INDAS – 12
INCOME TAXES

(TOTAL NO. OF QUESTIONS – 15)

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RTPs QUESTIONS

Q1 (MAY 18)

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

On 1st February, 20X2, it acquired a machine for Rs 120 thousand. Depreciation is charged on the machine on a monthly basis for accounting purposes. Under the tax law, the machine will be depreciated for 6 months. The machine's useful life is 1

0 years according to Ind AS as well as for tax purposes. In the year 20X1-20X2, expenses of Rs 8 thousand were incurred for charitable donations. These are not deductible for tax purposes.

You are required to 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 = Rs 104 thousand x 25% = Rs 26 thousand.

Computation of Taxable Profit:

	Rs in thousand
Accounting profit	100
Add: Donation not deductible	8
Less: Excess Depreciation	(4)
Total Taxable profit	**104**

	Rs in thousand	Rs in thousand
Profit & loss A/c Dr.	26	
To Current Tax		26
(Being tax calculated on taxable profit = 104 x 25% = 26)		

Deferred tax:

Machine's carrying amount according to Ind AS = Rs. 118 thousand (Rs120 thousand – Rs2 thousand)

Machine's carrying amount for taxation purpose = Rs. 114 thousand (Rs120 thousand – Rs6 thousand)

Therefore, taxable temporary difference = Rs. 4 thousand

Deferred Tax Liability = Rs4 thousand x 25%

	Rs in thousand	
Profit & loss A/c Dr.	1	
To Deferred Tax Liability		1

Tax reconciliation in absolute numbers:

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

Tax rate reconciliation

Applicable tax rate	25%
Expenses not deductible for tax purposes [(8x 25%) / 100]	2%
Average effective tax rate [27/100]	27%

Note -

1. Donation expense = Rs. 8 thousand. There will be no deduction for this expense in the current year as well as in future years. Hence, it is a permanent difference. In such cases, Carrying amount as per books = tax base. Therefore, no DTA / DTL will be created.
2. In case there is a Permanent Difference, a reconciliation will be prepared compulsorily.

Q2 (Nov. 18)

X Ltd. prepares consolidated financial statements to 31st March each year. During the year ended 31st March 2018, 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 Rs 30,00,000. Y Ltd. is unable to utilise this loss against previous tax liabilities. The 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 the 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 31stMarch, 2018, 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 Rs. 20,00,000 in its statement of financial position as at 31st March, 2018. The Income-tax Act allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31 March 2019, X Ltd. expects to make taxable profits which are well in excess of 20,00,000. On 31stMarch, 2018, X Ltd. Had taxable temporary differences from other sources which were greater than Rs. 20,00,000.

(iii) During the year ended 31 March 2017, X Ltd. capitalised development costs which satisfied the criteria in paragraph 57 of Ind AS 38 'Intangible Assets'. The total amount capitalised was Rs16,00,000. The development project began to generate economic benefits for X Ltd. from 1st January 2018. 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 31 March2018.

(iv) On 1 April 2017, X Ltd. borrowed Rs1,00,00,000. The cost to X Ltd. of arranging the borrowing was Rs. 2,00,000 and this cost qualified for a tax deduction on 1 April 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31 March 2020 will be Rs. 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 Rs. 30,43,800 will be claimable when the loan is repaid on 31stMarch, 2020.

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 31 March, 2018 as per Ind AS. Assume the rate of corporate income tax is 20%.

SOLUTION

(i) The tax loss creates a potential deferred tax asset for the group since its carrying value is nil and its tax base is Rs. 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.

(In simple words - we create DTA to recognize a potential tax benefit in the future. To avail this benefit, there must be some taxable profit in the future. In the given case, there is no probability for taxable profits and hence the DTA will not get set-off in future. Therefore, no DTA will be recognized on such items.)

(ii) The provision creates a potential deferred tax asset for the group since its carrying value is Rs20,00,000 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 Rs. 20,00,000 in the year to 31st March, 2019.

The amount of the deferred tax asset will be Rs. 4,00,000 (Rs. 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 (is treated as an Intangible Asset & will be depreciated over 5 years in books of accounts) have a carrying value of Rs. 15,20,000 [Rs. 16,00,000 – (Rs. 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 Rs. 3,04,000 (Rs. 15,20,000 x 20%). All deferred tax liabilities are shown as non-current.

(iv) The carrying value of the loan at 31st March, 2018 is Rs. 1,07,80,000 (Rs. 1,00,00,000 – Rs. 2,00,000 + (Rs. 98,00,000 x 10%)). - refer amortization table
The tax base of the loan is Rs. 1,00,00,000. (expense of Rs. 2,00,000 will be allowed separately)
This creates a deductible temporary difference of Rs. 7,80,000 (Rs. 1,07,80,000 – Rs. 1,00,00,000) and a potential deferred tax asset of Rs. 1,56,000 (Rs. 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.

Amortization Table for verification of effective rate of interest

Year	Opening balance (Rs) (A)	Interest @ 10% (Rs) (B)	Closing balance (Rs) (A) + (B)
1	(1,00,00,000 – 2,00,000) = 98,00,000	9,80,000	1,07,80,000
2	1,07,80,000	10,78,000	1,18,58,000
3	1,18,58,000	11,85,800	1,30,43,800

Q3 (May19) - Similar to Q2

PQR Ltd., a manufacturing company, prepares consolidated financial statements to 31st March each year. During the year ended 31st March, 2018, the following events affected the tax position of the group:

- QPR Ltd., a wholly owned subsidiary of PQR Ltd., incurred a loss adjusted for tax purposes of Rs 30,00,000. QPR Ltd. is unable to utilize this loss against previous tax liabilities. The Income-tax Act does not allow QPR Ltd. to transfer the tax loss to other group companies. However, it allows QPR Ltd. to carry the loss forward and utilize it against the company's future taxable profits. The directors of PQR Ltd. do not consider that QPR Ltd. will make taxable profits in the foreseeable future.
- During the year ended 31st March, 2018, PQR Ltd. capitalized development costs which satisfied the criteria as per Ind AS 38 'Intangible Assets'. The total amount capitalized was Rs 16,00,000. The

development project began to generate economic benefits for PQR Ltd. from 1st January, 2018. The directors of PQR 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, 2018.

- On 1st April, 2017, PQR Ltd. borrowed Rs 1,00,00,000. The cost to PQR Ltd. of arranging the borrowing was Rs 2,00,000 and this cost qualified for a tax deduction on 1st April 2017. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31st March 2020 will be Rs 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 Rs30,43,800 will be claimable when the loan is repaid on 31st March, 2020.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of PQR Ltd. group at 31st March, 2018 as per Ind AS. The rate of corporate income tax is 30%.

SOLUTION

Impact on consolidated balance sheet of PQR Ltd. group at 31st March, 2018

- The tax loss creates a potential deferred tax asset for the PQR Ltd. group since its carrying value is nil and its tax base is Rs 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.
- The development costs have a carrying value of Rs15,20,000(Rs16,00,000 – (Rs16,00,000 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 Rs4,56,000 (Rs15,20,000 x 30%). All deferred tax liabilities are shown as non-current.
- The carrying value of the loan at 31st March, 2018 is Rs1,07,80,000 (Rs1,00,00,000 – Rs200,000 + Rs98,00,000 x 10%)). The tax base of the loan is 1,00,00,000. This creates a deductible temporary difference of Rs7,80,000 and a potential deferred tax asset of Rs2,34,000 (Rs7,80,000 x 30%).

Q4 (Nov. 19)

An entity is finalizing its financial statements for the year ended 31st March, 20X2. Before 31st March, 20X2, the government announced that the tax rate was to be amended from 40% to 45% of taxable profit from 30th June, 20X2.

The legislation to amend the tax rate has not yet been approved by the legislature. However, the government has a significant majority and it is usual, in the tax jurisdiction concerned, to regard an announcement of a change in the tax rate as having the substantive effect of actual enactment (i.e. it is substantively enacted).

After performing the income tax calculations at the rate of 40 per cent, the entity has the following deferred tax asset and deferred tax liability balances:

Deferred Tax Asset	80,000
Deferred Tax Liability	60,000

Of the deferred tax asset balance, Rs. 28,000 related to a temporary difference. This deferred tax asset had previously been recognised in OCI and accumulated in equity as a revaluation surplus.

The entity reviewed the carrying amount of the asset in accordance with para 56 of Ind AS 12 and determined that it was probable that sufficient taxable profit to allow utilization of the deferred tax asset would be available in the future.

Show the revised amount of Deferred tax asset & Deferred tax liability and present the necessary journal entries.

SOLUTION

Calculation of Taxable temporary differences (using reverse working):

Deferred tax liability = 60,000

Existing tax rate = 40%

Deductible temporary differences = 60,000 / 40% = 1,50,000

Calculation of Deductible temporary differences (using reverse working):

Deferred tax asset = 80,000

Existing tax rate = 40%

Deductible temporary differences = 80,000/40% = 2,00,000

Of the total deferred tax asset balance of Rs. 80,000, 28,000 is recognized in OCI

Hence, Deferred tax asset balance of Profit & Loss is 80,000 - 28,000 = 52,000

Deductible temporary difference recognized in Profit & Loss is 1,30,000 (52,000 / 40%)

Deductible temporary difference recognized in OCI is 70,000 (28,000 / 40%)

The adjusted balances of the deferred tax accounts under the new tax rate are:

Deferred Tax Asset		
Previously credited to OCI – Equity	70,000 x 0.45	31,500
Previously recognised income	1,30,000 x 0.45	58,500
		90,000
Deferred Tax Liability		
Previously recognised expense	1,50,000 x 0.45	**67,500**

The net adjustment to deferred tax expense is a reduction of 2,500. Of this amount 3,500 is recognised in OCI and 1,000 is charged to P&L.

The amounts are calculated as follows:

	Carrying Amt. at 45%	**Carrying Amt. at 40%**	**Increase (decrease) in DT Expense**
Deferred Tax Assets			
Previously credited to OCI – Equity	31,500	28,000	-3,500
Previously recognised income	58,500	52,000	-6,500

	90,000	80,000	-10,000
Deferred Tax Liability			
Previously recognised expense	67,500	60,000	-7,500
Net Adjustment			**(2,500)**

An alternative method of calculations:	
DTA shown in OCI 70,000 x (0.45 - 0.40)	3,500
DTA shown in Profit or Loss 1,30,000 x (0.45-0.40)	6,500
DTL shown in Profit or Loss 1,50,000 x (0.45 -0.40)	7,500

Journal Entries

Deferred Tax Assets Dr. To OCI – Revaluation Surplus	3,500	 3,500
Deferred Tax Assets Dr. To Deferred Tax Expenses	6,500	 6,500
Deferred Tax Expense Dr. To Deferred Tax Liability	7,500	 7,500

Note – when a new tax rate is substantially enacted, all the existing DTA / DTL items need to be adjusted in such a manner so as to bring them to the values as per the new rate.

Q5 (Nov. 20)

On 1 January 2020, entity H acquired 100% share capital of entity S for Rs.15,00,000. The book values and the fair values of the identifiable assets and liabilities of entity S at the date of acquisition are set out below, together with their tax bases in entity S's tax jurisdictions. Any goodwill arising on the acquisition is not deductible for tax purposes. The tax rates in entity H's and entity S's jurisdictions are 30% and 40% respectively.

Acquisitions	Book Values Rs. '000	Tax Base Rs. '000	Fair Values Rs. '000
Land and Building	600	500	700
Property, Plant & Equipment	250	200	270
Inventory	100	100	80
Account Receivable	150	150	150
Cash & Cash Equivalents	130	130	130
Accounts Payable	-160	-160	-160
Retirement benefit Obligations	-100	-	-100

You are required to calculate the deferred tax arising on acquisition of Entity S. Also calculate the Goodwill arising on acquisition.

SOLUTION

Calculation of Net assets acquired (excluding the effect of deferred tax liability):

Net Assets Acquired	Tax Base Rs. '000	Fair Values Rs. '000
Land and Building	500	700
Property, Plant & Equipment	200	270
Inventory	100	80
Account Receivable	150	150
Cash & Cash Equivalents	130	130
Total Assets	**1,080**	**1,330**
Accounts Payable	-160	-160
Retirement Benefits Obligations	-	-100
Net Assets before DTL	**920**	**1,070**

Calculation of deferred tax arising on acquisition of entity S

	Rs. '000	Rs. '000
Fair Value of S's Identifiable Net Assets (Excluding Deferred Tax)		1,070
Less – Tax Base		-920
Temporary Differences arising on acquisition		**150**
Net DTL arising on acquisition of entity S (1,50,000 x 40%)		60
Calculation of goodwill		
Purchase Consideration		1,500
Less – Fair Value of entity S's Identifiable Net Assets (excluding DT)	1,070	
Less – DTL	-60	1,010
Goodwill Arising on acquisition		**490**

Note:

Since, the tax base of the goodwill is nil, taxable temporary difference of Rs. 4,90,000 arises on goodwill. However, no deferred tax is recognised on the goodwill. The deferred tax on other temporary differences arising on acquisition is provided at 40% and not 30%, because taxes will be payable or recoverable in entity S's tax jurisdictions when the temporary differences will be reversed.

*Goodwill gives rise to a Permanent Difference.

Q6 (May. 21)

The entity has an identifiable asset ASSOTA with a carrying amount of Rs.10,00,000. Its recoverable amount is Rs.6,50,000. The tax base of ASSOTA is Rs.8,00,000 and the tax rate is 30%. Impairment losses are not tax deductible. Entity expects to continue to earn profits in future.

For the identifiable asset ASSOTA, what would be the impact on the deferred tax asset/ liability at the end of the period?

SOLUTION

As per Ind AS 36, the revised carrying amount of asset ASSOTA would be Rs. 6,50,000.

The tax base of asset ASSOTA is given as Rs.8,00,000.

Carrying value of asset = Rs.6,50,000

Tax base of asset = Rs.8,00,000

Since the tax base is greater than the carrying value of the asset, a deferred tax asset would be created on the deductible temporary difference of Rs.1,50,000 (Rs. 8,00,000 – Rs. 6,50,000) at the given tax rate of 30%.

Hence, Deferred tax asset for the asset ASSOTA would be Rs.1,50,000 x 30% = Rs.45,000.

MTP QUESTIONS

Q7 (MTP AUGUST 2018)

QA Ltd. is in the process of computation of the deferred taxes as per applicable Ind AS. QA Ltd. had acquired 40% shares in GK Ltd. for an aggregate amount of Rs. 45 crores. The shareholding gives QA Ltd. significant influence over GK Ltd. but not control and therefore the said interest in GK Ltd. is accounted for using the equity method. Under the equity method, the carrying value of investment in GK Ltd. was Rs. 70 crores on 31st March, 2017 and Rs. 75 crores as on 31st March, 2018. As per the applicable tax laws, profits recognised under the equity method are taxed if and when they are distributed as dividend or the relevant investment is disposed of.

QA Ltd. wants you to compute the deferred tax liability as on 31st March, 2018 and the charge to the Statement of Profit for the same. Consider the tax rate at 20%.

SOLUTION

DTL created on accumulation of undistributed profits as on 31.3.2018

	Carrying value	Value as per tax records	Tax base	Taxable temporary differences	Total Deferred tax liability @ 20%	Charged to P&L during the year
a	B	c	d	E= b-d	F = e x 20%	g
31st March 2017	70 crores	45 crores	45 crores	25 crores	5 crores	5 crores
31st March 2018	75 crores	45 crores	45 crores	30 crores	6 crores	1 crore (6 crores – 5 crores

Q8 (March 19 – 10 Marks)

QA Ltd. is in the process of computation of the deferred taxes as per applicable Ind AS and wants guidance on the tax treatment for the following:

(i) QA Ltd. does not have taxable income as per the applicable tax laws, but pays 'Minimum Alternate Tax' (MAT) based on its book profits. The tax paid under MAT can be carried forward for the next 10 years and as per the Company's projections submitted to its bankers, it is in a position to get credit for the same by the end of eighth year. The Company is recognising the MAT credit as a current asset under IGAAP. The amount of MAT credit as on 31st March, 2016 is Rs. 8.5 crores and as on 31st March, 2017 is Rs. 9.75 crores;

(ii) The Company measures its head office property using the revaluation model. The property is revalued every year as on 31st March. On 31st March, 2016, the carrying value of the property (after revaluation) was Rs. 40 crores whereas its tax base was Rs. 22 crores. During the year ended 31st March, 2017, the Company charged depreciation in its Statement of Profit and Loss of Rs. 2 crores and claimed a tax deduction for tax depreciation of Rs. 1.25 crores. On 31st March, 2017, the property was revalued to Rs.45 crores. As per the tax laws, the revaluation of Property, Plant & Equipment does not affect taxable income at the time of revaluation.

The Company has no other temporary differences other than those indicated above. The Company wants you to compute the deferred tax liability as on 31st March, 2017 and the charge/credit to the Statement of Profit and Loss and/or Other Comprehensive Income for the same. Consider the tax rate at 20%.

SOLUTION

(i) MAT credit as on 31st December of Rs. 9.75 crores will be presented in the Balance Sheet as Deferred tax asset. DTA in the current year will be Rs. 1.25 crores (Rs. 9.75 crores – Rs. 8.50 crores).

DTA Dr 1.25 crores

To P&L 1.25 crores

Note – when we have MAT credit available, it means that we have to pay a lower tax amount in future and hence, MAT will always be a DTA.

(ii)

a) Deferred tax for year ending 31-03-2016

Sr. No.	Particulars	Before revaluation	After revaluation
A.	Carrying Value	22 crores	40 crores
B.	Tax Base	22 crores	22 crores
C.	Taxable / (Deductible) difference (A-B)	nil	18 crores
D.	DTL / (DTA) (c x 20%)	nil	3.60 crores DTL (charged to OCI)
E.	Journal Entry	-	OCI Dr. 3.60 crores To DTL 3.60 crores

Therefore, Net DTL for the year = 3.6 crores

b) Deferred tax for year ending 31-03-2017

Sr. No.	Particulars	Before revaluation	After revaluation
A.	Carrying Value	20 crores (22 - 2 depreciation)	45 crores
B.	Tax Base	20.75 crores (22 - 1.25 depreciation)	20.75 crores (22 - 1.25 depreciation)
C.	Taxable / (Deductible) difference (A-B)	(0.75 crores)	24.25 crores
D.	DTL / (DTA) (c x 20%)	(0.15 crores) DTA (charged to P&L)	5 crores DTL (charged to OCI) *
E.	Additional DTL / (DTA) for the year	(0.15 crores) DTA	1.40 crores DTL

		(charged to P&L)	(charged to OCI) #
F.	Journal Entry	DTA Dr. 0.15 crores To P&L 0.15 crores	OCI Dr. 1.40 crores To DTL 1.40 crores

Therefore, Net DTL for the year = 1.25 crores (1.4 - 0.15).

* The difference of 24.25 crores is the net change due to 2 reasons - 1. depreciation and 2. revaluation.
For the difference due to depreciation of (0.75 crores), we have already made DTA (before revaluation working). Hence, the remaining balance is leading to a taxable difference of 25 crores, on which DTL is created = 5 crores.

DTA / DTL are balance sheet items and hence cumulative numbers are shown in the balance sheet. Out of the total DTL of 5 crores, we had already created DTL of 3.6 crores in 2016. Therefore additional charge during the year is 1.4 crores.

Q9 (April 19 – 8 Marks)

B Limited is a newly incorporated entity. Its first financial period ends on March 31, 20X1. As on the said date, the following temporary differences exist:

(a) Taxable temporary differences relating to accelerated depreciation of Rs. 9,000. These are expected to reverse equally over the next 3 years.

(b) Deductible temporary differences of Rs. 4,000 expected to reverse equally over next 4 years.

It is expected that B Limited will continue to make losses for the next 5 years. Tax rate is 30%. Losses can be carried forward but not backwards.

Discuss the treatment of deferred tax as on March 31, 20X1.

SOLUTION

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

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

B Limited will recognise a deferred tax liability of Rs. 2,700 on taxable temporary difference relating to accelerated depreciation of Rs. 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 March 31, 20X4 amounting to Rs. 900 (Rs. 3,000 @ 30%).
- No deferred tax asset shall be recognized for the reversal of deductible temporary difference for the year ending on March 31, 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 March 31, 20X5 deferred tax asset on the remainder of Rs. 1,000 (Rs. 4,000 – Rs. 3,000) of deductible temporary difference could be recognised at the 30% tax rate.

Q10 (October 20 – 4 Marks)

What is the tax effect of the sale of property, plant, and equipment, considering the block of assets approach followed in the Income-tax Act, 1961?

A company has a block of assets with a written down value of Rs. 1,00,000 on April 1, 2018 for tax purposes. The book value of the assets for accounting purposes is also Rs. 1,00,000. The assets are depreciated on a written down value basis at 25 percent per annum for both accounting and tax purposes. Of the entire block, assets costing Rs. 5,000 on April 1, 2018, were sold for Rs. 10,000 on March 31, 2020. Compute the deferred tax asset/liability assuming tax rate of 40 per cent.

SOLUTION

In the case of a company, the following computations will be made:

2018-2019

In this year, depreciation for both accounting and taxation purposes would be Rs. 25,000 (25 percent of Rs. 1,00,000). Accordingly, no timing difference arises on this account.

2019-2020

Depreciation for the year would be Rs. 18,750 (25 percent of Rs. 75,000) as per the books of account, while for tax purposes it would be Rs. 16,250 as sale proceeds of Rs. 10,000 would be reduced from the block of assets prior to the computation of depreciation. Accordingly, the following timing differences arise:

- Depreciation for tax purposes is Rs. 16,250 and for accounting purposes Rs. 18,750 giving rise to a timing difference of Rs. 2,500.
- Profit on sale of property, plant and equipment amounting to Rs. 7,188 (Rs. 10,000 - Rs. 2,812 being the WDV of the asset as on 31st March, 2020) is recognized for accounting purposes. However, for tax purposes this income is not considered. This will result in a timing difference of Rs. 7,188.

The net timing difference would be Rs. 4,688 (Rs. 7,188 – Rs.2,500) by which the accounting income would exceed the taxable income, thus requiring creation of a deferred tax liability of Rs.1,875 (4,688 X 0.4).

The difference of Rs. 4,688 would reverse in future years when depreciation for accounting purposes would be higher as compared to depreciation for tax purposes because depreciation for accounting purposes would be computed on higher carrying amount of property, plant and equipment as compared to carrying amount of those assets for tax purposes.

Alternate answer

For 31 March 2019, Carrying Value = Tax Base.

For 31 March 2020

Carrying Value		**Tax Base**	
opening balance	75,000	opening balance	75,000
(-) depreciation	(18,750)	(-) asset sold	(10,000)
	56,250		65,000
(-)derecognition of asset sold at carrying value	(2,812) - WN.1.	(-) depreciation	(16,250)
closing value	53,438	closing value	48,750

Taxable temporary difference = 53,438 - 48,750 = 4,688

DTL on above = 1,875

WN.1. Carrying value of asset sold

Opening balance on 01-04-2018 = 5,000

Depreciation for 18-19 @ 25% = (1,250)

Balance on 31-03-2019 = 3,750

Depreciation for 19-20 @ 25% = (937)

Balance on 31-03-2020 = 2,812

Selling price = 10,000

Gain on sale = 7,188

Q11 (October 21 – 6 Marks)

On 1st April 20X1, A Ltd. acquired 12 Cr shares (representing 80% stake) in B Ltd. by means of a cash payment of Rs. 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 Rs. 2.00

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

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

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

– Plant and equipment having a carrying value of Rs. 11 Cr at 1st April 20X1 had an estimated market

value of Rs. 13 Cr at that date.

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

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

SOLUTION

Purchase Consideration:	Rs. 25 Cr
Non-Controlling Interest [{(12 Cr x (20% / 80%)} x Rs. 2 per share]	Rs. 6 Cr

Computation of Net Assets of B Ltd.

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

Computation of Goodwill:

Purchase Consideration	Rs. 25.00 Cr
Add: Non-Controlling Interest	Rs. 6.00 Cr
	Rs. 31.00 Cr
Less: Net Assets at Fair Value	(Rs. 27.40 Cr)
Goodwill on acquisition date	**Rs. 3.60 Cr**

QUESTIONS FROM PAST EXAM PAPERS

No Questions Asked in May 18, Nov 18, May 19 & Nov. 19 specifically from IndAS 12

Q12. (Nov. 20) - Similar to Q.2.(i) & (iv)

(i) Parent Limited, prepares consolidated financial statements of the group on 31St March every year. During the year ended March 31st, 2020, the following events affected the tax position of the group: S Limited, a wholly owned subsidiary of Parent Limited, incurred a loss of ₹ 20,00,000 which is adjustable from future taxable profits of the company for tax purposes. S Limited is unable to utilize this loss against previous tax liabilities. The Income-Tax Act does not allow S Limited to transfer the tax loss to other group companies. However, it allows S Limited to carry forward the loss and utilize it against the company's future taxable profits. The directors of Parent Limited estimate that S Limited will not make any taxable profits in the foreseeable future

(ii) On April 1", 2019, Parent Limited borrowed ₹ 50,00,000. The cost incurred by Parent Limited for arranging the borrowing was ₹ 1,00,000 on the said date and this expenditure is qualified for deduction under the Income Tax Act for the accounting year 2019-20. The loan was given for a three-year period. As per agreement, no principal or interest was payable on the loan during the tenure of loan but the amount repayable on 31st, March 2022 will be by way of a bullet payment of ₹ 65,21,900. As per Parent Limited, this equates to an effective annual interest rate of 10% on loan. As per the Income-tax Act, a further expense of ₹ 15,21,900 will be claimable from taxable income till the loan is repaid on March 31st, 2022

The rate of corporate income tax to be assumed @ 20%.

Explain and show how each of these events would affect the deferred tax assets / liabilities in the consolidated balance sheet of Parent Limited as at March 31", 2020 as per applicable Ind AS.

You are also required to examine whether the effective rate of interest arrived at by Parent Limited for the loan of ₹ 50,00,00 is in accordance with applicable Ind AS or not?

SOLUTION

i) The tax loss creates a potential deferred tax asset for the group since its carrying value is nil and its tax base is Rs 20,00,000.

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 carrying value of the loan at 31 March 2020 is Rs 53,90,000 (Rs 50,00,000 – Rs 1,00,000 + (Rs 49,00,000 x 10%)).

The tax base of the loan is Rs 50,00,000.

This creates a deductible temporary difference of Rs 3,90,000 (Rs 53,90,000 – Rs 50,00,000) and a potential deferred tax asset of Rs 78,000 (Rs 3,90,000 x 20%).

If there are prospects of availability of taxable profits in future, deferred tax asset can be recognised.

Amortization Table for verification of effective rate of interest

Year	Opening balance (Rs) (A)	Interest @ 10% (Rs) (B)	Closing balance (Rs) (A) + (B)
1	(50,00,000 – 1,00,000) 49,00,000	4,90,000	53,90,000
2	53,90,000	5,39,000	59,29,000

Year	Opening balance (Rs) (A)	Interest @ 10% (Rs) (B)	Closing balance (Rs) (A) + (B)
3	59,29,000	5,92,900	65,21,900

Since the closing balance calculated as per the above table on the basis of 10% matches with the bullet payment of Rs 65,21,900, it assures that 10% rate of interest taken as effective rate of interest is correct and is in accordance with Ind AS 109. It considers the impact of cost of borrowing adjusted from the loan amount at initial recognition.

Q13. (Jan. 21)

C Ltd. acquired the following assets and liabilities of D Ltd. in a business combination:

in Rs. 000s

	Fair Value	Carrying Amount	Temporary Difference
Plant & equipment	500	510	(10)
Inventory	130	150	(20)
Trade receivables	200	210	(10)
Loans and advances	80	85	(5)
	910	955	(45)
10% Debentures	200	200	
	710	755	
Consideration Paid	760	760	
	50	5	
Goodwill Paid	50	5	45

Goodwill is deductible as permissible expenses under the existing tax law. Calculate Deferred Tax Asset / liability as per relevant Ind AS and also pass related journal entry in the books of C Ltd. and assume tax rate at 25%.

SOLUTION

In this case there is a Deferred Tax Asset as the Tax base of assets acquired is higher by Rs. 45,000. Deferred Tax Asset would be Rs.11,250 (45,000 x 25%)

Journal entry

		Dr.	Cr.
Plant and equipment	Dr.	5,00,000	
Inventory	Dr.	1,30,000	
Trade receivables	Dr.	2,00,000	
Loans and advances	Dr.	80,000	
Goodwill (50,000 - 11,250)	Dr.	38,750*	
Deferred Tax Asset	Dr.	11,250	
To 10% Debentures			2,00,000
To Bank			7,60,000

(Assets and liabilities taken over, goodwill and deferred tax asset have been recognised)

Q14. (December 21 – 5 Marks) - Similar to Q.9.

PC Limited got incorporated on 1st April,2020. As on 31.03.2021, the said date, the following temporary differences exist:

- ***i)*** *Taxable temporary differences relating to accelerated depreciation of Rs 1,24,000. These are expected to reverse equally over the next 4 years.*
- ***ii)*** *Deductible temporary differences of Rs 80,000 expected to reverse equally over next 5 years.*

It is expected that PC Limited will continue to make losses for the next 5 years. Tax rate is 20%. Losses can be carried forward but not backwards. Discuss the treatment of deferred tax as on 31st March, 2021.

Solution

As per IndAS 12, DTA shall be recognised to the extent it is probable that the entity ***will have taxable profits*** *against which deductible temp. diff. shall be reversed; or the entity has* ***sufficient taxable temporary differences*** *relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;*

In the given situation, sufficient Taxable Income is not available, however the entity has some taxable temporary differences. Therefore deductible temporary differences to the extent of Rs. 64000 (16000 each year) shall be considered for recognising DTA.

Balance Rs. 16000 is to be ignored since it is reversible in the year 2026 where the entity does not have any Anticipated Taxable Temporary Differences.

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

	Year ending on 31st March, 2022	**Year ending on 31st March, 2023**	**Year ending on 31st March, 2024**	**Year ending on 31st March, 2025**	**Year ending on 31st March, 2026**
Reversal of taxable temporary difference relating to accelerated depreciation over next 3 years (Rs 1,24,000/4)	31,000	31,000	31,000	31,000	Nil
Reversal of deductible temporary difference relating to preliminary expenses over next 4 years (Rs 80,000/5)	16,000	16,000	16,000	16,000	16,000

PC Limited will recognise a deferred tax liability of Rs. 24,800 on taxable temporary difference relating to accelerated depreciation of Rs 1,24,000 @ 20%.

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 March 31, 2025. No deferred tax asset shall be recognized for the reversal of deductible temporary difference for the year ending on March 31, 2026 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 March 31, 2026 deferred tax asset on the remainder of Rs16,000 (Rs80,000 – Rs64,000) of deductible temporary difference could be recognised at the 20% tax rate.

NEWLY ADDED QUESTIONS IN ICAI MODULE

Q15. (ICAI MODULE) – Same as Q.5.

On 1 January 2020, entity H acquired 100% share capital of entity S for Rs15,00,000. The book values and the fair values of the identifiable assets and liabilities of entity S at the date of acquisition are set out below, together with their tax bases in entity S's tax jurisdictions. Any goodwill arising on the acquisition is not deductible for tax purposes. The tax rates in entity H's and entity S's jurisdictions are 30% and 40% respectively.

Acquisitions	Book values Rs'000	Tax base Rs'000	Fair values Rs'000
Land and buildings	600	500	700
Property, plant and equipment	250	200	270
Inventory	100	100	80
Accounts receivable	150	150	150
Cash and cash equivalents	130	130	130
Accounts payable	(160)	(160)	(160)
Retirement benefit obligations	(100)	-	(100)

You are required to calculate the deferred tax arising on acquisition of Entity S. Also calculate the Goodwill arising on acquisition.

SOLUTION

Calculation of Net assets acquired (excluding the effect of deferred tax liability):

Net assets acquired	Tax base Rs'000	Fair values Rs'000
Land and buildings	500	700
Property, plant and equipment	200	270
Inventory	100	80
Accounts receivable	150	150
Cash and cash equivalents	130	130
Total assets	1,080	1,330
Accounts payable	(160)	(160)
Retirement benefit obligations	-	(100)
Net assets before deferred tax liability	**920**	**1,070**

Calculation of deferred tax arising on acquisition of entity S and goodwill

	Rs '000	Rs '000
Fair values of S's identifiable assets and liabilities (excluding deferred tax)		1,070
Less: Tax base		(920)
Temporary difference arising on acquisition		150

Net deferred tax liability arising on acquisition of entity S (Rs150,000 @ 40%)		60
Purchase consideration		1,500
Less: Fair values of entity S's identifiable assets and liabilities (excluding deferred tax)	1,070	
Deferred tax liability	(60)	(1,010)
Goodwill arising on acquisition		**490**

Note: Since, the tax base of the goodwill is nil, taxable temporary difference of Rs 4,90,000 arises on goodwill. However, no deferred tax is recognised on the goodwill. The deferred tax on other temporary differences arising on acquisition is provided at 40% and not 30%, because taxes will be payable or recoverable in entity S's tax jurisdictions when the temporary differences will be reversed.