CONNECT THE GAAP

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Ind AS 12 – Income Taxes

Tax on income is an area of key interest to the Exchequer. In modern day financial statements, income tax has substantial implications on profitability and overall reporting. Under the Indian GAAP, accounting for taxes on income was governed by the Accounting Standard (AS) 22 (Accounting for Taxes on Income). With the Ministry of Corporate Affairs notifying the Indian Accounting Standards (Ind AS) for a select set of companies, Ind AS 12 – Income Taxes shall be the guideline prescribing accounting principles for income tax. The differences in the approach of Ind AS 12 and AS 22 shall bring about stark changes in financial statements drawn up under AS and Ind AS. However, fundamental concepts like current tax being the amount of income tax on the taxable profit of the period stay unchanged. In this month's issue of Connect the GAAP, we focus on Income Taxes and compare Ind AS 12 and AS 22 on the following parameters:

- Approach
- Measurement
- Recognition
- Special cases
- Additional disclosures
- First time adoption

Approach

Ind AS 12 and AS 22 adopt different approaches to recognise deferred tax assets and liabilities.

Guideline	Approach Adopted	Impact
AS 22	Revenue Statement Approach	Emphasises on timing differences arising between accounting and tax profits for the reporting period
Ind AS 12	Balance Sheet Approach	Emphasises on timing differences arising between the carrying amounts of assets and liabilities in the balance sheet and its tax base.

Usually, there is no difference between the two approaches. However, some exceptional items may have a deferred tax impact in Ind AS 12 but not under AS 22. A few examples of such cases are:

- Deferred taxes on revaluation of tangible assets;
- The impact due to fair valuation of assets acquired in amalgamation;
- Goodwill arising in a business combination; and
- The tax base of an asset or liability on the initial recognition differs from its initial carrying amount. For example, when an entity benefits from a non-taxable government grant related to assets.

Measurement

Ind AS 12 and AS 22 have similar measurement principles. These are highlighted below:

- Deferred tax assets and liabilities are measured at the tax rates enacted or substantially enacted at the end of the reporting period.
- Present valuation (discounting) of deferred taxes is not permitted.

Recognition

Under AS 22, all tax expenses for the current period comprising of current and deferred taxes are to be included in the computation of profit or loss for the period. AS 22 is silent on the recognition of any tax income or expense outside profit and loss. According to an announcement by the Institute of Chartered Accountants of India (ICAI), any income or expense adjusted directly against the reserves and surplus must be net of its tax effect.

Likewise, Ind AS 12 prescribes that current and deferred taxes should be recognised as income or expense and should be included in the computation of profit and loss for the period. Ind AS 12 specifically prescribes the treatment for transactions/events to be recognised outside profit and loss. This can be broadly summarised as:

Particulars	Impact
Item/transaction recognised in Other Comprehensive Income (OCI)	Tax consequence of such items/transactions, whether current or deferred, will be recognised in OCI.
Item recognised in Equity	Tax consequence of such items/transactions, whether current or deferred, will be adjusted directly in Equity.

Prudence in recognising deferred tax assets:

Under AS 22, in cases of loss-making companies, deferred tax assets are recognised only to the extent that there is **virtual certainty supported by conclusive evidence** of the availability of future taxable income against which such deferred tax assets can be realised. The Expert Advisory Committee's opinion issued by the ICAI suggests restricting the recognition of a deferred tax asset to the extent of a supporting deferred tax liability and binding profitable orders.

Under Ind AS 12, deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which timing differences can be utilised.

Though, it is acknowledged that unused tax losses may be indicative of unavailability of future taxable profit, Ind AS 12 is not as stringent as AS 22. Loss-making companies are allowed to recognise deferred tax assets in cases where they do not have binding profitable orders. The exercise of significant judgement and convincing evidence are mandated in case such deferred tax assets are recognised.

Special Cases

Impact on Consolidated Financial Statements

While eliminating intercompany profits, AS 22 doesn't mandate entities to create deferred tax asset on the same. It was measured by simply adding deferred taxes of all the entities getting consolidated.

Dividend Distribution Tax

Taxes on the distributions of an entity are covered within the scope of Ind AS 12. A legitimate argument that arises here is whether the Dividend Distribution Tax (DDT) is to be treated as a tax covered under Ind AS 12 or as a withholding tax on dividend paid to the shareholders. The ICAI has clarified (through FAQs) that considering Indian income tax laws, DDT should be recognised under the statement of profit and loss only if the corresponding dividend is recognised as an expense. This will be applicable when an entity has issued compound instruments or redeemable preference shares since a portion of the dividend is considered as an expense in profit/loss.

If the dividend is recognised through Equity, DDT shall also be routed through equity. Accordingly, when the entity issues plain-vanilla equity shares, DDT, in respect of such shares, shall be recognised through equity.

Business Combination

In case of business combinations, the identifiable assets and liabilities assumed are recognised at their fair values as on the acquisition date. Temporary differences shall arise when the **tax bases** of the acquired assets and assumed liabilities are either unaffected or affected differently. For example, when the carrying amount of an asset is increased to its fair value but the tax base of the asset remains at cost to the previous owner, a taxable temporary difference arises which results in a deferred tax liability.

Additional Disclosures

Ind AS 12 requires more disclosures than AS 22. One of the key disclosures required is the reconciliation between tax expense and accounting profit.

The reconciliation can be given in both or either of the methods mentioned below:

- Reconciliation between tax expenses and accounting profits multiplied by the applicable tax rate; and
- Reconciliation between average effective tax rate and applicable tax rate.

Most of the entities were already doing such reconciliations as a part of their financial statements closure process. Now, Ind AS entities will have to disclose such reconciliations in their financial statements.

Other key additional disclosures required under Ind AS are:

- The tax expense of each component of OCI;
- An explanation for the changes in tax rates; and
- The amount of temporarily deductible differences, unused losses and credits for which no deferred tax asset is recognised in the financial statements.

First Time Adoption

Ind AS 101 – First Time Adoption of Indian Accounting Standards provides no exemption or exception to the first time adoption of Ind AS 12. Adjustments made in the balance sheet on the transition date shall have a deferred tax impact. Heavy reliance shall be placed on the management while recognising deferred tax assets.

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