

## 8. IND AS 12 – INCOME TAXES

### Practical Example 1 (DTA on Goodwill – Not allowed)

An entity acquires a subsidiary and pays Rs. 1,00,000. The fair value of net identifiable assets is Rs. 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 Rs Nil. Hence the difference is Rs. 35,000. Assuming tax rate to be 30%, deferred tax liability of Rs. 10,500 needs to be created. Now because of recognition of this deferred tax liability, the following entry needs to be passed instead of the above entry:

#### Entry 2:

Goodwill	Dr.	45,500	
Net assets	Dr.	65,000	
To Consideration			1,00,000
To Deferred tax liability			10,500

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

### Practical Example 2: (DTL on Revaluation of PPE)

Company A buys an asset worth Rs.100 on 1st April, 2010. The useful life of the asset is five years and the tax laws allow it to be depreciated over four years. One year later, on 31st March, 2011, the Company revalue the asset to Rs.120. Tax Rate is 30%. In such a case the temporary difference will be as shown in the following Table.

#### **Solution**

##### **Table:**

Year ending March 31,	2011	2012	2013	2014	2015
Net book value	120	90	60	30	0
Tax base	75	50	25	0	0
Temporary difference	45	40	35	30	0

In the above case, the deferred tax liability created on revaluation on 31st March, 2011, of Rs.45 reverses in the subsequent periods. The accounting entry for the year 2011 would be:

Revaluation reserve (OCI) A/c Dr.	40x30%
Profit and Loss A/c Dr.	5x30%
To Deferred tax liability A/c	45x30%

Suppose on 31st March, 2013, the Company decides to sell the asset at Rs.70. In this case, there would be a gain of Rs.10 as per the books of accounts. However, the tax books will show a gain of Rs.45, thus offsetting the temporary difference of Rs.35.

#### Detailed Calculation:

	2011	2012	2013	2014	2015
CA without Revaluation	80	60	40	20	0
Tax Base	75	50	25	0	0
Temporary difference due to Depreciation	5	10	15	20	
CA with Revaluation	120	90	60	30	0
Total Temp. Diff.	45	40	35	30	0
Temp. Diff. due to Revaluation	40	30	20	10	0

#### Practical Example 3: (Business Combination)

Company A buys Company B for Rs. 1,500

- Book value of assets of B = 1 000
- Fair value of assets of B = 1,200
- Goodwill = 1,500 - 1,200 = 300
- Tax Rate = 30%
- Taxable temporary difference = 1,200 - 1,000 = 200
- DTL = 200x30% =60
- Goodwill = 300 + 60 = 360

#### ACCOUNTING ENTRY:

Goodwill A/c Dr. 60 (200 \* 30%)  
To DTL A/c 60

#### Practical Example 4: (Business Combination)

##### Balance Sheet of Subsidiary Co.

Particulars	Amount	Particulars	Amount
Equity	1300000	NCA	1200000
Liability	600000	CA	700000
<b>Total</b>	<b>1900000</b>	<b>Total</b>	<b>1900000</b>

- H Co. acquired subsidiary at an Investment of Rs. 14,00,000/- (acquired 100% shares)
- Non-Current Assets having Fair Value = Rs. 1250000
- All other are having Fair Value Equal to their book value.

Determine Deferred Tax impact on Consolidated Financial Statements of Holding co. Assume Tax Rate is 30%.

**SOLUTION:-****In the books of H CO.**

Standalone Financial Statements		Consolidated Financial Statements	
Investment A/c Dr	14,00,000	Non-Current Asset A/c Dr.	12,50,000
To Bank A/c	14,00,000	Current Assets A/c Dr.	7,00,000
		Goodwill (B/f) A/c Dr.	50,000
		To Liability A/c	6,00,000
		To Investments A/c	14,00,000

- Here we can see that Goodwill arise in business combination is = 50,000/-
- However, DTL shall be recognized on 50,000 Temporary difference due to recognition of Non-current Assets as Fair Value at 12,50,000 (assuming Tax base is same as book value i.e. 12,00,000) =  $50,000 \times 30\% = 15,000$
- Such DTL shall be recognized as a part of business combination transaction and hence this DTL shall directly affect Goodwill (as a balancing figure) arising due to Business Combination.

**Hence Correct Journal Entry in Consolidated Financial Statements:**

NCA	Dr.	12,50,000	
CA	Dr.	7,00,000	
Goodwill (B/f)	Dr.	65,000	
To CL			6,00,000
To DTL			15,000
To Investment			14,00,000

**Conclusion:** due to recognition of DTL, goodwill is increased by the same amount.

**Example 5: (Tax Rate of Holding and Subsidiary)**

- Company X (Holding) sold goods costing ₹ 60 to Company Y (Subsidiary)
- In the Standalone Balance Sheet of Y stock is shown at ₹ 100
- In the Consolidated Balance Sheet Stock will be shown at ₹ 60
- Tax base for Y is ₹ 100 and Y's Tax rate is 30%, X's Tax rate is 25%
- Deductible Temporary Difference =  $100 - 60 = ₹ 40$
- DTA =  $Rs.40 \times 30\% = ₹12$

**ACCOUNTING ENTRY:**

Deferred Tax Asset A/c	Dr.	12	
To Profit and Loss A/c			12

**Practical Example 6: (Reconciliation)**

An entity has made an accounting profit of Rs 1,00,000. The tax rate is 30%. In computing the accounting profit, a penalty of Rs 10,000 has been considered which is not tax deductible. There are no other tax impacts. In this case, the taxable profits are Rs1,10,000 (Rs1,00,000 + Rs10,000) and tax expense @ 30% is Rs. 33,000.

The two types of disclosures are as under:

Particulars	Amount (Rs)
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:-	3,000
Penalties Tax expense	33,000

The two types of disclosures are 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.

### **Practical Example 7: (Reconciliation)**

A Company operating in India, Australia and Dubai. Australia and Dubai is considered as Branches.

Tax rates and accounting incomes are as under:

Particulars	India HO	Australia Branch	Dubai Branch
Accounting Income	5,00,000	3,00,000	8,00,000
Applicable Tax Rates	30%	18%	5%
Permanent Differences (exp. Disallowed)	50,000	30,000	Nil

Calculate the following:

- 1) Current Taxes in their respective tax jurisdictions
- 2) Reconcile Total Current Tax of whole entity and Tax on Accounting Profit as a whole.

### **Solution:**

#### **1) Calculation of Current Taxes in their respective tax jurisdictions:**

S.No.	Particulars	India	Australis	Dubai
A	Tax rate	30%	18%	5%
B	A/C Income	5,00,000	3,00,000	8,00,000
C	(+) Parmanent Difference	50,000	30,000	NIL
D	Taxable Income	5,50,000	3,30,000	8,00,000
E	Current Tax (DxA)	1,65,000	59,400	40,000

Hence Total Current Tax as a whole = Rs. 2,64,400/-

## 2) Reconciliation of Total Current Tax with Tax on Accounting Income as a whole:

PARTICULARS	AMOUNT
Total Accounting profit (as a whole)	16,00,000
Domestic Tax Rate	30%
<b>Total Tax on Total Accounting Profit at Domestic Rate (as shown in combined profit and loss)</b>	<b>4,80,000</b>
<b>Less:</b>	
Tax Effects due to change in tax rates of branches	
Australia = 3,00,000 × 12%	(36,000)
Dubai = 8,00,000 × 25%	(2,00,000)
<b>Add:</b>	
Tax effect due to Parmanent differences	
80,000 × 30%	24,000
<b>Less:</b>	
Tax effect on Parmanent difference item of Australia branch	
30,000 × 12%	(3,600)
<b>Total Aggregate Current Tax as a Whole</b>	<b>264,400</b>

In Short :- Tax expense = 1,65,000 + 59,400 + 40,000 = 2,64,400

### Practical Example 8: (Reconciliation)

In 20X2, an entity has accounting profit in its own jurisdiction (country A) of Rs.1500 (20X1: Rs. 2000) and in country B of Rs.1500 (20X1: Rs.500). The tax rate is 30% in Country A and 20% in country B. In country A, Expense of Rs. 100(20X1: Rs.200) are not deductible for tax purposes.

Reconcile Total Current Tax of whole entity and Tax on Accounting Profit as a whole?

#### Solution:

The following reconciliation will be prepared:

Particulars	Amount	
	20X2	20X1
Accounting Profit	3,000	2500
Tax at the domestic rate of 30%	900	750
Tax effect of expenses that are not tax deductible for tax purposes	30	60
	(150)	(50)
Effect of lower tax rates in country B	780	760
Tax Expense		

### Practical Example 9: (DTL on Compound Financial Instruments)

If the instrument is classified on initial recognition in two components viz. Equity and Liability then Taxable temporary difference will arise since in books liability will have lower amount and in tax base the entire amount is liability. Therefore, **DTL is recognized through Equity**. The same example has

been explained as under -

8% Convertible Debentures issued of Rs. 10,00,000. Holders are given an option to convert the instruments into equity shares or to receive cash after 5 years. Entity's IRR/Effective Rate of Interest is 12% pa. Calculate the Deferred Tax Impact.

### SOLUTION

By applying IndAS 109 Financial Instruments, following will be the Journal Entry at the time of Issue of Debentures -

Bank A/c Dr.	10,00,000
To 8% Debentures (FL) A/c	8,56,000
To 8% Debentures (Equity) A/c	1,44,000

Now the Carrying Amount of Liability at the time of issue is 8,56,000 however the Tax Base will be Rs. 10,00,000 therefore, Temporary Difference of Rs. 1,44,000 arises (because of IndAS 109 principle by segregating the Financial Instrument into Liability and Equity)

Hence DTL of Rs. 43,200 (assuming 30% Tax Rate i.e. 1,44,000 x 30%) will be created through Equity at the time of issue as under-

Other Equity (Reserve) A/c Dr.	43,200
To DTL A/c	43,200

### Practical Example 10: (DT on Share Based Payment Transaction)

On 1st April 20X1, P Ltd. had granted 1 Cr share options worth ₹ 4 Cr 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.

### SOLUTION:

#### On 31st March 20X2: The tax benefit is calculated as under:

Carrying amount of Share based payment	₹ 0.00 Cr
Tax Base of Share based payment (₹ 1.60 Cr x $\frac{1}{2}$ )	₹ 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)