CHAPTER

6 IND AS 12 — INCOME-TAXES

SYNOPSIS

Students are expected to have Income-tax knowledge. This approach followed in this standard is different compared to AS-22 – Taxes on Income. You need **most attention** to understand. Sometimes, you may feel confused but don't lose confidence, trust us, you will understand it for sure in the second reading. As usual, read the asset & liability definition before starting this Ind AS.

1. INTRODUCTION AND OBJECTIVE

Income-tax expense is one of the significant items in the Profit and loss statement of an entity. The objective of the standard is to ensure current year income should be taxed in the same year. As per matching concept, taxes on income (income-tax) are considered to be an expense incurred by the entity in earning income and are **accrued in the same period as the revenue and expenses to which they relate irrespective of actual payment**. Due to tax laws, accounting income **differs from** taxable income as per the tax laws. Sometimes, current year income/expense are recognised in the next year.

The approach of this standard is fundamentally different from the existing approach prescribed by AS-22. The approach for determination of deferred tax assets and liabilities is **changing from Profit and Loss Account approach to Balance Sheet approach**. However, the underlying concepts remain the same.

Consider the following Example

Particulars	Accounting Records	Tax Records
Cost of an Asset	1,00,000	1,00,000
Depreciation	10,000	20,000
WDV	90,000	80,000
Known as	**Carrying amount**	**Tax Base**
As per AS-22	The difference in depreciation is ₹ 10,000 (₹ 20,000 – ₹ 10,000). This difference will be ***reversed over*** the remaining life of the asset - hence we call it as timing difference *(i.e., in the future years, accounting depreciation will be greater than tax depreciation)*. As the depreciation expense is more in Tax Records, the entity pays less tax in the current year. When we say "less tax", it is actually liable to pay more considering accounting records it means *the current year profit is not correctly taxed*. Hence by the entity should create a deferred tax liability (DTL) for ₹ 10,000 × 30% = ₹ 3,000 (assuming tax rate is 30%) and *(i.e., debit – tax expense & credit – DTL).* As our discussion is based on accounting income and taxable income, this approach is called as P & L Approach.	
As per Ind AS-12	*(The effect remains same in the balance sheet approach also – but the way of thinking & calculation changes little)* Carrying amount of Asset is ₹ 90,000 and Tax base is ₹ 80,000. Difference is ₹ 10,000. *This should be interpreted like this* The carrying amount of the asset is ₹ 90,000 means the entity gets probable future economic benefits of ₹ 90,000 *(by way of use or sale)* and which will be taxed in the future. This is comparatively more than tax base, i.e., ₹ 80,000. It means, the entity is liable to pay more tax on ₹ 10,000 (₹ 90,000 – ₹ 80,000), Tax on the difference amount is postponed (i.e., deferred). Hence it should create a deferred tax liability for ₹ 10,000 × 30% = ₹ 3,000 (assuming tax rate is 30%) and *(i.e., debit – tax expense & credit – DTL).* This approach is called as Balance Sheet Approach.	

The following will satisfy your question in mind

When do we recognise an asset?

As per the conditions for recognising the asset – The inflow of future economic benefits are PROBABLE *(i.e., more likely than not)* and it can be measured reliably. When the inflows are probable, tax expense or income is also probable – hence deferred tax should be recognised.

2. PRINCIPLE OF ACCOUNTING FOR DEFERRED TAX *(READ CAREFULLY)*

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. This Standard requires an entity to recognise a deferred tax liability (deferred tax asset), with **certain limited exceptions** *(discussed later)*.

This is a little different standard – I will try to make you understand with the help of examples. You may need to go through this Standard for more than one time.

Example 1

A Ltd. has a building worth ₹ 2,00,000. The current tax rate is 20%. A Ltd. decides to revalue the building at a fair value of ₹ 5,00,000. By doing so, the entity is recognizing that in future it is able to generate ₹ 5,00,000 by use **or** sale. Assume the current **tax base** (book value as per tax records) is ₹ 2,00,000.

As per Ind AS 16 - the revaluation gain is recognised through other comprehensive income (OCI) and routed to revaluation reserve which is part of equity.

Future taxable income (₹5 lakh) from the asset is more than that of the tax base (₹2 lakh), hence for difference of ₹ 3,00,000 (additional future taxable income), the entity should recognise deferred tax liability (future tax liability) of ₹ 3,00,000 × 20% = ₹ 60,000.

As it is a liability it will be credited. ***What about the debit?***

Before answering, one should question themself. Is this income transferred to P&L or OCI or directly to Equity?

Depending on the answer – If such income is credited to P&L – tax expense will be debited to the statement of

P&L; If is credited to OCI – tax expense will be debited to the statement of OCI and if is directly credited to any reserve i.e., equity – tax expense should be debited to that reserve in the equity.

In the given case, as revaluation gain of ₹ 3,00,000 is credited to OCI, this deferred tax expense of ₹ 60,000 should be debited to OCI. So, net revaluation gain presented in the statement of OCI after tax effect will be ₹ 2,40,000 (₹ 3,00,000 – ₹ 60,000).

3. SCOPE

1 This Standard shall be applied in accounting for income-taxes. It includes all domestic and foreign taxes chargeable on taxable profits. Income- taxes also include taxes, such as **withholding taxes** *like TDS*, which are payable by a subsidiary, associate or joint arrangement on distributions of dividends to the reporting entity.

(*Withholding taxes* are *taxes deducted at source*, especially one levied by some countries on interest or dividends paid to a person resident outside that country).

2 This Standard does **not** deal with the methods of accounting for government grants (*Refer* Ind AS-20) or investment tax credits. However, this Standard **does deal** with the accounting for temporary differences that may arise from such grants or investment tax credits.

4. DEFINITIONS

Meanings of terms are used in this Standard – we learn the remaining definitions at the later point of time.

- ***Accounting profit*** is profit or loss **before** tax expense as per accounting records;
- ***Taxable profit (tax loss)*** is the profit (loss) for a period as determined by tax laws, upon which income-taxes are payable (recoverable);
- ***Tax expense (tax income)*** is the total of **current tax expense (income)** and **deferred tax expense (income)** for the period;
- ***Current tax*** is the amount of income-taxes payable or recoverable for the period as per the tax laws, i.e., tax liability as per tax laws.

5. RECOGNITION OF CURRENT TAX LIABILITIES AND ASSETS

Let us learn first accounting treatment of current taxes

❖ Taxes on income payable for the current period is generally called current tax;

❖ Current tax for current or previous years, to the **extent unpaid**, should be recognised as a liability;

❖ If the amount **already paid** by way of advance tax, etc., and **exceeds the amount due,** *i.e., provision for tax* for those periods, the **excess** shall be recognised as **an asset (net)**.

Accounting entries for current tax

When Advance Tax is paid

Advance Tax A/c (Balance Sheet) Dr.

To Bank A/c

When Expense is recognised

Current Tax Expense A/c (Profit and Loss) Dr.

To Current Tax Liability (Balance Sheet)

When Current Tax Asset and Liability are adjusted against each other

Current Tax Liability A/c Dr.

To Advance Tax A/c

To Bank A/c (if tax liability is more than advance tax) (b/f)

The standard envisages a situation (different one – Does not exist in India right now – read carefully)

Say, Initially company has earned profits and paid taxes but subsequently if it make losses, the entity can **get back the earlier tax paid (Refund of tax) [So happy right, if we get loss, government pays tax (sorry refund)]**. This is tax loss carrying BACK.

If any such benefit exists, the entity should recognise an asset to the extent of benefit. Such asset should be recognised in the period in which the tax loss occurs because it is probable that the benefit will flow to the entity and the benefit can be reliably measured.

Now let us enter into the main topic of deferred tax

6. DEFERRED TAX

Temporary differences

It is the difference

	₹
Carrying amount of asset/Liability as per balance sheet	XXX
Less: Tax base (See below discussion) *(Book value as per tax books)*	XX
Temporary difference	**XXX**

Remember this

On temporary difference, the entity recognises either deferred tax asset (DTA) or deferred tax liability (DTL). The temporary differences should be **checked at every balance sheet date** and if such difference is reversed/reduced in the subsequent year, DTA/DTL will be reversed accordingly. (*This is the basic rule and there are some exceptions to this*)

We introduced a word "Tax base" – understanding this very important for further study – hence read very carefully.

7. WHAT IS TAX BASE?

The tax base of **an asset or liability** is the amount attributed to that asset or liability for tax purposes, i.e., in simple words - It is an asset or liability **balance as per tax records**.

TAX BASE OF AN ASSET

Tax base of an asset is based on the **taxability of economic benefits** (i.e., revenue/cash flows) from the asset.

Economic benefits – means Money / Money's worth

- Revenue generated by using the machine (asset) i.e., using the machine entity can produce goods / provide services and make money;
- It can get cash flows by selling the asset; or
- It can rent the asset and get cash flows.

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. If those benefits arising from the asset will **not be taxable**, the **tax base** of the asset is **equal to its carrying amount**.

If the economic benefits are

Taxable → The amount **deductible** from taxable economic benefits flow to the entity

NOT Taxable → Tax Base = Carrying amount

Read the above definition again before trying the following examples.

(a) When Economic Benefits are taxable

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. *It means tax base is the amount which will be allowed to deduct from sales of goods generated from asset/sale of asset/rental income from the asset.*

Say, the entity bought PPE for ₹1,000, this is allowed for

Example 2

A machine cost ₹ 100. *For tax purposes*, depreciation of ₹ 30 has already been deducted in the current and prior periods and the **remaining cost will be deductible in future periods**, either as depreciation or through a deduction on disposal. Revenue generated by using the machine is taxable (i.e., taxable economic benefits from the assets), any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes. What is tax base?

Answer

Tax base is the amount deductible from future taxable economic benefits flow to the entity. In the given case ₹ 70 (₹ 100 – ₹ 30) is deductible in the future. Hence tax base is ₹ 70.

Example 3

In the books of X Ltd. an amount of ₹ 25,000 is recorded as **rent paid in advance**. For income-tax purpose, the amount is deductible on accrual basis. Determine the tax base of asset.

Answer

Total amount of advance rent will be deducted from the future taxable income; hence tax base of Asset = ₹ 25,000.

Example 4

Assume that interest receivable on the balance sheet date is ₹ 100 and such interest is **taxed on cash basis**. When benefits flow to the entity (interest realised in cash) it will be subject to tax. Determine the tax base of asset.

Answer

If interest income is taxable on cash basis and whereas on balance sheet date it is not received, it is NOT an income as per tax. No amount is deductible from this asset, hence tax base = Nil.

Example 5

What is the tax base of inventory?

Answer

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.

In case of sale, the total amount of inventory is charged as against the revenue (as COGS). As the entire amount is deductible from revenue, the carrying amount is the tax base. *Recovery of the asset implies either consumption or sale of inventory.*

(b) When economic benefits are NOT TAXABLE

If those benefits arising from the asset **are not taxable**, the **tax base = its carrying amount**.

Example 6

X Ltd. recorded dividends of ₹ 25,000 receivable from its subsidiary. The dividend is exempt from tax. Determine the tax base of the asset.

Answer

Dividend is not taxable, hence tax base of the asset = its carrying amount. Therefore, tax base of dividend receivable is ₹ 25,000

Example 7

When a trade receivable of ₹ 120 (being an asset in Balance Sheet) is realised in full, the economic benefits receivable from the said asset is already included in the taxable profits when sales occurred. *On receipt of money from debtor, it is not taxable*. Determine the tax base of asset.

Answer

If the benefits arising from the asset are not taxable; Tax base = Carrying amount; Therefore, tax base of the asset = ₹ 120.

Example 8

An entity has trade receivable of ₹ 1,000 as per books. It creates a provision for doubtful debts for an amount of ₹ 50. What is the tax base of the asset?

Answer

The carrying amount of the asset in the books is ₹ 1,000 – ₹ 50 = ₹ 950

Even if the entity receives ₹ 1,000 – It is not taxable – So the tax base of the asset is ₹ 1,000.

Explanation*:* Entity is entitled for a deduction of ₹ 1,000 against recovery of trade receivable. Also trade receivable is already included in revenue when the sale transaction is recognised and it will not be taxed on receipt of cash from customer.

Example 9

A company has an investment in listed equity shares. *Assume* there is no tax on gains that arise on sale of these listed equity shares. What is the tax base of the Asset?

Answer

Since investment in listed equity shares has no tax consequence in future, the carrying amount of the asset is equal to its tax base. (CA = TB)

Example 10

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

Answer

If the benefits arising from the asset are not taxable; Tax base = Carrying amount; therefore, the tax base of the loan is ₹ 100.

Example 11

What is the tax base of an **asset carried at fair value**? *(Read carefully)*

Answer

In case of asset carried at fair value and *fair value is* ***not allowed*** *for charging depreciation for tax purpose* – carrying amount of the asset is fair value. Tax base is the original cost allowed as per tax laws ***less*** tax depreciation allowed.

(b) In case of asset carried at fair value and fair value is ***allowed*** for charging depreciation for tax purpose – carrying amount of the asset is the tax base. (CA = TB)

(c) In case of ***financial assets*** carried at fair value when fair value *gain is not taxed and fair value loss is disallowed* for tax purpose – carrying amount is the fair value and tax base is the original cost of acquisition or **indexed cost of acquisition** wherever allowed.

Tax Base of a liability

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.

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.

Tax base of a liability is studied in two parts

Liability for revenue received in advance

Carrying amount	XXX
Less: Revenue that is NOT taxable in future	XX
The tax base of a liability	**XXX**

Other Liabilities

Carrying amount	XXX
Less: Any amount deductible for tax purposes in future periods	XX
The tax base of a liability	**XXX**

In simple terms:

Carrying amount (CA) – Deductible amount in future

Go through again before attempting the following examples

(i) Tax base of a liability for income received in advance

Example 12

Rent received in advance ₹ 10,000 already taxed on receipt basis. This amount will not be taxed again in future. Determine tax base of the liability.

Answer

Tax base for advance income = Carrying amount – Amount of revenue that will not be taxable in future

Since already the amount is taxed on receipt basis, it will not be taxed in future again.

Therefore, Tax base = ₹ 10,000 – ₹ 10,000 = 0

If the rent receipt is taxable on accrual basis

It means, this receipt is taxable in the next year – the other way – not taxable in the future = Nil

So, tax base = ₹ 10,000 – Nil = ₹ 10,000

Example 13

Advance received for supply of goods and services is ₹ 2,00,000. This is shown as a liability in books of the entity. What is the tax base of this liability?

Answer

This advance received for supply of goods is taxed on accrual basis when revenue is recognised.

Tax base = Carrying amount – amount of revenue that will not be taxable in future.

Tax base = ₹ 2,00,000 – 0 = ₹ 2,00,000

(ii) Tax base of other liabilities, i.e., other than advances for revenue

Example 14

A Ltd. created a provision of ₹ 2,00,000 towards bonus (expense). Such expenditure towards bonus is tax deductible only on payment of that liability (when the bonus is actually paid, being subject to Section 43B of the Income-tax Act). Determine tax base of liability?

Answer

The tax base of other liabilities =

Carrying amount ***less*** Amount that will be deductible in future = ₹ 2,00,000 – 2,00,000 = ₹ Nil.

In other words, since it is recognised on accrual basis in accounting and is allowed as a deduction in income-tax law as per cash basis, the temporary difference will be the full amount of provision recognised. By reverse working Tax Base is "Nil". Since Carrying amount = 2,00,000 and TB = 0 there is a temporary deductible difference of ₹ 2,00,000.

Example 15

A company has made provision for warranty costs of ₹ 1,00,000 in its accounts. The tax laws do not permit deduction until the company actually incurs the costs. Determine the tax base.

Answer

The tax base = Nil. (Carrying amount – Amount that will be deductible in future) = 1,00,000 – 1,00,000

Example 16

Current liabilities include accrued fines and penalties with carrying amount of ₹ 10,000. What is the tax base of this liability?

Answer

Fines and penalties are not deductible for tax purpose. There is no temporary difference in this case.

Tax Base of liability = Carrying amount – Amount deductible for tax purpose in future.

Tax Base = ₹ 10,000 – 0 = ₹ 10,000.