ACCOUNTING STANDARD – 22 ACCOUNTING FOR TAXES ON INCOME

OBJECTIVE OF AS 22	1. Income tax liability is determined in accordance with the prevailing tax laws 2. A business entity may recognise various items of income or expense in an accounting period 3. But for tax purposes, they may be considered in a different period 4. Results in a tax expense/liability not matching with the items of income/expense recognized in that period
NOT APPLICABLE TO	This Standard does not specify when, or how, an enterprise should account for taxes that are payable on distribution of dividends and other distributions made by the enterprise.
DEFINITIONS	1. **Accounting income :** is the Net Profit or Loss for a period, as reported in the statement of profit and loss, before deducting income tax expense or adding income tax saving. 2. **Taxable income (tax loss):** is the amount of the income (loss) for a period, determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined. 3. **Current tax:** is the amount of Income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period. 4. **Deferred tax:** is the tax effect of timing differences 5. **Timing differences:** are the differences between taxable income and accounting income for a period that originate in one period and are capable of reversal in one or more subsequent periods. 6. **Permanent differences:** are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently. Permanent differences do not result in deferred tax assets or deferred tax liabilities. 7. **Tax Expense (Tax Saving):** is the aggregate of Current tax and Deferred tax charged or credited to the statement of profit and loss for the period. Tax Expense = Current Tax Expense + Deferred Tax Expense – DT Income
EXAMPLES OF TIMING DIFFERENCES	1. Depreciation as per Companies Act different from Depreciation as per Income Tax (Sec 32 of IT Act) – Resulting DTA or DTL 2. Sec 43B of Income Tax Act (Deductions available on cash basis not on provision basis – Bonus, Interest, PF etc) – resulting DTA 3. Preliminary Expenses deduction allowed in 5 years as per Income Tax, but as per AS 26 fully written off – resulting DTA

	4. Scientific Research Expenses or Specified Expenses allowed 100% in the same year however in the Books only part is written off. 5. Provision for Doubtful debts disallowed under IT Act until actual bad debts occur.
EXAMPLES OF PERMANENT DIFFERENCES	1. Personal Expenses disallowed always, never allowed in the Future 2. Donations to unspecified trust – Disallowed always
UNABSORBED DEPRECIATION AND CARRY FORWARD OF LOSSES	(a) Unabsorbed depreciation and (b) Carry forward of Losses which can be set off against future taxable income are also considered as timing difference and result in deferred tax assets, subject to consideration of prudence.
RECOGNITION	**Current Tax:** Amount of income-tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period **Deferred Tax:** Deferred tax is the tax effect of timing difference. Tax expenses (on accrual basis) - current tax liability (as per income-tax act) = Deferred tax (assets / liability)
MEASUREMENT	**Current Tax**: Measured at the amount expected to be paid to (recovered from) taxation authorities using applicable tax rates and tax laws. **Deferred Tax:** Deferred tax should be measured using the rates and tax laws that have been enacted or substantially enacted by the balance sheet date.
REVIEW OF DEFERRED TAX ASSETS	The carrying amount of deferred tax assets should be reviewed at each balance sheet date.
ACCOUNTING FOR TAXES ON INCOME:	see table below
RE-ASSESSMENT OF UNRECOGNISED DEFERRED TAX ASSETS	At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets. The enterprise recognises previously unrecognised deferred tax assets to the extent that it has become reasonably certain or virtually certain, as the case may be , that sufficient future

Accounting for taxes on income:

Situation	Status
(i) Accounting Income > Taxable Income	Create Deferred Tax Liability Profit & Loss Account Dr. To Deferred Tax Liability A/c
(ii) Accounting Income < Taxable Income	Create Deferred Tax Assets Deferred Tax Assets A/c Dr. To Profit & Loss A/c

	taxable income will be available against which such deferred tax assets can be realised.
TAX HOLIDAY	1. The deferred tax in respect of timing differences which reverse during the tax holiday period, should not be recognized to the extent the gross total income of the enterprise is subject to such deductions 2. The deferred tax in respect of timing difference which reverse after the tax holiday period should be recognized in the year in which the timing differences originate, subject to consideration of prudence 3. Timing differences which originate first should be considered as reversing first.
DISCLOSURE	• The break-up of deferred tax asset / liability should be disclosed. • In case of deferred tax asset arises out of unabsorbed depreciation or loss, evidence supporting recognition should be disclosed. • Deferred tax asset / liability should be disclosed separately from current asset / liabilities. • Deferred tax asset and liability should be set off if permissible under the tax laws but to be shown separately if not permissible

LETS PRACTICE SOME QUESTION:

QUESTION 1:

Classify the following as Timing Difference and Permanent Difference and also state whether they would result in Deferred Tax Asset or Deferred Tax Liability:

(a) Unabsorbed depreciation

(b) Income tax penalty

(c) Interest on loan taken from scheduled bank accounted in the books, but not paid till the date of filing Return of Income.

Solution:

Particulars	Nature of difference	DTA/ DTL
Unabsorbed depreciation	Timing Difference	DTA
Income tax penalty	Permanent Difference	Neither DTA nor DTL to be created
Interest on loan taken from scheduled bank accounted in	Permanent Difference	Neither DTA nor DTL to be created

the books, but not paid till the date of filing Return of Income.		

QUESTION 2:

Parshuram Ltd., which commenced its operations in 2019-20, provides the following details:

Financial year	Profit before tax	Timin Difference	Permanent Difference	Corporate tax rate	Remarks
2019-20	28,00,000	+ 3,15,000	+ 3,50,000	40%	Reversible in 2022-23
2020-21	31,50,000	+ 2,10,000	+ 2,80,000	38%	Reversible in 2021-22
2021-22	35,00,000	- 70,000	+ 3,15,000	35%	Reversible in 2022-23
2022-23	24,50,000	Nil	+ 4,20,000	30%	--

You are required to calculate the amount of Current Tax for the four financial years.

Solution: Calculation of Current Tax (in ₹ Lakhs)

Particulars	2019-20	2020 - 21	2021-22	2022-23
Profit before tax	28.00	31.5	35.00	24.50
Timing Differences	3.15	2.10	(0.70)	Nil
Permanent Differences	3.50	2.80	3.15	4.20
Taxable Income	34.65	36.40	37.45	28.70
Corporate tax rate	40%	38%	35%	30%
Current Tax (Taxable Income Tax rate)	13.86	13.832	13.1075	8.61

QUESTION 3:

The following information is available from the records of Vishnu Ltd.:

Depreciation charged to income statement ₹ 8,00,000; Depreciation u/s 32 of Income Tax Act ₹ 20,00,000; Unamortised preliminary expenditure as per income tax records ₹ 1,50,000.

It is communicated that there is adequate evidence of future profit sufficiency. Given that the corporate tax rate is 40%, you are required to ascertain the amount of deferred tax asset/ deferred tax liability to be created in this situation.

Solution: Timing Difference = Additional depreciation as per Income Tax Act (-) Preliminary expenditure to be allowed = ₹ (20,00,000 – 8,00,000) - 1,50,000 = ₹ 10,50,000.

Deferred Tax Liability = ₹ 10,50,000 40% = ₹ 4,20,000.

QUESTION 4:

AB Ltd. has provided depreciation as per accounting records ₹8,00,000 and as per tax records ₹14,00,000. Unamortized preliminary expenses, as per tax record is ₹11,200. There is adequate evidence of future profit sufficiency. How much deferred tax asset / liability should be recognized as transition adjustment. Tax rate is 40%.

Solution:

As per AS-22 deferred tax should be recognized for all the timing differences. In the instant case the timing difference i.e., difference between taxable income and accounting income is –

Excess depreciation as per tax ₹14,00,000 – ₹8,00,000 =	₹6,00,000
Less: Expenses provided in taxable income ₹	11,200
₹	5,88,800

As tax expense is more than the current tax due to timing difference of ₹5,88,800, therefore deferred tax liability = 40% of ₹5,88,800 = ₹2,35,520 shall be credited in accounts.

QUESTION 5:

Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognises revenue from these contracts on percentage of completion method for financial statements during 20X0-20X1, 20X1-20X2 and 20X2-20X3 for ₹ 11,00,000, ₹ 16,00,000 and ₹ 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognised revenue of ₹ 7,00,000, ₹ 18,00,000 and ₹ 23,00,000 for the years 20X0-20X1, 20X1-20X2 and 20X2-20X3 respectively. Income-tax rate is 35%. Compute the amount of deferred tax asset/liability for the years 20X0-20X1, 20X1- 20X2 and 20X2-20X3.

Solution:

Calculation of Deferred Tax Asset/Liability in Omega Limited

Particulars	2014-15	2015-16	2016-17
Income as per Books	11,00,000	16,00,000	21,00,000
Taxable income as per Income tax	7,00,000	18,00,000	23,00,000
Timing Difference (Balance)	4,00,000	2,00,000	Nil
Current tax @ 35%	3,85,000	5,60,000	7,35,000
Deferred Tax Liability	1,40,000	70,000	Nil