AS 22 : Accounting for Taxes on Income

(This AS allocates tax expense on systematic basis to each year)

Accounting Income ≠ Taxable Income

Tax on Accounting Income ≠ Tax on Taxable Income

Tax Expense ≠ Current Tax

Tax Expense = Current Tax ± Deferred Tax

(Debited in P&L) (As per Tax Laws) (Tax Effect on Timing Differences : DTL / DTA)

Definitions :

Accounting Income : Net Profit / Loss as per Statement of P&L

Taxable Income : Income / Loss as per Tax Laws

Tax Expense : Current Tax ± Deferred Tax

Current Tax : Tax calculated as per tax laws

Deferred Tax : Tax effect on Timing Differences

Timing Differences : Differences between Taxable Income & Accounting Income that originate in one period & capable of reversal in subsequent period
(DTL / DTA recognised in respect of Timing Differences)

Permanent Difference : Other than Timing Differences
(No DTL / DTA in respect of Permanent Differences)

Differences between Accounting Income & Taxable Income

Timing Differences

Example:

- Depreciation Difference
- Expenditure allowed/deductible on cash/payment basis (Sec 43B)
- Deferred Revenue Exp. (Preliminary Expenses)

DTL / DTA to be created/recognised

(DTL: Deferred Tax Liability & DTA: Deferred Tax Asset)

Accounting Income > Taxable Income

Fresh/New Diff.: DTL = Timing Diff. x Tax Rate

Earlier Diff.: Reversal of DTA

Accounting Income < Taxable Income

Fresh/New Diff.: DTA = Timing Diff. x Tax Rate

Earlier Diff.: Reversal of DTL

Permanent Differences

Example:

- Exempted Income
- Donation to private trusts
- Fines & Penalties

No recognition of DTL/DTA

Notes:

1) DTA / DTL should not be discounted to their present value.
2) DTA/DTL should be disclosed under Non current Assets/Non Current Liabilities in Balance sheet
3) If there is change in tax rate then computation of DTA/DTL to be done on cumulative basis. (ie. Balance sheet value to be computed)

Recognition of DTA: If there is reasonable certainity that there will be future taxable income

Special case: Unabsorbed Depreciation & carry forward of Losses:

Create DTA if there is virtual certainity with convincing evidence (VCCE) that there will be future taxable income against which DTA can be adjusted.

Note: At each Balance sheet date, entity need to review whether any unrecognised DTA to be recognised due to probable future taxable income.

Entity having Tax Holiday:

- Timing Differences which arise in tax holiday & are capable of reversal in tax holiday will be ignored.
- Timing Differences which originate first should be considered to reverse first (FIFO Basis)

Example: Tax holiday period Y_1 to Y_5. Tax Rate 30%.

	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7
Dep. as per books	10000	10000	10000	10000	10000	10000	10000
Dep. as per Tax	19000	16000	12000	8000	6000	5000	4000

Minimum Alternate Tax (MAT): Sec 115JB of Income Tax Act, 1961

Tax Payable for the year = Higher of (Taxable Income X Tax Rate) OR (Book Profit X MAT Rate)

Mat credit: Excess of MAT paid over Tax on Total Income.

Case 1

Taxable Income = 10,00,000 Book Profit = 25,00,000
Tax Rate = 30% MAT Rate = 15%

Case 2

Taxable Income = 10,00,000 Book Profit = 12,00,000
Tax Rate = 30% MAT Rate = 15%

Deferred Tax: To be calculated using regular tax rate & not MAT rate.

Tax Expense = Current Tax ± Deferred Tax

⇓ (Current Tax) Tax liability as per Provisions of Income tax & not tax payable as per Sec 115JB.

Tax Debited in P&L = Current Tax + MAT credit (Excess of MAT over current Tax) + Deferred Tax

Tax Rates:

Current Tax: Use Tax rate that is applicable to current period.

Deferred Tax: Use Tax rate that have been enacted or substantively enacted by the balance sheet date (ie use future tax rate if announced by Government before year end)

Example: CY 25-26 Tax Rate 30%

In 25-26 Govt. announced / proposed 25% tax rate for future years.

Current Tax → 30%. Deferred Tax → 25%.