 10031.47 | 5318.73 |
| | Discontinued Operations | – | 11199.23 |
| | | 10031.47 | 16517.96 |
| (2) | Corporate tax rate as per Income Tax Act, 1961 | 25.17% | 25.17% |
| (3) | Tax on Accounting profit (3)=(1)*(2) | 2524.72 | 4157.24 |
| (4) | (i) Tax on expenses not tax deductible: | | |
| | (A) Corporate social responsibility | 33.14 | 39.08 |
| | (B) Tax on employee perquisites borne by the Company | 3.04 | 2.52 |
| | (ii) Tax effect on impairment recognised on which deferred tax asset is not recognised | – | 795.33 |
| | (iii) Effect of current tax related to earlier years | 3.08 | 5.73 |
| | (iv) Effect of lower tax rate on long term capital gains | (12.96) | (266.65) |
| | (v) Tax effect of losses in joint operation of current year on which no deferred tax benefit is recognised | 3.48 | 6.95 |
| | (vi) Effect of deduction with respect to dividend income | (407.49) | (260.34) |
| | (vii) Reversal of deferred tax on brought forward losses on utlisation as set off against gains | – | 103.51 |
| | (viii) Tax effect on various other items | 5.01 | 136.80 |
| | Total effect of tax adjustments [(i) to (viii)] | (372.70) | 562.93 |
| (5) | Tax expense recognised during the year (5)=(3)+(4) | 2152.02 | 4720.17 |
| (6) | Effective tax Rate (6)=(5)/(1) | 21.45% | 28.58% |

*(Source: Annual report for 2021-2022 of Larsen & Toubro Ltd.)*

4. *Annual Report of SpiceJet Ltd. for the year ending 31st March 2022 (Page 110)*

**52. Income tax expense**

Reconciliation of tax expense and the accounting profit multiplied by India's domestic tax rate for March 31, 2022 and March 31, 2021 :

| Particulars | Year ended March 31, 2022 | Year ended March 31, 2021 |
|---|---|---|
| **Accounting loss before income tax** | **(17,254.65)** | **(9,983.02)** |
| Loss before income tax multiplied by standard rate of corporate tax in India 25.168% (March 31, 2021: 25.168%) | (4,342.65) | (2,512.53) |
| **Effects of:** | | |
| Non-deductible expenses for tax purposes | (824.72) | (485.40) |
| Set-off of brought forward losses | 5,167.37 | 2,997.92 |
| **Net effective income tax** | **-** | **-** |

*(Source: Annual report for 2021-2022 of SpiceJet Ltd.)*

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(e) 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 48**

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:

| Particulars | Amount (₹ ) | |
|---|---|---|
| | 20X2 | 20X1 |
| Accounting profit | 3,000 | 2,500 |
| Tax at the domestic rate of 30% | 900 | 750 |
| Tax effect of expenses that are not deductible for tax purposes | 30 | 60 |
| Effect of lower tax rates in country B | (150) | (50) |
| Tax expense | 780 | 760 |

*Relevant Extracts from Financial Statements of selected Listed Entities are presented below:*

*Annual Report of Bharti Airtel Ltd. for the year ending 31st March 2022 (Page 357):*

The impact of different tax rates is disclosed separately in Consolidated Financial Statements whose extract is given below [10th line item with amounts of ₹ 2,594 and ₹ (13,887)]:

The reconciliation between the amount computed by applying the statutory income tax rate to the loss before tax and the income tax charge is summarised below:

| | For the year ended March 31, 2022 | For the year ended March 31, 2021 |
|---|---|---|
| Profit / (loss) before tax (from continuing and discontinued operations) | 124,831 | (31,184) |
| Enacted tax rates in India | 25.168% | 25.168% |
| Tax expense @ Company's domestic tax rate 25.168% | 31,418 | (7,849) |
| Effect of: | | |
| Share of profits in associates and joint ventures | (6,093) | (1,728) |
| Tax holiday | 1,913 | 542 |
| Adjustments in respect of previous years | (420) | (481) |
| Effect of changes in tax rate including MAT | - | 85,369 |
| Additional taxes / taxes for which no credit is allowed | 158 | 690 |
| Difference in tax rate applicable to group companies | 2,594 | (13,887) |
| Adjustment in respect of tax amnesty scheme | - | (20,280) |
| Losses against which no deferred tax asset recognised | - | 36,690 |
| Expense / (Income) not deductible / (taxable) (net) | 6,823 | (8,262) |
| Tax on undistributed retained earnings of subsidiaries / joint venture | 8,745 | 2,908 |
| Items for which no deferred tax has been recognised | (2,866) | 16,746 |
| Settlement of various disputes | 385 | 766 |
| Tax on common control transactions | - | (9) |
| Others | (878) | 1,241 |
| **Income tax expense** | **41,779** | **92,456** |

*(Source: Annual report for 2021-2022 of Bharti Airtel Ltd.)*

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**Illustration 6**

*A Ltd.'s profit before tax according to Ind AS for Year 20X1-20X2 is ₹ 100 thousand and taxable profit for year 20X1-20X2 is ₹ 104 thousand. The difference between these amounts arose as follows:*

1. *On 1st February, 20X2, it acquired a machine for ₹ 120 thousand. Depreciation is charged on the machine on a monthly basis for accounting purpose. Under the tax law, the machine will be depreciated for 6 months. The machine's useful life is 10 years according to Ind AS as well as for tax purposes.*
2. *In the year 20X1-20X2, expenses of ₹ 8 thousand were incurred for charitable donations. These are not deductible for tax purposes.*

*Prepare necessary entries as at 31st March 20X2, taking current and deferred tax into account. The tax rate is 25%. Also prepare the tax reconciliation in absolute numbers as well as the tax rate reconciliation.*

**Solution**

Current tax= Taxable profit x Tax rate = ₹ 104 thousand x 25% = ₹ 26 thousand.

**Computation of Taxable Profit:**

| | ₹ in thousand |
|---|---|
| Accounting profit | 100 |
| *Add:* Donation not deductible | 8 |
| *Less:* Excess Depreciation (6-2) | (4) |
| Total Taxable profit | 104 |

| | | ₹ in thousand | ₹ in thousand |
|---|---|---|---|
| Profit & loss A/c | Dr. | 26 | |
| To Current Tax | | | 26 |

**Deferred tax:**

Machine's carrying amount according to Ind AS is ₹ 118 thousand (₹ 120 thousand – ₹ 2 thousand)

Machine's carrying amount for taxation purpose = ₹ 114 thousand (₹ 120 thousand – ₹ 6 thousand)

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**Deferred Tax Liability** = ₹ 4 thousand x 25%

| | | ₹ in thousand | |
|---|---|---|---|
| Profit & loss A/c | Dr. | 1 | |
| To Deferred Tax Liability | | | 1 |

**Tax reconciliation in absolute numbers:**

| | ₹ in thousand |
|---|---|
| Profit before tax according to Ind AS | 100 |
| Applicable tax rate @ 25% | |
| Tax | 25 |
| Expenses not deductible for tax purposes (₹ 8 thousand x 25%) | 2 |
| Tax expense (Current and deferred) | 27 |

**Tax rate reconciliation**

| | |
|---|---|
| Applicable tax rate | 25% |
| Expenses not deductible for tax purposes | 2% |
| Average effective tax rate | 27% |

*****

## 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 is 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.

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(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.

Relevant Extracts from Financial Statements of selected Listed Entities are presented below:

*A. Annual Report of SpiceJet Ltd. for the year ending 31st March 2022 (Page 111):*

Brought forward losses and unabsorbed depreciation for which no deferred tax assets have been recognized are attributable to the following:

| Particulars | As at March 31, 2022 | As at March 31, 2021 |
|---|---|---|
| Unused tax losses * | 19,886.84 | 10,551.73 |
| Unabsorbed tax depreciation # | 17,632.43 | 16,587.47 |
| **Net deferred tax asset/ (liabilities)** | **37,519.27** | **27,139.20** |

**# Unabsorbed depreciation does not have any expiry period under the Income-tax Act, 1961**

*The following table details the expiry of the brought forward tax losses

| | | |
|---|---|---|
| 0-4 years | 9,022.44 | 1,823.32 |
| 4-8 years | 10,864.40 | 8,728.41 |
| **Total** | **19,886.84** | **10,551.73** |

The brought forward losses and unabsorbed depreciation considered above includes information from tax records and returns of the Company filed upto Assessment Year 2021-22 and does not consider the potential effect of matters under dispute/ litigation with the tax authorities which are currently sub-judice at various levels. Also refer note 48.

*(Source: Annual report for 2021-2022 of SpiceJet Ltd.)*

*Annual Report of Larsen and Toubro Ltd. for the year ending 31st March 2020 (Page 416):*

**[NOTE 44]**

Disclosure pursuant to Ind AS 12 "Income Taxes" *(contd.)*

(c) (i) Unused tax losses for which no deferred tax asset (DTA) is recognised in Balance Sheet

| Sr. No. | Particulars | As at 31-3-2020 | | | As at 31-3-2019 | | |
|---|---|---|---|---|---|---|---|
| | | Base Amount (₹ crore) | Deferred Tax (₹ crore) | Expiry date | Base Amount (₹ crore) | Deferred Tax (₹ crore) | Expiry date |
| | Business loss and unabsorbed depreciation | | | | | | |
| | - Amount of losses having expiry | 2028.43 | 510.52 | FY 2021-28 | 2033.64 | 710.63 | FY 2020-28 |
| | - Amount of losses having no expiry | 981.38 | 246.99 | | 981.38 | 342.93 | |
| | Capital loss | – | – | | 3355.81 | 614.38 | FY 2025-27 |
| | Total | 3009.81 | 757.51 | | 6370.83 | 1667.94 | |

(ii) Unrecognised deductible temporary differences for which no deferred tax asset (DTA) is recognised in Balance Sheet

₹ crore

| Sr. No. | Particulars | As at 31-3-2020 | | As at 31-3-2019 | |
|---|---|---|---|---|---|
| | | Base Amount | Deferred Tax | Base Amount | Deferred Tax |
| 1. | Deductible temporary differences towards provision for diminution in value of investments on which DTA not created | 2966.98 | 686.82 | 3017.55 | 705.59 |
| 2. | Temporary differences arising out of revaluation of tax base of assets (on account of indexation benefit) | 6541.94 | 1496.80 | 5813.32 | 1354.27 |
| 3. | Other items giving rise to temporary differences | 78.08 | 19.65 | 78.08 | 27.29 |
| | Total | 9587.00 | 2203.27 | 8908.95 | 2087.15 |

*(Source: Annual report for 2021-2022 of Larsen and Toubro Ltd.)*

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## 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.

*Relevant Extracts from Financial Statements of selected Listed Entities are presented below:*

A *Annual Report of SpiceJet Ltd. for the year ending 31 March 2022 (Page 111):*

Brought forward losses and unabsorbed depreciation for which no deferred tax assets have been recognized are attributable to the following:

| Particulars | As at March 31, 2022 | As at March 31, 2021 |
|---|---|---|
| Unused tax losses * | 19,886.84 | 10,551.73 |
| Unabsorbed tax depreciation # | 17,632.43 | 16,587.47 |
| **Net deferred tax asset/ (liabilities)** | **37,519.27** | **27,139.20** |

**# Unabsorbed depreciation does not have any expiry period under the Income-tax Act, 1961**

*The following table details the expiry of the brought forward tax losses

| | | |
|---|---|---|
| 0-4 years | 9,022.44 | 1,823.32 |
| 4-8 years | 10,864.40 | 8,728.41 |
| **Total** | **19,886.84** | **10,551.73** |

The brought forward losses and unabsorbed depreciation considered above includes information from tax records and returns of the Company filed upto Assessment Year 2021-22 and does not consider the potential effect of matters under dispute/ litigation with the tax authorities which are currently sub-judice at various levels. Also refer note 48.

*(Source: Annual report for 2021-2022 of SpiceJet Ltd.)*

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B. Annual Report of Larsen and Toubro Ltd. for the year ending 31 March 2020 (Page 416):

**[NOTE 44]**

Disclosure pursuant to Ind AS 12 "Income Taxes" *(contd.)*

(c) (i) Unused tax losses for which no deferred tax asset (DTA) is recognised in Balance Sheet

| Sr. No. | Particulars | As at 31-3-2020 | | | As at 31-3-2019 | | |
|---|---|---|---|---|---|---|---|
| | | Base Amount (₹ crore) | Deferred Tax (₹ crore) | Expiry date | Base Amount (₹ crore) | Deferred Tax (₹ crore) | Expiry date |
| | Business loss and unabsorbed depreciation | | | | | | |
| | - Amount of losses having expiry | 2028.43 | 510.52 | FY 2021-28 | 2033.64 | 710.63 | FY 2020-28 |
| | - Amount of losses having no expiry | 981.38 | 246.99 | | 981.38 | 342.93 | |
| | Capital loss | – | – | | 3355.81 | 614.38 | FY 2025-27 |
| | Total | 3009.81 | 757.51 | | 6370.83 | 1667.94 | |

(ii) Unrecognised deductible temporary differences for which no deferred tax asset (DTA) is recognised in Balance Sheet

₹ crore

| Sr. No. | Particulars | As at 31-3-2020 | | As at 31-3-2019 | |
|---|---|---|---|---|---|
| | | Base Amount | Deferred Tax | Base Amount | Deferred Tax |
| 1. | Deductible temporary differences towards provision for diminution in value of investments on which DTA not created | 2966.98 | 686.82 | 3017.55 | 705.59 |
| 2. | Temporary differences arising out of revaluation of tax base of assets (on account of indexation benefit) | 6541.94 | 1496.80 | 5813.32 | 1354.27 |
| 3. | Other items giving rise to temporary differences | 78.08 | 19.65 | 78.08 | 27.29 |
| | Total | 9587.00 | 2203.27 | 8908.95 | 2087.15 |

*(Source: Annual report for 2021-2022 of Larsen and Toubro Ltd.)*

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

(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.

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### 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

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- 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 ay 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.

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## 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*).

*Relevant Extracts from Financial Statements of selected Listed Entities are presented below:*

*Annual Report of SpiceJet Ltd. for the year ending 31st March 2020 (Page 415):*

**[NOTE 44]**

Disclosure pursuant to Ind AS 12 "Income Taxes" *(contd.)*

(b) Reconciliation of tax expense and the accounting profit multiplied by domestic tax rate applicable in India:

₹ crore

| Sr. No. | Particulars | 2019-20 | 2018-19 |
|---|---|---|---|
| (1) | Profit before tax from: | | |
| | Continuing Operations | 6985.91 | 9219.46 |
| | Discontinued Operations | 865.38 | 812.40 |
| | | 7851.29 | 10031.86 |
| (2) | Corporate tax rate as per Income tax Act, 1961 | 25.17% | 34.94% |
| (3) | Tax on accounting profit (3)=(1)*(2) | 1976.01 | 3505.53 |
| (4) | (i) Tax on Income exempt from tax : | | |
| | (A) Dividend income | (347.18) | (523.73) |
| | (B) Long-term capital gains exempt from tax | (121.27) | (978.42) |
| | (C) Interest on tax free bonds | (1.04) | (2.50) |
| | (ii) Tax on expenses not tax deductible: | | |
| | (A) CSR expenses | 36.57 | 42.52 |
| | (B) Expenses in relation to exempt income | 36.42 | 28.35 |
| | (C) Tax on employee perquisites borne by the Company | 2.08 | 1.52 |
| | (iii) Weighted deductions on R&D expenditure and deduction u/s 80IA | – | (147.05) |
| | (iv) Effect of previously unrecognised tax losses used to reduce deferred tax expense | (787.94) | (0.27) |
| | (v) Tax effect on impairment and fair valuation losses recognised on which deferred tax asset is not recognised | – | 685.62 |
| | (vi) Effect on deferred tax balances due to the change in income tax rate | 179.67 | – |
| | (vii) Effect of current year net capital/business loss on which no deferred tax asset is recognised | – | (123.61) |
| | (viii) Effect of current tax related to earlier years | (60.68) | 227.14 |
| | (ix) Effect of previously unrecognised tax losses used to reduce current tax expense | – | (477.86) |
| | (x) Tax effect of losses in joint operation of current year on which no deferred tax asset is recognised | 3.87 | 37.68 |
| | (xi) Tax effect on various other items | 25.34 | 18.33 |
| | (xii) Reversal of MAT credit entitlement | 230.23 | – |
| | Total effect of tax adjustments [(i) to (xii)] | (803.93) | (965.08) |
| (5) | Tax expense recognised during the year (5)=(3)+(4) | 1172.08 | 2540.47 |
| (6) | Effective tax Rate (6)=(5)/(1) | 14.93% | 25.32% |

The Company has opted to pay the tax under section 115BAA of the Income Tax Act,1961. Accordingly;

(I) the provision for current and deferred tax has been determined at the rate of 25.17%,

(II) the deferred tax assets and deferred tax liabilities as at April 1, 2019 have been restated at the rate of 25.17% and

(III) the unutilised credit for minimum alternate tax as at April 1, 2019 has been written-off.

*(Source : Annual report of 2019-2020 of SpiceJet Ltd.)*

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**Illustration 7**

*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.

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**Illustration 8**

*A Limited recognises interest income in its books on accrual basis. However, for income tax purposes the method is 'cash basis'. On 31st December, 20X1, it has interest receivable of ₹ 10,000 and the tax rate was 25%. On 28th February, 20X2, the finance bill is introduced in the legislation that changes the tax rate to 30%. The finance bill is enacted as Act on 21st May, 20X2.*

*Discuss the treatment of deferred tax in case the reporting date of A Limited's financial statement is 31st December, 20X1 and these are approved for issued on 31st May, 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 31st December, 20X1.

It will not recognise the deferred tax liability @ 30% because as on 31st December, 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.

*****

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**Illustration 9**

*A Ltd prepares financial statements to 31st March each year. The rate of income tax applicable to A Ltd is 20%. The following information relates to transactions, assets and liabilities of A Ltd during the year ended 31st March 20X2:*

*(i) A Ltd has a 40% shareholding in L Ltd. A Ltd purchased this shareholding for ₹ 45 Cr. The shareholding gives A Ltd significant influence over L Ltd but not control and therefore A Ltd. accounts for its interest in L Ltd using the equity method. The equity method carrying value of A Ltd's investment in L Ltd was ₹ 70 Cr on 31st March 20X1 and ₹ 75 Cr on 31st March 20X2. In the tax jurisdiction in which A Ltd operates, profits recognised under the equity method are taxed if and when they are distributed as a dividend or the relevant investment is disposed of.*

*(ii) A Ltd. measures its head office building using the revaluation model. The building is revalued every year on 31st March. On 31st March 20X1, carrying value of the building (after revaluation) was ₹ 40 Cr and its tax base was ₹ 22 Cr. During the year ended 31st March 20X2, A Ltd charged depreciation in its statement of profit or loss of ₹ 2 Cr and claimed a tax deduction for tax depreciation of ₹ 1.25 Cr. On 31st March 20X2, the building was revalued to ₹ 45 Cr. In the tax jurisdiction in which A Ltd operates, revaluation of property, plant and equipment does not affect taxable income at the time of revaluation.*

*Basis the above information, you are required to compute:*

*(a) The deferred tax liability of A Ltd at 31st March 20X2*

*(b) The charge or credit to both profit or loss and other comprehensive income relating to deferred tax for the year ended 31st March 20X2*

**Solution:**

**(A) Deferred Tax Liability as at 31st March 20X2**

**Investment in L Ltd:**

| | | |
|---|---|---|
| Carrying Amount | = | ₹ 75 Cr |
| Tax base | = | ₹ 45 Cr (Purchase cost) |
| Temporary Difference | = | ₹ 30 Cr |

Since carrying amount is higher than the tax base, the temporary difference is recognized as a taxable temporary difference. Using the tax rate of 20%, a deferred tax liability of ₹ 6 Cr is recognized:

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**Head office building**

| | | |
|---|---|---|
| Carrying Amount | = | ₹ 45 Cr (Revalued amount on 31st March 20X2) |
| Tax base | = | ₹ 20.75 Cr (22 Cr – 1.25 Cr) |
| Temporary Difference | = | ₹ 24.25 Cr |

Since carrying amount is higher than the tax base, the temporary difference is recognized as a taxable temporary difference. Using the tax rate of 20%, a deferred tax liability of ₹ 4.85 Cr is created.

Total Deferred Tax Liability ₹ 6 Cr + ₹ 4.85 Cr = ₹ 10.85 Cr

**(B) Charge to Statement of Profit or Loss for the year ended 31st March 20X2:**

**Investment in L Ltd.**

| **Particulars** | **Carrying amount** | **Tax Base** | **Temporary Difference** |
|---|---|---|---|
| Opening Balance (1st April 20X1) | ₹ 70 Cr | ₹ 45 Cr | ₹ 25 Cr |
| Closing Balance (31st March 20X2) | ₹ 75 Cr | ₹ 45 Cr | ₹ 30 Cr |
| Net Change | | | ₹ 5 Cr |
| Increase in Deferred Tax Liability (20% tax rate) | | | ₹ 1 Cr |

Considering the increase in the value of investment arising through Statement of Profit or Loss, the accounting for the increase in deferred tax liability is made as under:

| | | | |
|---|---|---|---|
| Tax expense (Profit or Loss Statement) | Dr | ₹ 1 Cr | |
| To Deferred Tax Liability | | | ₹ 1 Cr |

(Being increase in deferred tax liability recognized)

**Head Office Building:**

The deferred tax liability at 31st March 20X1 is ₹ 3.6 Cr (20% x {₹ 40 Cr – ₹ 22 Cr}).

At 31st March 20X2, prior to revaluation, the carrying amount of the property is ₹ 38 Cr and its tax base is ₹ 20.75 Cr (₹ 22 Cr – ₹ 1.25 Cr). The deferred tax liability at this point is ₹ 3.45 Cr (20% x {₹ 38 Cr – ₹ 20.75 Cr}).

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The reduction in this liability is ₹ 0.15 Cr (₹ 3.6 Cr – ₹ 3.45 Cr). This would be credited to income tax expense in arriving at profit or loss.

Post revaluation, the carrying value of the building becomes ₹ 45 Cr and the tax base stays the same. Therefore, the new deferred tax liability is ₹ 4.85 Cr (20% x (₹ 45 Cr – ₹ 20.75 Cr)). The increase in the deferred tax liability of ₹ 1.4 Cr (₹ 4.85 Cr – ₹ 3.45 Cr) is charged to other comprehensive income.

*****

**Illustration 10**

*K Ltd prepares consolidated financial statements to 31st March each year. During the year ended 31st March 20X2, K Ltd entered into the following transactions:*

*(a) On 1st April 20X1, K Ltd purchased an equity investment for ₹ 2,00,000. The investment was designated as fair value through other comprehensive income. On 31st March 20X2, the fair value of the investment was ₹ 2,40,000. In the tax jurisdiction in which K Ltd operates, unrealised gains and losses arising on the revaluation of investments of this nature are not taxable unless the investment is sold. K Ltd has no intention of selling the investment in the foreseeable future.*

*(b) On 1st August 20X1, K Ltd sold products to A Ltd, a wholly owned subsidiary operating in the same tax jurisdiction as K Ltd, for ₹ 80,000. The goods had cost to K Ltd for ₹ 64,000. By 31st March 20X2, A Ltd had sold 40% of these goods, selling the remaining during next year.*

*(c) On 31st October 20X1, K Ltd received ₹ 2,00,000 from a customer. This payment was in respect of services to be provided by K Ltd from 1st November 20X1 to 31st July 20X2. K Ltd recognised revenue of ₹ 1,20,000 in respect of this transaction in the year ended 31st March 20X2 and will recognise the remainder in the year ended 31st March 20X3. Under the tax jurisdiction in which K Ltd operates, ₹ 2,00,000 received on 31st October 20X1 was included in the taxable profits of K Ltd for the year ended 31st March 20X2.*

*Explain and show how the tax consequences (current and deferred) of the three transactions would be reported in its statement of profit or loss and other comprehensive income for the year ended 31st March 20X2. Assume tax rate to be 25%.*

**Solution:**

(a) Because the unrealised gain on revaluation of the equity investment is not taxable until sold, there are no current tax consequences. The tax base of the investment is ₹ 2,00,000. The revaluation creates a taxable temporary difference of ₹ 40,000 (₹ 2,40,000 – ₹ 2,00,000).

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This creates a deferred tax liability of ₹ 10,000 (₹ 40,000 x 25%). The liability would be non-current. The fact that there is no intention to dispose of the investment does not affect the accounting treatment. Because the unrealised gain is reported in other comprehensive income, the related deferred tax expense is also reported in other comprehensive income.

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

In the consolidated financial statements the carrying value of the unsold inventory would be ₹ 38,400 (₹ 64,000 x 60%). The tax base of the unsold inventory would be ₹ 48,000 (₹ 80,000 x 60%). In the consolidated financial statements there would be a deductible temporary difference of ₹ 9,600 (₹ 38,400 – ₹ 48,000) and a potential deferred tax asset of ₹ 2,400 (₹ 9,600 x 25%). This would be recognised as a deferred tax asset since A Ltd is expected to generate sufficient taxable profits against which to utilise the deductible temporary difference. The resulting credit would reduce consolidated deferred tax expense in arriving at profit or loss.

(c) The receipt of revenue in advance on 1st October 20X1 would create a current tax liability of ₹ 50,000 (₹ 200,000 x 25%) as at 31st March 20X2. The carrying value of the revenue received in advance at 31st March 20X2 is ₹ 80,000 (₹ 200,000 – ₹ 120,000). Its tax base is nil. The deductible temporary difference of ₹ 80,000 would create a deferred tax asset of ₹ 20,000 (₹ 80,000 x 25%). The asset can be recognised because K Ltd has sufficient taxable profits against which to utilise the deductible temporary difference.

*****

## 1.9 PILLAR TWO LEGISLATION AND PILLAR TWO INCOME TAXES

***AMENDMENT IN IND AS 12 'INCOME TAXES'***

***Pillar Two legislation includes Pillar Two Model Rules as per Organisation for Economic Co-operation and Development (OECD) including tax law that implements qualified domestic minimum top-up taxes described in those rules.***

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***As an exception to the requirements in this Standard, an entity shall neither recognise nor disclose information about deferred tax assets and liabilities related to Pillar Two income taxes.***

***The amendments to Ind AS 12 states that***

- ***An entity shall disclose that it has applied the exception to recognising and disclosing information about deferred tax assets and liabilities related to Pillar Two income taxes.***
- ***An entity shall disclose separately its current tax expense (income) related to Pillar Two income taxes.***
- ***In periods in which Pillar Two legislation is enacted or substantively enacted but not yet in effect, an entity shall disclose known or reasonably estimable information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from that legislation.***
- ***To meet the above disclosure, an entity shall disclose qualitative and quantitative information about its exposure to Pillar Two income taxes at the end of the reporting period.***

***This information does not have to reflect all the specific requirements of the Pillar Two legislation and can be provided in the form of an indicative range. To the extent information is not known or reasonably estimable, an entity shall instead disclose a statement to that effect and disclose information about the entity's progress in assessing its exposure.***

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

| S. No. | Particulars | Ind AS 12 | AS 22 |
|---|---|---|---|
| 1. | *Approach for creating Deferred Tax* | Ind AS 12 is based on balance sheet approach.<br>It requires recognition of tax consequences of differences between the carrying amounts of assets and liabilities and their tax base. | AS 22 is based on income statement approach. It requires recognition of tax consequences of differences between taxable income and accounting income. For this purpose, differences between taxable income and |

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| | | | |
|---|---|---|---|
| | | | accounting income are classified into permanent and timing differences. |
| **2.** | *Limited Exceptions for Recognition of Deferred Tax Asset* | As per Ind AS 12, subject to limited exceptions, deferred tax asset is recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. The criteria for recognising deferred tax assets arising from the carry forward of unused tax losses and tax credits are the same that for recognising deferred tax assets arising from deductible temporary differences. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused | 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.<br>AS 22 explains what may be considered as virtual certainty supported by convincing evidence. |

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| | | | |
|---|---|---|---|
| | | tax credits can be utilised by the entity. | |
| **3.** | *Recognition of Current and Deferred Tax* | As per Ind AS 12, current and deferred tax are recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from a transaction or event which is recognised outside profit or loss, either in other comprehensive income or directly in equity, in those cases tax is also recognised in other comprehensive income or in equity, as appropriate. | AS 22 does not specifically deal with this aspect. |
| **4.** | *Investments in subsidiaries, associates and joint ventures* | As per Ind AS 12, deferred tax liability is recognised for all taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, if certain conditions are satisfied. | AS 22 does not deal with this aspect. |
| **5.** | *Elimination of profit and losses resulting from the intra- group transactions* | As per Ind AS 12, deferred tax should be recognised on temporary differences that arise from the elimination of profit and losses resulting from the intra- group transactions. | As per AS 22, deferred tax in consolidated financials are a simple aggregation of the deferred tax recognised by the group entities. |
| **6.** | *DTA/DTL arising out of Revaluation of Assets* | Ind AS 12 requires that deferred tax asset/liability arising from revaluation of non-depreciable assets shall be measured on the basis of tax | AS 22 does not deal with this aspect. |

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| | | | |
|---|---|---|---|
| | | consequences from the sale of asset rather than through use. | |
| **7.** | *Changes in Entities Tax Status or that of its Shareholders* | Ind AS 12 provides guidance as to how an entity should account for the tax consequences of a change in its tax status or that of its shareholders. | AS 22 does not deal with this aspect. |
| **8.** | *Guidance for Recognition of Deferred Tax in a Tax Holiday Period* | Ind AS 12 does not specifically deal with these situations. | 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' |
| **9.** | *In case of a company paying tax under section 115JB.* | Ind AS 12 does not specifically deal with this aspect. | 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. |
| **10.** | *Guidance on Uncertainty Over Income Tax Treatment* | Ind AS 12 gives special guidance on it. | AS 11 gives no such guidance. |

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# TEST YOUR KNOWLEDGE

## 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 and the corresponding deferred tax or liability, if any.

2. On 1st April 20X1, ABC Ltd acquired 100% shares of XYZ Ltd for ₹ 4,373 crore. By 31st March, 20X5, XYZ Ltd had made profits of ₹ 5 crore, which remain undistributed. Based on the tax legislation in India, the tax base investment in XYZ Ltd is its original cost. Show deferred tax treatment.

3. ABC Ltd. acquired 30% of the shares in PQR Ltd. on 1st January, 20X1 for ₹ 1,000 crore. By 31st March, 20X5, PQR Ltd. had made profits of ₹ 50 crore (ABC Ltd.'s share), which remained undistributed. Based on the tax legislation in India, the tax base of the investment in PQR Ltd. is its original cost. Show deferred tax treatment.

4. A company had purchased an asset at ₹ 1,00,000. Estimated useful life of the asset is 5 years and depreciation rate is 20% SLM. Depreciation rate for tax purposes is 25% SLM. 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.

5. A Ltd. acquired B Ltd. The following assets and liabilities are acquired in a business combination: **₹ 000's**

| | Fair Value | Carrying amount | Temporary Difference |
|---|---|---|---|
| Plant and Equipment | 250 | 260 | (10) |
| Inventory | 120 | 125 | (5) |
| Debtors | 200 | 210 | (10) |
| | 570 | 595 | (25) |
| 9% Debentures | (100) | (100) | |
| | 470 | 495 | |
| Consideration paid | 500 | 500 | |
| Goodwill | 30 | 5 | (25) |

Assume tax rate as 30%.

Calculate deferred tax asset assuming that the carrying amount is the tax base and prepare the journal entries.

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6. B Limited is a newly incorporated entity. Its first financial period ends on 31st March, 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 relating to preliminary expenses 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 31st March, 20X1.

7. X Ltd. prepares consolidated financial statements to 31st March each year. During the year ended 31st March 20X2, the following events affected the tax position of the group:

   (i) Y Ltd., a wholly owned subsidiary of X Ltd., made a loss adjusted for tax purposes of ₹ 30,00,000. Y Ltd. is unable to utilise this loss against previous tax liabilities. Income-tax Act does not allow Y Ltd. to transfer the tax loss to other group companies. However, it allows Y Ltd. to carry the loss forward and utilise it against company's future taxable profits. The directors of X Ltd. do not consider that Y Ltd. will make taxable profits in the foreseeable future.

   (ii) Just before 31st March, 20X2, X Ltd. committed itself to closing a division after the year end, making a number of employees redundant. Therefore, X Ltd. recognised a provision for closure costs of ₹ 20,00,000 in its balance sheet as at 31st March, 20X2. Income-tax Act allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31st March 20X3, X Ltd. expects to make taxable profits which are well in excess of ₹ 20,00,000. On 31st March, 20X2, X Ltd. had taxable temporary differences from other sources which were greater than ₹ 20,00,000.

   (iii) During the year ended 31st March, 20X1, X Ltd. capitalised development costs which satisfied the criteria in paragraph 57 of Ind AS 38 'Intangible Assets'. The total amount capitalised was ₹ 16,00,000. The development project began to generate economic benefits for X Ltd. from 1st January, 20X2. The directors of X Ltd. estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31st March, 20X2.

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(iv) On 1st April, 20X1, X Ltd. borrowed ₹ 1,00,00,000. The cost to X Ltd. of arranging the borrowing was ₹ 2,00,000 and this cost qualified for a tax deduction on 1st April, 20X1. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31st March, 20X4 will be ₹ 1,30,43,800. This equates to an effective annual interest rate of 10%. As per the Income-tax Act, a further tax deduction of ₹ 30,43,800 will be claimable when the loan is repaid on 31st March, 20X4.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of X Ltd. group at 31st March, 20X2 as per Ind AS. Assume the rate of corporate income tax is 20%.

## Answers

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

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

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**4.** Calculation of the Book Value as per financial and tax purposes.

**Financial Accounting:** ₹ 000's

| Year | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Gross Block | 100 | 100 | 100 | 100 | 100 |
| Accumulated Depreciation | 20 | 40 | 60 | 80 | 100 |
| Carrying Amount | 80 | 60 | 40 | 20 | 0 |

**Tax Accounting:** ₹ 000's

| Year | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Gross Block | 100 | 100 | 100 | 100 | 100 |
| Accumulated Depreciation | 25 | 50 | 75 | 100 | 100 |
| Carrying Amount | 75 | 50 | 25 | 0 | 0 |

**Calculation of DTL:** ₹ 000's

| Year | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Carrying Amount | 80 | 60 | 40 | 20 | 0 |
| Tax Base | 75 | 50 | 25 | 0 | 0 |
| Difference | 5 | 10 | 15 | 20 | 0 |
| Deferred Tax Liability (Difference x 30%) | 1.5 | 3 | 4.5 | 6 | 0 |

**5.** 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 |

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

| Particulars | Year ending on 31st March, 20X2 | Year ending on 31st March, 20X3 | Year ending on 31st March, 20X4 | Year ending on 31st March, 20X5 |
|---|---|---|---|---|
| Reversal of taxable temporary difference relating to accelerated depreciation over next 3 years (₹ 9,000/3) | 3,000 | 3,000 | 3,000 | Nil |
| Reversal of deductible temporary difference relating to preliminary expenses over next 4 years (₹ 4,000/4) | 1,000 | 1,000 | 1,000 | 1,000 |

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 31st March, 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 31st March, 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 31st March, 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.

**7.** (i) The tax loss creates a potential deferred tax asset for the group since its carrying value is nil and its tax base is ₹ 30,00,000.

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

(ii) The provision creates a potential deferred tax asset for the group since its carrying value is ₹ 20,00,000 and its tax base is nil.

This deferred tax asset can be recognised because X Ltd. is expected to generate taxable profits in excess of ₹ 20,00,000 in the year to 31st March, 20X3.

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The amount of the deferred tax asset will be ₹ 4,00,000 (₹ 20,00,000 x 20%).

This asset will be presented as a deduction from the deferred tax liabilities caused by the (larger) taxable temporary differences.

(iii) The development costs have a carrying value of ₹ 15,20,000 (₹ 16,00,000 – (₹ 16,00,000 x 1/5 x 3/12)).

The tax base of the development costs is nil since the relevant tax deduction has already been claimed.

The deferred tax liability will be ₹ 3,04,000 (₹ 15,20,000 x 20%). All deferred tax liabilities are shown as non-current.

(iv) The carrying value of the loan at 31st March, 20X2 is ₹ 1,07,80,000 (₹ 1,00,00,000 – ₹ 2,00,000 + (₹ 98,00,000 x 10%)).

The tax base of the loan is ₹ 1,00,00,000.

This creates a deductible temporary difference of ₹ 7,80,000 (₹ 1,07,80,000 – ₹ 1,00,00,000) and a potential deferred tax asset of ₹ 1,56,000 (₹ 7,80,000 x 20%).

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

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