

TABLE OF CONTENTS

| <u>SR. NO.</u> | <u>PARTICULARS</u> | <u>PAGE NO.</u> |
|-----------------------|---|------------------------|
| 1 | Ind AS 12 Income Taxes | 2-6 |
| 3 | Ind AS 21 The Effects of Changes in Foreign Exchange Rates | 7-11 |

Ind AS 12 INCOME TAXES

1. SCOPE & OBJECTIVE

Indian Accounting Standard (Ind AS) 12 *Income Taxes* should be applied for accounting for income taxes i.e. for the current and future tax consequences. Current tax is tax on current income. Deferred tax is future tax. Income taxes include foreign taxes and withholding taxes, which are payable by a subsidiary, associate or joint-venture on distributions to the reporting entity. Ind AS 12 deals with the accounting for temporary differences. There is no concept as “Permanent differences” in Ind AS 12.

Ind AS 12 does not deal with the methods of accounting for government grants and investment tax credits.

The principal issue in accounting for income taxes is how to account for the current and future tax consequences of:

- (a) the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity’s balance sheet; and
- (b) transactions and other events of the current period that are recognised in an entity’s financial statements.

2. KEY DEFINITIONS

- ✚ **Deferred tax assets** are tax recoverable in future with respect to deductible temporary differences, or c/f of unused losses or c/f of unused tax credits.
- ✚ **Temporary difference** is difference between carrying amount of asset/liability and its tax base.
- ✚ **Taxable temporary differences** are temporary differences that increase taxable profits of future and give rise to deferred tax liability.
- ✚ **Deductible temporary differences** are temporary differences that decrease taxable profits of future and give rise to deferred tax asset.
- ✚ **Tax base** is the amount attributed to that asset/liability for tax purpose.

- ✚ **TAX BASE ASSET:** The 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 economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

- ✚ **TAX BASE 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.

3. CURRENT TAX

Current tax provisions are similar to AS-22. There is an additional provision to create a (Tax due) asset to give effect of benefit of current losses that can be carried back to recover current profits of previous period. However there are no such provisions in Income Tax Act, 1961.

4. DEFERRED TAX

Balance sheet approach- The fundamental principle of Ind AS 12 is that an asset or liability will recover or settle in future and upon that if tax payments increase or decrease then deferred tax asset/liability accordingly is to be recognized based on manner of recovery, with certain limited exceptions. The exceptions are temporary differences arising on:

- (a) the initial recognition of goodwill (for deferred tax liability only); or
- (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 to Balance sheet Approach:- Some items e.g. research costs have a tax base but they are not recognised in the statement of financial position as they do not have carrying amount. If such items do affect taxable income of future, the effect of the same is to be considered for calculation of deferred tax.

Ind AS 12 requires recognition of all taxable temporary differences except the above exceptions. Ind AS 12 requires recognition of all deductible temporary differences to the extent they are probable to be recovered.

In case of investment in subsidiaries, branches, associates and joint ventures; temporary differences arises when the carrying amount of investment of the subsidiary, branch, associate or interest of investee, becomes different from the tax base (which is often cost) of the investment or interest. Ind AS 12 requires recognizing such temporary differences if the parent cannot control the timing of reversal of the temporary difference.

5. DEFERRED TAX ASSET

Deferred tax asset recognized for deductible temporary differences for sufficient probable reversible taxable profits available for adjustment shall be reassessed at each reporting period and adjusted for change of probability of sufficient taxable profits.

Probability of future taxable profit being available is if there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity in same period when deferred tax assets are expected to reverse or if in period of reversal tax loss arising from them can be carried forward or back or if tax planning opportunities are available

Ind AS 12 requires recognition of deferred tax assets arising from the carry forward of unused tax losses and tax credits same as deferred tax assets arising from deductible temporary differences. However, Ind AS 12 provides guidance on assessing the probability. An entity considers the following criteria in assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised:

- ✚ whether 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;
- ✚ whether it is probable that the entity will have taxable profits before the unused tax losses or unused tax credits expire;
- ✚ whether the unused tax losses result from identifiable causes which are unlikely to recur; and
- ✚ whether tax planning opportunities are available to the entity that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

6. RECOGNITION IN SPECIAL CASES

6.1. Business Combination

In case of Business combinations, apart from few exceptions in IFRS 3, the identifiable assets acquired and liabilities assumed are recognised at their fair values at the acquisition date. Temporary differences arise when the tax bases of the identifiable assets acquired and liabilities assumed are not affected by the business combination i.e. it remains the same as prior to acquisition or are affected differently. For example, when the carrying amount of an asset is increased to 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. Such deferred tax needs to be recognized.

6.2. Assets carried at fair value

In case of revaluation or use of fair value as required by other IFRSs, the recognition of deferred tax will depend on the respective treatment in Tax laws. If in income tax revaluation is permissible and is of same extent it may result into no temporary difference. However, if revaluation is not permissible or is different in tax, tax base will remain same or change and future economic benefits in case of recovery or sale will also change. So deferred tax would arise or change which shall be treated accordingly.

7. GOODWILL

Goodwill in Business combination is Purchase consideration less net assets.

Ind AS 12 does not permit the recognition of the resulting deferred tax liability on goodwill because goodwill is measured as a residual and the recognition of the deferred tax liability would increase the carrying amount of goodwill.

8. MEASUREMENT

Ind AS 12 requires measurement of taxes same as AS-22. Few major notes to the measurement principles are:

- ✚ Budgeted Tax rate- if substantive consider same
- ✚ Use average rate for different tax rates applied to different level of income.
- ✚ Tax rate and tax base to differ to reflect the tax consequences of manner of recovery or settlement.
- ✚ Tax rates vary when part of retained earnings or net profit is kept undistributed
- ✚ Deferred tax not to be discounted

9. ACCOUNTING

Ind AS 12 requires an entity to account for the tax consequence of transactions and other events in the same way that it accounts for the transactions and events. Any change in the carrying amount of deferred tax shall be accounted in the same way as the original accounting is done. Ind AS 12 allows use of Pro-rata allocation or appropriate method if any change in deferred tax cannot be related to particular event or transaction.

10. Offset

10.1. Current Tax

An entity shall offset current tax assets and current tax liabilities if the entity has a legally enforceable right to set off the recognised amounts; and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Current tax will be allowed to offset when it is of same entity, tax authority and authority permits it. In case of consolidation group as a whole should be allowed to set off and simultaneous realization is intended

10.2. Deferred tax

As an exception it may happen that the conditions fulfilled partially i.e. the legal enforceable right and intention to settle net is for some period but not for others. In such case a detailed schedule is required to show whether DTL of one entity will result in increased tax payments in future in same period in which DTL reverses and DTA in same period of reversal of another entity reduces tax payments. Then set off will be permitted.

11. DISCLOSURE

The major components of tax expense (income) shall be disclosed separately.

An entity shall disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:

- the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences;

- entity has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.

In case of undistributed profits by a subsidiary, an entity shall disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. In addition, the entity shall disclose the amounts of the potential income tax consequences practicably determinable and whether there are any potential income tax consequences not practicably determinable.

12. BASIC STEPS

- 12.1. Calculate tax base**
- 12.2. Calculate temporary difference**
- 12.3. Identify the temporary difference that give rise to deferred tax assets or liabilities**
- 12.4. Calculate deferred tax balance using appropriate tax rate**
- 12.5. Recognize deferred tax in income/equity/ as an adjustment to goodwill**

Ind AS 21- THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES

1. OBJECTIVE OF Ind AS 21

- ✚ To prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity
- ✚ To translate financial statements into a presentation currency.
- ✚ The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements.

2. KEY DEFINITIONS

- ✚ **Functional currency:** The currency of the primary economic environment in which the entity operates.
- ✚ **Foreign Currency:** The Currency other than the functional currency of an entity.
- ✚ **Presentation currency:** The currency in which the financial statements are presented.
- ✚ **Exchange difference:** the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.
- ✚ **Foreign operation:** a subsidiary, associate, joint venture, or branch whose activities are based in a country or currency other than that of the reporting entity.

3. DETERMINATION OF FUNCTIONAL CURRENCY

The functional currency should be determined by looking at several factors. This currency should be the one in which the entity normally generates and spends cash and in which transactions are normally denominated. It reflects the Primary Economic Environment in which the entity operates. Indicators of such currency are :-

The currency that:-

Primary Indicators:

- ✚ Influence on SALES PRICE, and
- ✚ Influence on COST- Labour , Material and other cost
- ✚ influence the entity's pricing structure

Other Indicators:

- ✚ Where Funds from Financing Activities are generated
- ✚ Receipts of Operating activities are retained

For Foreign Operation there are few additional indicators to functional currency:-

Additional Indicators:

- ✚ Foreign Operation is an extension of reporting Entity
- ✚ Transaction with reporting entity are a high or low proportion of foreign Enterprise
- ✚ Cash Flows from activities of Foreign operation affect the cash flows of Reporting Entity
- ✚ Cash Flows from activities of Foreign Operations are sufficient to service the normally expected debt obligation without funds made available by reporting Enterprise

All transactions in currencies other than the functional currency are treated as transactions in foreign currencies.

4. BASIC STEPS FOR TRANSLATING FOREIGN CURRENCY AMOUNTS INTO THE FUNCTIONAL CURRENCY

Steps apply to a stand-alone entity, an entity with foreign operations (such as a parent with foreign subsidiaries), or a foreign operation (such as a foreign subsidiary or branch).

1. the reporting entity determines its functional currency
2. the entity translates all foreign currency items into its functional currency

5. FOREIGN CURRENCY TRANSACTIONS

A foreign currency transaction should be recorded initially at the rate of exchange at the date of the transaction (use of averages is permitted if they are a reasonable approximation of actual).

At each subsequent balance sheet date:

- ✚ foreign currency monetary amounts should be reported using the closing rate
- ✚ non-monetary items carried at historical cost should be reported using the exchange rate at the date of the transaction
- ✚ non-monetary items carried at fair value should be reported at the rate that existed when the fair values were determined

Exchange differences arising when monetary items are settled or when monetary items are translated at rates different from those at which they were translated when initially recognised or in previous financial statements are reported in profit or loss in the period, with following two exceptions:-

- ✚ The exception is that exchange differences arising on monetary items that form part of the reporting entity's net investment in a foreign operation are recognised, in the consolidated financial statements that include the foreign operation, in other comprehensive income; they will be recognised in profit or loss on disposal of the net investment.
- ✚ The second exception is an irrevocable option provided to companies whereby they can choose to recognize and accumulate exchange differences arising on restatement of long-term foreign currency monetary items, directly in equity. The amount so accumulated in equity will be transferred to profit or loss over the period of maturity of the item, in an appropriate manner. The option, once selected, is irrevocable and needs to be applied to all such items. The option provided is not available for the long-term monetary assets and long-term monetary liabilities during the period they are classified as at fair value through profit or loss in accordance with Ind AS 39, either because they are held for trading or because of their designation as at fair value through profit or loss. The option provided shall be exercised for the first time when the exchange difference arising on a long-term

monetary asset or a long-term monetary liability is recognised. A monetary asset or a monetary liability shall be treated as long-term, if that asset or liability has a maturity period of twelve months or more from the date of the initial recognition of that asset or liability.

As regards a monetary item that forms part of an entity's investment in a foreign operation, the accounting treatment in consolidated financial statements should not be dependent on the currency of the monetary item. Also, the accounting should not depend on which entity within the group conducts a transaction with the foreign operation.

If a gain or loss on a non-monetary item is recognised in other comprehensive income (for example, a property revaluation under Ind AS 16), any foreign exchange component of that gain or loss is also recognised in other comprehensive income.

6. CHANGE IN THE FUNCTIONAL CURRENCY

When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

The functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency.

The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost. Exchange differences arising from the translation of a foreign operation previously recognised in other comprehensive income are not reclassified from equity to profit or loss until the disposal of the operation. When the irrevocable option to accumulate exchange differences arising on restatement of long-term foreign currency monetary items, directly in equity is exercised, such exchange differences are not transferred to profit or loss immediately on change of the entity's functional currency. They shall continue to be transferred to profit or loss in the same manner as they were previously transferred.

7. TRANSLATION FROM THE FUNCTIONAL CURRENCY TO THE PRESENTATION CURRENCY

The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy are translated into a different presentation currency using the following procedures:

- ✚ assets and liabilities for each balance sheet presented (including comparatives) are translated at the closing rate at the date of that balance sheet. This would include any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation are treated as part of the assets and liabilities of the foreign operation
- ✚ income and expenses for each income statement (including comparatives) are translated at exchange rates at the dates of the transactions; and
- ✚ all resulting exchange differences are recognised in other comprehensive income.

Any exchange difference that relates to the minority interest is recognized in the balance sheet amount.

Special rules apply for translating into a different presentation currency the results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy. All amounts are translated at the closing spot rate. The one exception is that the comparative amounts will be shown as presented in the previous period.

8. TRANSLATION OF A FOREIGN OPERATION

When preparing group accounts, it is normal to deal with entities that utilize different currencies. The financial statements should be translated into the presentation currency.

Any goodwill and fair value adjustments are treated as assets and liabilities of the foreign entity and therefore are retranslated at each balance sheet date at the closing spot rate.

Exchange differences on intra-group items are recognized in profit or loss unless the difference arises on the retranslation of an entity's net investment in a foreign operation when it is classified as equity.

Dividends paid in a foreign currency by a subsidiary to its parent company may lead to exchange differences in the parent's financial statements and will not be eliminated on consolidation but recognized in profit or loss.

When the irrevocable option provided to accumulate exchange differences arising on restatement of long-term foreign currency monetary items, directly in equity is exercised, in the consolidated financial statements of the reporting entity, such an exchange difference is directly recognised in equity and disposed of in the an appropriate manner.

9. DISPOSAL OF A FOREIGN OPERATION

When a foreign operation is disposed of, the cumulative amount of the exchange differences recognised in other comprehensive income and accumulated in the separate component of equity relating to that foreign operation shall be recognised in profit or loss when the gain or loss on disposal is recognised. In case of partial disposal the same is to be proportionately

differentiated and transferred to profit and loss A/c. However if there is partial disposal of a subsidiary then the proportionate exchange difference should be transferred to Non Controlling Interest.

10. DISCLOSURE

- ✚ The amount of exchange differences recognised in profit or loss (excluding differences arising on financial instruments measured at fair value through profit or loss in accordance with Ind AS 39)
- ✚ Net exchange differences recognised in other comprehensive income and accumulated in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period
- ✚ When the presentation currency is different from the functional currency, disclose that fact together with the functional currency and the reason for using a different presentation currency
- ✚ A change in the functional currency of either the reporting entity or a significant foreign operation and the reason therefore

When an entity presents its financial statements in a currency that is different from its functional currency, it may describe those financial statements as complying with IFRS only if they comply with all the requirements of each applicable Standard (including Ind AS 21) and each applicable Interpretation

11. CONVENIENCE TRANSLATIONS

Sometimes, an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency simply by translating all amounts at end-of-period exchange rates. This is sometimes called a convenience translation. A result of making a convenience translation is that the resulting financial information does not comply with all IFRS, particularly Ind AS 21. In this case, the following disclosures are required:

- ✚ Clearly identify the information as supplementary information to distinguish it from the information that complies with IFRS
- ✚ Disclose the currency in which the supplementary information is displayed
- ✚ Disclose the entity's functional currency and the method of translation used to determine the supplementary information.