Ind AS Technical Facilitation Group Clarification Bulletin 23

Ind AS Technical Facilitation Group (ITFG) of Ind AS Implementation Committee has been constituted for providing clarifications on timely basis on various issues related to the applicability and /or implementation of Ind AS under the Companies (Indian Accounting Standards) Rules, 2015, and other amendments finalised and notified till March 2019, raised by preparers, users and other stakeholders. Ind AS Technical Facilitation Group (ITFG) considered the following issues received from members and decided to issue following clarifications[1] on October 26, 2019 as these are relevant in context of Ind AS financial statements/results for the quarter ended 30 September 2019.

Issue 1:

The Taxation Laws (Amendment) Ordinance, 2019 (or 'the Ordinance'), promulgated by the President of India, was published in the Gazette of India on 20 September, 2019. The Ordinance came into force immediately upon its publication in the Gazette.

The Ordinance has brought about significant changes to corporate income-tax rates. The Ordinance provides an option to domestic companies to pay income-tax at a lower rate (22% or 15%, depending on the conditions specified in this behalf) instead of the normal rate of 30%. However, a domestic company can avail of the lower tax rate only if it opts for not availing of certain exemptions or incentives specified in this behalf in the Ordinance.

Whether a domestic company can give effect to lower tax rate as per the Ordinance while determining current tax and deferred tax assets or liabilities for the purpose of presenting interim results/ interim financial statements as of 30 September 2019?

Response:

Paragraphs 46, 47 and 51 of Ind AS 12, *Income Taxes*, state as follows:

"46 Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

47 Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates

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[1] Clarifications given or views expressed by the Ind AS Technical Facilitation Group (ITFG) represent the views of the ITFG and are not necessarily the views of the Ind AS Implementation Committee or the Council of the Institute. The clarifications/views are based on the accounting principles as on the date the Group finalises the particular clarification. The date of finalisation of this Bulletin is October 26, 2019. The clarification must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of clarifications by the ITFG. The clarifications given are only for the accounting purpose. The commercial substance of the transaction and other legal and regulatory aspects has not been considered and may have to be evaluated on case to case basis.

(and tax laws) that have been enacted or substantively enacted by the end of the reporting period."

"51 *The measurement of deferred tax liabilities and deferred tax assets shall reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities"*

In the given case, the Ordinance came into force on 20 September 2019. Thus, the lower tax rate has been "enacted" by the interim reporting date of 30 September 2019. However, considering the requirements of above paragraphs of Ind AS 12, the lower tax rates as per the Ordinance should be applied by a company for measurement of current and deferred taxes only if it expects to opt for the lower rates.

Accordingly, if a company's intention to opt for lower tax rate is appropriately evidenced, lower tax rate as per the Ordinance should be given effect to while determining the current tax and deferred tax assets or liabilities for the purpose of presenting interim results/interim financial statements for the quarter/half-year ended 30 September 2019.

It may be clarified that where a company expects to avail of the lower tax rate only from a later financial year (say, from financial year 2020-21), it should apply the lower tax rate in measurement of deferred taxes only to the extent that the deferred tax assets are expected to be realised or deferred tax liabilities are expected to be settled in the periods during which the company expects to be subject to lower tax rate. To the extent deferred tax assets are expected to be realised or deferred tax liabilities are expected to be settled in earlier periods, the normal tax rate should be applied.

Issue 2:

At the time of first-time adoption of Ind ASs, Entity X made adjustments resulting from recognition of deferred tax assets and deferred tax liabilities directly in equity as per the requirements of Ind AS 101, *First-time Adoption of Indian Accounting Standards.* Subsequently, it made similar adjustments for tax effects directly in equity at the time of initial application of Ind AS 115, *Revenue from Contracts with Customers* and Ind AS 116, *Leases.*

Entity X has decided to avail the lower tax rate in financial year 2019-20 as per the Taxation Laws (Amendment) Ordinance, 2019. As a result of change in tax rate, the above referred deferred tax assets and deferred tax liabilities, to the extent unrealised/not settled, would be required to be remeasured.

Whether Entity X should recognise the resultant differences in amount of deferred tax assets and deferred tax liabilities arising from change in tax rates directly in equity?

Response:

Paragraph 57 of Ind AS 12, *Income Taxes*, lays down the principle for accounting of current and deferred tax effects, "Accounting for the current and deferred tax effects of a transaction or other event is consistent with the accounting for the transaction or event itself…." Ind AS 12, further states the following with regard to where in the financial statements (i.e., in profit or loss, in other comprehensive income, or directly in equity) should the current and deferred tax be recognised:

> *"58 Current and deferred tax shall be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from:*
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> *(a) a transaction or event which is recognised, in the same or a different period, outside profit or loss, either in other comprehensive income or directly in equity (see paragraphs 61A -65); or*
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> *(b) a business combination (other than the acquisition by an investment entity, as defined in Ind AS 110, Consolidated Financial Statements, of a subsidiary that is required to be measured at fair value through profit or loss) (see paragraphs 66 -68)."*

> "60 *The carrying amount of deferred tax assets and liabilities may change even though there is no change in the amount of the related temporary differences. This can result, for example, from:*
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> (a) *a change in tax rates or tax laws;*
>
> (b) *……….*
>
> *The resulting deferred tax is recognised in profit or loss, except to the extent that it relates to items previously recognised outside profit or loss. "*

Further paragraph 61A of Ind AS 12 states as follows:

> *"61A Current tax and deferred tax shall be recognised outside profit or loss if the tax relates to items that are recognised, in the same or a different period, outside profit or loss. Therefore, current tax and deferred tax that relates to items that are recognised, in the same or a different period:*
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> *(a) in other comprehensive income, shall be recognised in other comprehensive income (see paragraph 62).*
>
> *(b) directly in equity, shall be recognised directly in equity (see paragraph 62A)."*

As per the above, an entity is required to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in profit or loss, any related tax effects are also recognised in profit or loss. For transactions and other events recognised outside profit or loss (either in other comprehensive income or directly in equity), any related tax effects are also recognised outside profit or loss (either in other comprehensive income or directly in equity, respectively).This raises the issue whether the changes in amounts arising from remeasurement of deferred tax assets or deferred tax liabilities at lower tax rates introduced by the Ordinance should be recognised directly in equity in respect of deferred tax assets or deferred tax liabilities which were recognised by corresponding adjustment to equity at the time of first-time adoption of Ind ASs or at the time of initial application of Ind AS 115, *Revenue from Contracts with Customers*, to the extent still unrealised/ not settled, or Ind AS 116, *Leases*.

It is important to note that adjustments to equity in respect of deferred tax assets or deferred tax liabilities in the aforesaid circumstances do not necessarily mean that the items to which these deferred taxes relate were recognised "directly in equity" in the sense in which this term is used in paragraphs 58 and 61A of Ind AS 12 reproduced above. The 'transaction or event' in paragraphs 57 and 58(a), refers to the source which gave rise to the deferred tax implication. Consequently, the words 'directly in equity' in paragraphs 58(a) and 61A(b), relate to the base transaction/event. In other words, the deferred tax accounting follows the accounting of the source transactions/ events. Consider, for example, the following:

- At the time of first-time adoption of Ind ASs, an entity restates a previous business combination which it had accounted for under the previous GAAP on book value basis. As a result of restatement of the business combination, the entity recalculates the depreciation charge for items of property, plant and equipment acquired as part of the business combination based on their acquisition-date fair values for the previous periods from the date of business combination to the date of transition to Ind ASs and adjusts the resultant increase (or decrease) in cumulative depreciation in retained earnings as on the date of transition to Ind ASs. In doing so, the entity is in effect restating the depreciation charge in profit or loss for each of the previous periods from the date of business combination to the date of transition to Ind ASs. If the entity presents comparative information for all such previous periods, the increased (or reduced) depreciation for a period would be reflected in profit or loss for that period. Thus, the cumulative adjustment to retained earnings at the date of transition to Ind ASs is not an adjustment "directly in equity" for purposes of paragraphs 58 and 61A."

- At the time of first-time adoption of Ind ASs, an entity remeasures investments in certain equity instruments at 'fair value though other comprehensive income'. The investments in these instruments were measured at cost less diminution (other than temporary in nature) under the entity's previous GAAP. The entity adjusts the resultant increase in carrying amount of the investments in an appropriate equity head (e.g. Other comprehensive income) on the date of transition to Ind ASs. In doing so, the entity is in effect reflecting the fair value changes in other comprehensive income for each of the previous periods up to the date of transition to Ind ASs. If the entity presents comparative information for all such previous periods, the increase (or decrease) in the fair value for a period would be reflected in other comprehensive income for that period. Thus, the cumulative adjustment to equity at the date of transition to Ind ASs is not a transaction or event recognised "directly in equity" for purposes of paragraphs 58 and 61A. The remeasurement of deferred taxes on such items shall be recognised in OCI.

- At the time of first-time adoption of Ind ASs, an entity adjusts the unamortised balance of costs of issue of equity shares in an appropriate equity head on the date of transition to Ind ASs. The adjustment is made on the basis of requirement of Ind AS 32 that "transaction costs of an equity transaction shall be accounted for as a deduction from equity." Accordingly, even if the entity were an existing adopter of Ind ASs at the time of issuance of the equity share, it would have adjusted the issue costs directly in equity. Thus, the adjustment to equity at the date of transition to Ind ASs is an adjustment "directly in equity" for purposes of paragraphs 58 and 61A. The remeasurement of deferred taxes on such items shall be recognised directly in equity.

An entity should determine the nature of the underlying items with respect to which deferred taxes were recognised by it at the time of first-time adoption of Ind ASs or at the time of initial application of Ind AS 115 or Ind AS 116. For example, for Ind AS adjustments made on first-time adoption of Ind AS, it needs to be determined (using the entity's current accounting policies) where the items on which the original deferred tax arose would have been recognised if Ind AS had been applied in the earlier periods.

Accordingly, depending on the nature of an item, the change in the amount of the related deferred tax asset or deferred tax liability resulting from the remeasurement of the same at lower tax rates introduced by the Ordinance should be recognised in profit or loss, other comprehensive income or directly in equity as required by paragraphs 58 and 61A of Ind AS 12.