

AS 22 – ACCOUNTING FOR TAXES ON INCOME

Illustration 1 (RTP Nov'20, Past Exam May'18, May'19)

Rama Ltd., has provided the following information:

	₹
Depreciation as per accounting records	= 2,00,000
Depreciation as per income tax records	= 5,00,000
Unamortised preliminary expenses as per tax record	= 30,000

There is adequate evidence of future profit sufficiency. How much net deferred tax asset/liability should be recognised as transition adjustment? Tax rate 50%. (5 Marks)

Solution

Table showing calculation of deferred tax asset / liability

Particulars	Amount	Timing differences	Deferred tax	Amount @ 50%
	₹			₹
Excess depreciation as per tax records (₹ 5,00,000 – ₹ 2,00,000)	3,00,000	Timing	Deferred tax liability	1,50,000
Unamortised preliminary expenses as per tax records	30,000	Timing	Deferred tax asset	(15,000)
Net deferred tax liability			1,35,000	

Illustration 2 (Past Exam Nov'19, Nov'20) (RTP Nov'19, Nov'23)

From the following details of A Ltd. for the year ended 31-03-20X1, calculate the deferred tax asset/ liability as per AS 22 and amount of tax to be debited to the Profit and Loss Account for the year.

Particulars	₹
Accounting Profit	6,00,000
Book Profit as per MAT	3,50,000
Profit as per Income Tax Act	60,000
Tax rate	20%
MAT rate	7.50%

Solution

(5 Marks)

Tax as per accounting profit $6,00,000 \times 20\% = ₹ 1,20,000$

Tax as per Income-tax Profit $60,000 \times 20\% = ₹ 12,000$

Tax as per MAT $3,50,000 \times 7.50\% = ₹ 26,250$

Tax expense= Current Tax +Deferred Tax

₹ 1,20,000 = ₹ 12,000+ Deferred tax

Therefore, Deferred Tax liability as on 31-03-20X1

= ₹ 1,20,000 – ₹ 12,000 = ₹ 1,08,000

Amount of tax to be debited in Profit and Loss account for the year 31-03-20X1

Current Tax + Deferred Tax liability + Excess of MAT over current tax

= ₹ 12,000 + ₹ 1,08,000 + ₹ 14,250 (26,250 – 12,000) = ₹ 1,34,250

Illustration 3

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.20X1. For the years ending 31.3.20X2 and 31.3.20X3, it made profits of ₹ 1,00,000 and ₹ 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for eight years and tax rate is 40%. By the end of 31.3.20X1, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the years ending 20X2 and 20X3 for tax purposes. Prepare a statement of Profit and Loss for the years ending 20X1, 20X2 and 20X3.

Solution**Statement of Profit and Loss**

	31.3.20X1	31.3.20X2	31.3.20X3
	₹	₹	₹
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax (20,000 x 40%)			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year (2,00,000 x 40%)	80,000		
Tax effect of timing differences reversed/adjusted during the year (1,00,000 x 40%)		(40,000)	(40,000)
Profit (Loss) After Tax Effect	(1,20,000)	60,000	72,000

Illustration 4

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**

Year	Accounting Income	Taxable Income	Timing Difference	Timing Difference (balance)	Deferred Tax	Deferred Tax Liability (balance)
20X0- 20X1	11,00,000	7,00,000	4,00,000	4,00,000	1,40,000	1,40,000
20X1- 20X2	16,00,000	18,00,000	(2,00,000)	2,00,000	(70,000)	70,000
20X2- 20X3	21,00,000	23,00,000	(2,00,000)	NIL	(70,000)	NIL
	48,00,000	48,00,000				

Illustration 5 (Past Exam, May'19)

Write short note on Timing differences and Permanent differences as per AS 22.

(5 Marks)**Solution**

In current practices, companies, in general, prepare books of accounts as per Companies Act, 2013 generating Accounting Profit/Loss and Income-tax Act, 1961 generating Taxable Profit/Loss. Accounting income and taxable income for a period are seldom the same. Permanent differences are those which arise in one period and do not reverse subsequently. For e.g., an income exempt from tax or an expense that is

not allowable as a deduction for tax purposes. Timing differences are those which arise in one period and are capable of reversal in one or more subsequent periods. For e.g., Depreciation Bonus, etc.

Illustration 6 (MTP Oct 19) (RTP Nov'18)

Y Ltd. is a full tax free enterprise for the first ten years of its existence and is in the second year of its operation. Depreciation timing difference is INR 200 lakhs and INR 400 lakhs respectively which will result in a tax liability in year 1 and 2. From the third year it is expected that the timing difference would reverse each year by INR 10 lakhs. Assuming tax rate of 40%, find out the deferred tax liability at the end of the second year and any charge to the Profit and Loss account. **(5 Marks)**

Solution

As per AS 22, 'Accounting for Taxes on Income', deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Income tax Act. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence. For this purpose, the timing differences which originate first should be considered to reverse first.

Out of 200 lakhs timing difference due to depreciation, difference amounting 80 lakhs (10 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognised. However, for 120 lakhs (200 lakhs – ₹ 80 lakhs), deferred tax liability will be recognised for 48 lakhs (40% of 120 lakhs) in first year. In the second year, the entire amount of timing difference of ₹ 400 lakhs will reverse only after tax holiday period and hence, will be recognised in full. Deferred tax liability amounting 160 lakhs (40% of 400 lakhs) will be created by charging it to profit and loss account and the total balance of deferred tax liability account at the end of second year will be 208 lakhs (48 lakhs + 160 lakhs).

Illustration 7

Ultra Ltd. has provided the following information:

Depreciation as per accounting records = INR 4,00,000

Depreciation as per tax records = INR 10,00,000

Unamortized preliminary expenses as per tax record = INR 30,000

There is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognized as transition adjustment when the tax rate is 50%?

Solution

Calculation of difference between taxable income and accounting income

Particulars	Amount (₹)
Excess depreciation as per tax ₹ (10,00,000 – 4,00,000)	6,00,000
Less: Expenses unamortized in tax records	(30,000)
Timing difference	5,70,000

Tax expense is more than the current tax due to timing difference.

Therefore deferred tax liability = 50% x 5,70,000 = 2,85,000

Illustration 8

Saras Ltd. closes its books as on 31st March 20X2. They have accrued ₹ 5,00,000 towards GST Liability for the month of March 20X2 by debiting their Profit and loss statement which is expected to be paid off by 21st April 20X2. As per the provisions of Section 43B of the Income Tax Act, 1961 – Any expenditure of the nature mentioned in section 43B (e.g. taxes, duty, cess, fees, etc.) accrued in the statement of profit and loss on mercantile basis will be allowed for tax purposes in subsequent years on payment basis only. Assuming a Tax rate of 30% determine the Deferred Tax Asset/Liability as at 31st March 20X2.

Solution

Calculation of difference between taxable income and accounting income

Particulars	Amount (₹)
GST Liability debited in books	5,00,000
Less: GST Liability allowed under Income Tax Act (Section 43B)	Nil
Timing difference	5,00,000

Tax expense is less than the current tax due to timing difference.

Therefore, deferred tax Asset = 30% x 5,00,000 = 1,50,000

Illustration 9

ABC Company limited had an investment in Venture Capital amounting ₹ 10 Crores. Venture capital in turn had invested in the below portfolio companies (New Start- ups) on behalf of ABC Limited:

Portfolio Companies	Amount of investment (₹ in Crores)
Oscar Limited	2
Zee Limited	3
Star Limited	4
Sony Limited	1
Total	10

During the FY 2019-2020, Venture Capital had sold their investment in Star Limited and realised an amount of ₹ 8 Crores on sale of shares of star Limited and entire proceeds of ₹ 8 Crores have been transferred by Venture Capital to ABC Company Limited.

The accounts manager has received the following additional information from venture capital on 31.03.2020:

(1) 8 Crores has been deducted from the cost of investment and carrying amount of investment as at year end is 2 Crores.

(2) Company had to pay a capital gain tax @ 20% on the net sale consideration of ₹ 4 Crores.

(3) Due to COVID-19, the remaining start- ups (i.e. Oscar Limited, Zee Limited, and Sony Limited) are not performing well and will soon wind up their operations. Venture capital is monitoring the situation and if required they will provide an impairment loss in June 2020 Quarter.

You need to suggest the accounts manager what should be the correct accounting treatment as per AS 22 "Accounting for Taxes on Income".

Solution

As company had to pay capital gain tax @ 20% on the net sale consideration as per income tax laws, the company has to recognise a current tax liability of 0.8 Crores computed as under:

Particulars	Amount (₹ in Crores)
Sales Consideration	8
Cost of Investment	4
Net gain on Sale	4
Tax @ 20%	0.8

As per AS 22, Timing differences are those 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.

Particulars	Amount (₹ in Crores)	Rationale
Taxable Income	4	As per income tax laws

Accounting Income	Nil	As the same is deducted from the cost of investment
Timing Difference	4	

As per AS 22, deferred tax assets should be recognised and carried forward only to the extent that there is a reasonable certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Since in current scenario, due to Covid 19 the portfolio companies are not performing well, thus the company may not have sufficient future taxable income which will reverse deferred tax assets. Therefore, the company should not recognise DTA of ₹ 0.8 Crores and company should recognize only current tax liability of ₹ 0.8 Crores.

MTP / RTP / Past Exam**Question 1 (RTP Nov '21)**

Can an enterprise offset deferred tax assets and deferred tax liabilities? If yes, prescribe the conditions required for such offset as per provisions of AS 22. ?

Solution:

Yes. It can offset deferred tax assets and deferred tax liabilities.

As per AS 22, an enterprise should offset deferred tax assets and deferred tax liabilities if:

- (i) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and
- (ii) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

Question 2 (RTP May'21, Past Exam Nov'22)

(a) The following information is furnished in respect of Slate Ltd. for the year ending 31-3-2019:

(i) Depreciation as per books	Rs. 2,80,000
Depreciation for tax purpose	Rs. 1,90,000

The above depreciation does not include depreciation on new additions.

- (ii) A new machinery purchased on 1.4.18 costing Rs. 1,20,000 on which 100% depreciation is allowed in the 1st year for tax purpose whereas Straight-line method is considered appropriate for accounting purpose with a life estimation of 4 years.
- (iii) The company has made a profit of Rs. 6,40,000 before depreciation and taxes.
- (iv) Corporate tax rate of 40%.

Prepare relevant extract of statement of Profit and Loss for the year ending 31-3-2019 and also show the effect of above items on deferred tax liability/asset as per AS 22.

(b) What are the disclosure requirements for deferred tax assets and deferred tax liabilities in the balance sheet as per AS 22? **(5 Marks)**

Solution:**(a) Statement of Profit and Loss for the year ended 31st March, 2019 (Extract)**

	Rs.	
Profit before depreciation and taxes		6,40,000
Less: Depreciation for accounting purposes (2,80,000+30,000)		(3,10,000)
Profit before taxes	(A)	3,30,000
Less: Tax expense	(B)	
Current tax (W.N.1) (3,30,000 x 40%) Deferred tax (W.N.2)	1,32,000	(1,32,000)
Profit after tax	(A-B)	NIL 1,98,000

Working Notes:**1. Computation of taxable income**

	Amount (Rs.)
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Profit before depreciation and tax	6,40,000
Less: Depreciation for tax purpose (1,90,000 + 1,20,000)	(3,10,000)
Taxable income	3,30,000
Tax on taxable income @ 40%	1,32,000

2. Impact of various items in terms of deferred tax liability / deferred tax asset

S.No.	Transactions	Analysis	Nature of difference	Effect	Amount (Rs.)
(i)	Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	(2,80,000 - 1,90,000) x 40% = (36,000)
(ii)	Depreciation on new machinery	Due to allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less.	Timing difference	Creation of DTL	(1,20,000 - 30,000) x 40% = 36,000
	Net impact				NIL

(b) The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balance should be disclosed in the notes to accounts. Deferred tax assets and liabilities should be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities should be disclosed under a separate heading in the balance sheet of the enterprise, separately from current assets and current liabilities. The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax laws.

Question 3 (RTP May 22)

The following transactions were reported by PQR Ltd. during the year 2020-2021:

	Tax Rate	30%
		(Rs. in lakh)
i.	Items disallowed in 2019-2020 and allowed for tax purposes in 2020-2021.	20.00
ii.	Interest to Financial Institutions accounted in the books on accrual basis, but actual payment was made before the due date of filing return and allowed for tax purpose also.	20.00
iii.	Donations to Private Trust made in 2020-2021 (not allowed under Income Tax Laws).	10.00

You are required to show impact of the above items in terms of Deferred Tax Assets/Deferred Tax Liability for the year ended 31.03.2021.

Solution

Impact of various items in terms of deferred tax liability/deferred tax asset as per AS 22

Transactions	Analysis	Nature of difference	Effect	Amount
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Timing difference	Reversal of DTA	Rs. 20 lakh X 30% = Rs. 6 lakh
Interest to financial institutions	It is allowed as deduction under IT Act, if the payment is made before the due date of filing the return of income	No timing difference	Not applicable	Not applicable
Donation to private trusts	Not an allowable expenditure under IT Act.	Permanent difference	Not applicable	Not applicable

Question 4 (RTP May 19)

Is it permissible not to recognize deferred tax liability on the ground that the Company expects that there will be losses both for accounting and tax purposes in near future? You are required to give advice to the company.

Solution:

The Company should provide for deferred tax liability on the timing differences irrespective for the fact that these timing differences will reverse in the period in which the Company expects to be in loss both from the accounting as well as tax point of view. It may, however, be added that the deferred tax liability recognized at the balance sheet date will give rise to future taxable income at the time of reversal thereof.

Question 5 (RTP Nov'22)

Define followings as per AS 22:

- (i) Accounting income (loss)
- (ii) Taxable income (tax loss)
- (iii) Tax expense (tax saving)

Solution:

Accounting income (loss) 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.

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.

Taxable expenses is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

Question 6 (Past Exam July'21)

The following particulars are stated in the Balance Sheet of Deep Limited as on 31st March, 2020:

	(₹ In Lakhs)
Deferred Tax Liability (Cr.)	28.00
Deferred Tax Assets (Dr.)	14.00

The following transactions were reported during the year 2020 -2021:

- (i) Depreciation as per books was ₹ 70 Lakhs whereas Depreciation for Tax purposes was ₹ 42 Lakhs.
There were no additions to Fixed Assets during the year.
- (ii) Expenses disallowed in 2019-20 and allowed for tax purposes in 2020-21 were ₹ 14 Lakhs.
- (iii) Share issue expenses allowed under section 35(D) of the Income Tax Act, 1961 for the year 2020-21 (1/10th of ₹ 70.00 lakhs incurred in 2019-20).
- (iv) Repairs to Plant and Machinery were made during the year for ₹ 140.00 Lakhs and was spread over the period 2020-21 and 2021-22 equally in the books. However, the entire expenditure was allowed for income-tax purposes in the year 2020-21.

Tax Rate to be taken at 40%. You are required to show the impact of above items on Deferred Tax Assets and Deferred Tax Liability as on 31st March, 2021. **(5 Marks)**

Solution:**Impact of various items in terms of deferred tax liability/deferred tax asset on 31.3.21**

Transactions	Analysis	Nature of difference	Effect	Amount (₹)
Difference in depreciation	Generally, written down value method of depreciation is adopted under IT Act which leads to higher depreciation in earlier years of useful life of the asset in comparison to later years.	Responding timing difference	Reversal of DTL	28 lakhs X 40% = ₹ 11.20 lakhs
Disallowances, as per IT Act, of earlier years	Tax payable for the earlier year was higher on this account.	Responding timing difference	Reversal of DTA	14 lakhs X 40% = 5.6 lakhs
Share issue expenses	Due to disallowance of full expenditure under IT Act, tax payable in the earlier years was higher.	Responding timing difference	Reversal of DTA	7 lakhs X 40% = ₹ 2.8 lakhs
Repairs to plant and machinery	Due to allowance of full expenditure under IT Act, tax payable of the current year will be less.	Originating timing difference	Increase in DTL	70 lakhs X 40% = 28 lakhs

Question 7 (Past Exam Nov'23)

The following particulars are stated in the Balance Sheet of Siddhi Limited as on 31st March, 2022:

Particulars	(₹ In lakhs)
Deferred Tax Liabilities (Cr.)	2.50
Deferred Tax Assets (Dr.)	1.35

The following transactions were reported during the year 2022-23:

	₹ in lakhs
(i) Depreciation as per accounting records	15.00
(ii) Depreciation as per income tax records	20.00
(iii) Interest paid to NBFC accounted in books on accrual basis but paid on 30.06.2023	6.00
(iv) Items disallowed for tax purposes in 2021-22 but allowed in 2022- 23	1.05
(v) Donation to Private Trust	40.00
(vi) Tax rate	15%

(vii) There were no additions to fixed assets during the year.

You are required to calculate the Deferred Tax Asset and Deferred Tax Liability as on 31-03-2023 as per AS-22. (5 Marks)

Solution:

Balances of Deferred tax assets and Deferred tax liability as on 31st March, 2023

	₹ (in lakhs)
Deferred tax liability (Cr.) (2.5 + .75)	3.25
Deferred tax asset (Dr.) (1.35 - .158*)	1.192

Working Note:

Impact of various items in terms of deferred tax liability / deferred tax asset

S. No.	Transactions	Nature of difference	Effect	Amount (₹)
(i), (ii)	Difference in depreciation	Responding timing difference	Creation of DTL	$(20 - 15) \times 15\% = .75$
(iii)	Interest to financial institutions	No timing difference	Not applicable	Not applicable
(iv)	Disallowances, as per IT Act, of earlier years	Timing difference	Reversal of DTA	₹ 1.05 lakh $\times 15\% =$ ₹ .158* lakh
(v)	Donation to private trusts	Permanent difference	Not applicable	Not applicable

*Alternatively, may be rounded off as ₹ .157 lakh or 0.1575.

MCQs

1. As per AS 22 on 'Accounting for Taxes on Income', tax expense is:

- (a) Current tax + deferred tax charged to profit and loss account
- (b) Current tax-deferred tax credited to profit and loss account
- (c) Either (a) or (b)
- (d) Deferred tax charged to profit and loss account

2. G Ltd. has provided the following information:

Depreciation as per accounting records = ₹ 2,00,000

Depreciation as per tax records = ₹ 5,00,000

There is adequate evidence of future profit sufficiency.

How much deferred tax asset/liability should be recognized as transition adjustment when the tax rate is 50%?

- (a) Deferred Tax asset = ₹ 2,70,000.
- (b) Deferred Tax asset = ₹ 1,35,000.
- (c) Deferred Tax Liability = ₹ 2,70,000
- (d) Deferred Tax Liability = ₹ 1,35,000.

3. State which of the followings statements are correct:

- (1) There are no pre-conditions required to recognize deferred tax liability,
 - (2) Deferred tax asset under all circumstances can only be created if and only if there is reasonable certainty that future taxable income will arise.
- (a) Both are correct.
 - (b) Only (1) is correct.
 - (c) Only (2) is correct.
 - (d) None of the statements are correct.

4. Which of the following statement are incorrect:

- (a) Only timing differences result in creation of deferred tax.
- (b) Permanent differences do not result in recognition of deferred tax.
- (c) The tax rate used for measurement of deferred tax is substantively enacted tax rate.
- (d) The entity has to recognize deferred tax liability/asset arising out of timing difference. There are no conditions which are required to evaluated for their recognition.

ANSWERS/SOLUTIONS**MCQs**

1. (c) 2. (d) 3. (a) 4. (d)