Ind AS 12 – Income taxes

Presented at:
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AGENDA

- Key difference between AS 22 & Ind AS 12
- Background and basics
- More interesting aspects
- Allocating the deferred tax charge and credit
- Disclosure and presentation issues

Key difference between AS 22 and Ind AS 12:

Ind AS 12	AS 12
Balance sheet approach (recognition of tax consequences of differences between the carrying amounts of assets and liabilities and their tax base.)	Income statement approach (recognition of tax consequences of differences between taxable income and accounting income - differences between taxable income and accounting income are classified into permanent and timing differences)
Intention of Asset Use Vs. Sale- determines DTA/DTL	No such requirement
Reasonable certainty for recognizing DTA on account of tax losses	Virtual certainty supported by evidence that future taxable profit will be available
Presentation of current and deferred tax in P&L or OCI	No such criteria
Disclosure required in more detailed format	Limited disclosure

Ind AS 12 Deferred tax - Objective

– Will the future recovery of an asset or settlement of a liability have a tax consequence?

– Will future tax payments be larger or smaller than would have been the case if recovery/settlement had no tax consequence?

– If so recognise a deferred tax asset/ liability .. With limited exceptions

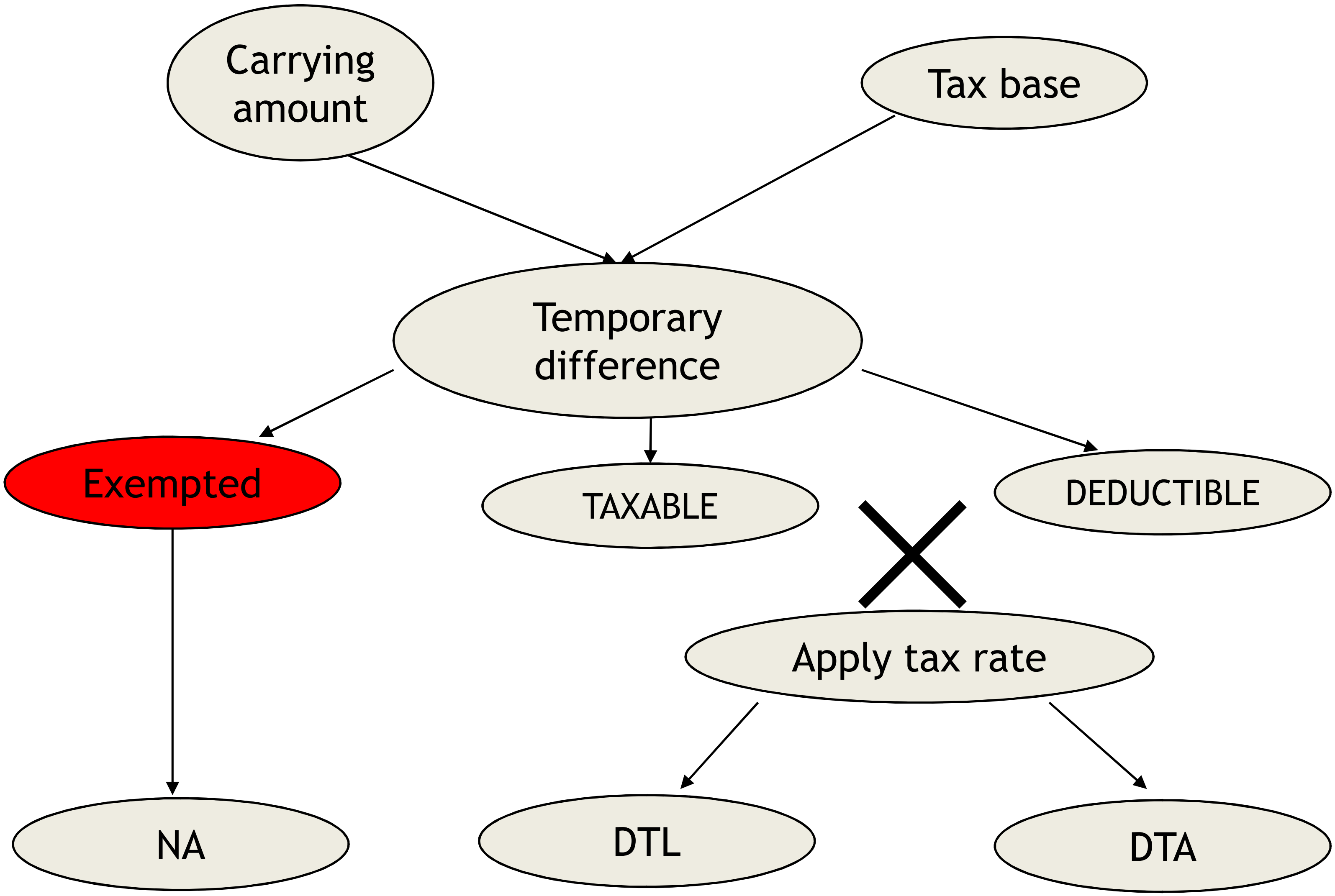
Examples of deferred tax arising

- Depreciation of PP&E
- Share based payments
- Capitalisation of development costs
- Items taxed on a cash basis
- Unutilised losses
- Valuations
    - PPE
    - Investment properties
    - Financial instruments

More interesting aspects

– Expected manner of recovery
– Exemptions / exceptions
– Unabsorbed tax losses
– Group issues
– Financial instruments
– Accounting vs. Tax currency

Calculating deferred tax



Tax base - accounting asset

Will taxable economic benefits flow to the entity when carrying value is recovered through use or sale?

NO

Tax base =

Carrying value

No deferred tax

YES

Tax base =

Amounts that will be deductible against these benefits

Deferred tax

Examples:

Revalued Asset:

When an asset is revalued and that asset is non-depreciable the carrying amount of that asset will not be recovered through use.

In accordance with SIC 21 “Income taxes-recovery of revalued non-depreciable assets, the tax base and tax rate will be those applicable to the sale of that Asset.

Items with a tax base but no accounting base:

Some items have a tax base but no accounting base, for example:

– Carried forward tax losses
– Research cost which may be permitted for tax deduction at a later period
– Share options

Tax Base - Accounting Liability

Revenue received in advance

Tax base = carrying value ***less*** any amounts not taxable in the future

All other liabilities:

Tax base = carrying value ***less*** any amounts deductible in the future

Examples:

a) A machine cost Rs. 100. For tax purposes, depreciation of Rs. 30 has already been deducted in the current and prior periods.

b) Interest receivable has a carrying amount of Rs. 100. The related interest revenue will be taxed on cash basis.

c) Trade receivables have a carrying amount of Rs. 100.

d) Company A issues 100,000 share options to its employees. The options vest immediately. A charge is recognised in profit or loss of Rs.100,000. A tax deduction will be available when those options are exercised.

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

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

Taxable Vs. Deductible differences:

Temporary differences can be either taxable or deductible:

A taxable differences that will result in taxable amounts in determining taxable profit (tax losses) of future periods when the carrying amount of the asset or liability is recovered or settled.

A deductible differences that will result in amounts that are deductible in determining taxable profit (tax losses) of future periods when the carrying amount of the asset or liability is recovered or settled.

Which rate?

Tax rates .. expected to apply .. when the asset is realised or the liability is settled .. based on rates ... enacted or substantively enacted by the end of the reporting period ..

Expected manner of recovery

<u>Methodology for calculating deferred tax on dual intention assets:</u>

- Step 1: Allocating the carrying value between Use and Sale
- Step 2: Calculate temporary differences through use and sale
- Step 3: Apply relevant tax rate to calculate DTA/ DTL

On December 31, 2014 Company A purchases a building which is considered to be an PPE to be accounted for at fair value model. The initial cost of the building is Rs. 20 Lacs. According to A's investment strategy, A will hold the property for 7 years and then sell the asset. A determines:

– that Rs. 14 Lacs is expected to be recovered through use and Rs.6 lacs through sale.

– Any profit from sale of asset will be taxed at 20%. A's regular income tax rate is 30%.

– Let's evaluate the status after one year and assumed the asset revalued to Rs. 24 Lacs and difference allocated through use.

Taxable temporary differences where deferred tax is not recognised

Exception 1 - Initial recognition of an asset or liability in a transaction which

- is not a business combination; AND
- at the time of the transaction affects neither accounting P&L nor taxable profit

Exception 2 - Initial recognition of goodwill

Exception 3 - Taxable temporary differences associated with investments in subs, branches, associates and JVs if:

- The investor is able to control the timing of the reversal of the temporary difference; AND
- It is probable the difference will not reverse in the foreseeable future

Initial recognition exemption

Goodwill:

Company A purchases subsidiary B. Goodwill of Rs.150,000 arises on the acquisition. No tax deduction is available in the future for this goodwill because it only arises in the consolidated financial statements. There is a taxable temporary difference of Rs. 150,000, corresponding deferred tax liability would not be provided.

Initial recognition of an asset:

Company A purchases a machinery for Rs. 200,000. No tax deduction is available for this asset either through its use or on its disposal. There is therefore a taxable temporary difference of Rs. 200,000 on initial recognition of the asset. Assuming the same asset was not purchased in a business combination, the resulting deferred tax liability would not be recognized.

Assume the above asset has been recognised in the consolidated financial statements as a result of business combination, deferred tax would be recognised and effect would be to increase goodwill by an equal amount.

Goodwill

Non-tax deductible – do not provide

	Accounts	Tax
Initial recognition	10,000	Nil
Impairment	1,000	Nil
NBV	9,000	Nil

Tax deductible - provide

	Accounts	Tax
Initial recognition	10,000	10,000
Impairment	1,000	400
NBV	9,000	9,600

Initial recognition exemption

<u>Taxable temporary differences on investment in subsidiary:</u>

Company A purchased Company B on April 1, 2013 for Rs. 300,000. By March 31, 2014, Company B had made profits, which remained undistributed of Rs. 50,000. The tax base of the investment in Company B is its original cost.

A taxable temporary difference of Rs. 50,000 therefore exists. As a parent, by definition controls a subsidiary it will be able to control the reversal temporary difference, for example through control of the dividend policy of the subsidiary.

Therefore deferred tax on such temporary differences is generally not provided unless it is probable that the temporary difference will reverse in the foreseeable future.

In the above example, if Company B will be treated as an Associate, then in the absence of control, Company A shall be required to create deferred tax liability.

Initial recognition exemption

Avoids balance sheet gross up

Buy Rs. 100 asset where only Rs. 60 will be deductible

- No accounting entries re deferred tax at point of purchase
- Accounting and tax lives the same – no DT entries ever
- Accounting and tax lives different – book DT only on the new differences

When is deferred tax not recognised on deductible temporary differences?

Exception 1 – It is not probable that sufficient taxable temporary differences will be available against which the deductible temporary difference can be utilised relating to same taxation authority.

Exception 2 – The deferred tax asset arises from the initial recognition of an asset or liability in a transaction that

- is not a business combination; AND
- at the time of the transaction affects neither accounting P&L or taxable profit

Exception 3 - Deductible temporary differences arising from investments in subs, branches, associates and JVs if it is NOT probable that:

- the difference will reverse in the foreseeable future; OR
- Taxable profit will be available against which the temporary difference can be utilised

Initial recognition exemption

<u>Availability of taxable temporary differences:</u>

Company A has deductible temporary differences of Rs. 45K which are expected to reverse in the next year and has also taxable temporary differences of Rs 50K, out of which Rs 30K will be reversed in next year and Rs. 20K will be reversed in the year after.

Hence, Company A's deferred tax asset will be restricted on deductible temporary differences to Rs.30K only.

<u>Initial recognition of an asset:</u>

Company A purchases a machinery for Rs. 100,000. Tax deductions of Rs. 150,000 will be available for that asset. There is therefore a deductible temporary differences of Rs. 50,000 on initial recognition.

Assuming the same asset was not purchased in a business combination, the resulting deferred tax asset would not be recognized.

Unabsorbed tax losses

- Is it probable that future taxable profits will be available against which the unused tax losses can be utilised?

- Losses expire?

- Capital vs. trading?

- Tax planning opportunities

Group issues

- Investments in subsidiaries:
    - May give rise to temporary differences
    - Consider ability to control remitting of profits, and timing of this.
- Business combinations
- Intragroup transactions

Business combination

Deferred tax asset or liability arises on a business combination, a calculation of that DTA / DTL is required at the date of acquisition. The impact goes to goodwill at the date of acquisition, not profit or loss.

Example: Company A (tax rate 28%) acquired Company B (tax rate 30%) for Rs. 50 Lacs and at the date of acquisition fair value of identifiable assets and liabilities of Company B was Rs. 25 Lacs. This included an intangible asset of Rs. 5 Lacs which was not recognised by B. The tax base of all other assets and liabilities acquired other than Intangible asset was equal to their accounting base. The tax base of Intangible asset was Nil. Therefore, a taxable temporary difference of Rs.5Lacs exists at the date of acquisition, hence DTL of Rs. 1.5 lacs is provided and corresponding goodwill increased to Rs.26.5 Lacs.

In the 2^{nd} year, lets assume the Intangible asset has been amortized and now have carrying value of Rs. 4 Lacs. As amortization of Intangible asset is provided in P&L, hence movement of DTL of Rs. 30K will be recognized in P&L.

Intra-group transactions

Affects consolidated accounts where:

- Group companies trade with one another
- Unrealised profits have to be eliminated on consolidation; and
- Transacting group companies pay tax at different rates (small company rate v large company rate, or companies not in same tax jurisdiction)

Intra group transactions

A Ltd. and B Ltd. are in the same group

In year 1 A Ltd. sells INR 100 of goods costing INR 60 to B Ltd, paying tax on the INR 40 profit at 30% (i.e. INR 12).

B Ltd. holds the stock at the year end of year 1

B Ltd. sells the stock in year 2 for INR 120 paying tax at 40%

What is the deferred tax asset under IAS 12 at the end of year 1 in the group's consolidated accounts?

Intra group transactions

	A	B	Adj	Cons
Sales	100	-	(100)	-
Cost of Sales	(60)	-	60	-
Profit before tax	40	-	(40)	-
Tax (Charge) / Credit	(12)	-	*16*	4
Profit after tax	28	-	(24)	4
Stock	-	100	(40)	60
Cash	40	(100)	-	(60)
Deferred tax asset	-	-	*16*	16
Current tax liability	(12)	-	-	(12)
	28	-	-	4
P&L reserves	28	-	(24)	4

Financial instruments

Fair value vs. Cost

Timing of tax deductions

Compound instruments

- Convertible debt

Company A issues a convertible bond for Rs 800 which is interest free. The bond holders can convert each bond into a fixed number of equity shares after 5 years. Company A determined liability component of the bond is to be Rs.700 and residual portion has gone to equity.

The imputed interest charges are not tax deductible and hence the tax base of bond is Rs.800. A taxable temporary difference of Rs 100 arises on initial recognition. A deferred tax liability of Rs. 30 (assuming tax rate is 30%) to be recorded in equity and subsequently movement in deferred tax to be credited to P&L account.

Disclosure and presentation issues

- Non current
- Reconciliation
- Offset
- Un-recognized amounts

Thank You

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