

current tax asset against a current tax liability when they relate to income taxes levied by the same taxation authority and the taxation laws permit the entity to make or receive a single net payment.

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

**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**

	₹
<b>ASSETS</b>	
<b>Non-current assets</b>	
Property, plant and equipment	4,20,00,000
Product development costs	21,00,000
Investment in subsidiary – S Ltd.	1,54,00,000
<b>Current assets</b>	
Trading investments	72,80,000
Trade receivables	2,19,10,000
Inventories	1,06,40,000
Cash and cash equivalents	63,00,000
<b>TOTAL ASSETS</b>	<b>10,56,30,000</b>
<b>EQUITY &amp; LIABILITIES</b>	
<b>Equity</b>	
Share capital	4,20,00,000
Accumulated profits	2,86,24,330
Revaluation surplus	30,80,000

*Handwritten notes:*

- Tax Base** (circled)
- Tax Base 80,50,000** (circled)
- Tax Base 1,12,70,000** (circled)
- Tax Base** (circled)
- DT** (circled)
- cy CT** (circled)
- 30%** (circled)
- 32%** (circled)
- 3,42,30,000** (circled)
- 3,42,30,000** (circled)
- 721,000** (circled)
- 1,45,60,000** (circled)
- 5,60,00,000** (circled)

<b>Non-current liabilities</b>	
Deferred income - government grants	14,00,000
Liability for product warranty costs	5,60,000
Deferred tax liability (from 20X6-20X7)	7,75,670
<b>Current liabilities</b>	
Trade payables	2,67,40,000
Medical benefits for employees	24,50,000
<b>TOTAL EQUITY &amp; LIABILITIES</b>	<b>10,56,30,000</b>

**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.

- 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. *→ Perm. Diff.*
- 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. *P.D*
- 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. *diff 161000 P.D*

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)	<u>59,50,000</u>
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
Petrol over limit (W.N.3)		<u>1,61,000</u>
Total	(B)	<u>120,47,000</u>

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

### 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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**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 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**

<b>ASSETS</b>	₹
<b>Non-current assets</b>	
Property, plant and equipment ✓	420,00,000
Product development costs ✓	21,00,000

Investment in subsidiary – S Ltd.	154,00,000
<b>Current assets</b>	
Trading investments	72,80,000
Trade receivables	219,10,000
Inventories	106,40,000
Cash and cash equivalents	63,00,000
<b>Total Assets</b>	<b>10,56,30,000</b>
<b>EQUITY &amp; LIABILITIES</b>	₹
<b>Equity</b>	
Share capital	420,00,000
Accumulated profits	258,10,330
Revaluation surplus	30,80,000
<b>Long-term liabilities</b>	
Deferred income - government grants	14,00,000
Liability for product warranty costs	5,00,000
Deferred tax liability (from 20X6-20X7)	7,75,670
<b>Current liabilities</b>	
Trade payables	267,40,000
Medical benefits for employees	24,50,000
Current Tax Liability	28,14,000
<b>Total Equity &amp; Liabilities</b>	<b>10,56,30,000</b>

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

DTL  
DTL  
-  
DTA  
DTA  
DTA

Cash and cash equivalents	63,00,000	✓ 63,00,000	-
Deferred income - government grants L	-14,00,000	✓ 0	PD
Liability for product warranty costs L	-5,60,000	✓ 0	DTA
Trade payables L	-267,40,000	✓ -267,40,000	-
Health care benefits for employees L	-24,50,000	✓ 0	DTA

**Working Notes:**

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

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- However, for deductible temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures, a deferred tax asset shall be recognised in accordance with paragraph 44 of Ind AS 12.
- ❖ From a reading of the aforesaid principles, deferred tax liabilities and deferred tax assets needs to be recognised in most of the cases. But the recognition of deferred tax liabilities or deferred tax assets are subject to exceptions with respect to the following items:
  - (a) the initial recognition of goodwill arising in a business combination (exception 1);
  - (b) the initial recognition of an asset or liability in a transaction which:
    - (i) is not a business combination; and
    - (ii) at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss) (exception 2);
  - (c) temporary differences associated with investments in subsidiaries, branches and associates, and interests in joint ventures (exception 3).

These exceptions are discussed in Step 5.

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

**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
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)	<b>excluded</b>	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
<b>Deferred tax asset - total</b>					<b>23,07,200</b>
<b>Deferred tax liability - total</b>					<b>(31,58,400)</b>
<b>Deferred tax total</b>					<b>(8,51,200)</b>

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### 1.6.5 Step 5: Identify exceptions

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

- In the case of a business combination, when the consideration paid exceeds the net identifiable assets, goodwill is created.
- Technically speaking, goodwill arising in a business combination is measured as the excess of (a) over (b) below:
  - (a) the aggregate of:
    - (i) the consideration transferred measured in accordance with Ind AS 103, which generally requires acquisition date fair value;
    - (ii) the amount of any non-controlling interest in the acquiree recognized in accordance with Ind AS 103; and
    - (iii) in a business combination achieved in stages, the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.
  - (b) the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed measured in accordance with Ind AS 103.
- As per principles enunciated in this Ind AS 12, the entity has to determine the tax base of this goodwill to compute the temporary difference, either taxable or deductible, at the time of recognition and subsequently when impairment takes place. The Standard provides separate guidance for taxable temporary difference (Situation A) and deductible temporary difference (Situation B).
- **Situation A:** Where the temporary difference is in the nature of taxable temporary difference. Again, in this case, the prescribed treatment is different where goodwill is