

## TOPIC – 20

### ACCOUNTING STANDARD - 22

### ACCOUNTING FOR TAXES ON INCOME

#### Total No. of Question 20

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#### SERIES 100 - BASIC QUESTIONS

##### Q.AS22.SM.101: (May 2014, 4 Marks)

*What are the Timing Differences and Permanent Differences as per Accounting Standard 22?*

##### Q.AS22.SM.102

*Saras Ltd. closes its books as on 31<sup>st</sup> 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 21<sup>st</sup> 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 31<sup>st</sup> March 20X2.*



**Q.AS22.SM.103: (CA Final book) (RTP November 2006)**

Classify the following as "Timing Difference" and "Permanent Difference"

- (i) Interest on loans payable to Scheduled Banks not paid during current year but accounted as an expenditure in the books.  
 (ii) Difference in Depreciation rates as per Income Tax and as per Books.  
 (iii) Unabsorbed losses.  
 (iv) Revaluation Reserve.

## SOLUTIONS OF ABOVE QUESTIONS OF SERIES 100

**Solution Q101**

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 etc.

**SOLUTION Q102**

*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
<b>Timing difference</b>	<b>5,00,000</b>

Tax expense is less than the current tax due to timing difference. Therefore, deferred tax Asset = 30% x 5,00,000 = 1,50,000

**ANSWER: Q103**

Classification of the items into timing and permanent differences is as under-

- (i) Interest paid to bank is a timing difference.  
 (ii) Difference in depreciation rates is a timing difference.  
 (iii) Unabsorbed losses is a timing difference.  
 (iv) Revaluation Reserve is a permanent difference.

## SERIES 200 - IMPORTANT QUESTIONS ON CALCULATION OF CURRENT TAX AND DEFERRED TAX

### Q.AS22.SM.201: (RTP May18)

Rama Ltd., has provided the following information:

	Rs
Depreciation as per accounting records	2,00,000
Depreciation as per income tax records	5,00,000
Unamortized preliminary expenses as per tax record	30,000



There is adequate evidence of future profit sufficiency.

You are required to **calculate** the amount of deferred tax asset/liability to be recognized as transition adjustment assuming Tax rate as 50%.

### Q.AS22.OM.202: (CA Final)

From the following information given below you are required to compute Deferred Tax Assets and Deferred Tax Liability for Ramanujam Ltd. as on 31<sup>st</sup> March, 20X1. The tax applicable is 35%.

- The company has charged Rs. 7,42,900 in the books of accounts while as per Income Tax Computation, the depreciation available for the company is Rs. 8,65,400.
- The Company has made provision for doubtful debts for Rs. 54,300 during the year.
- The company has debited share issue expenses of Rs. 6,23,500 which will be available for deduction under the income tax Act from the next year.
- The expenses of Rs. 7,84,500 has been charged to profit and loss account which are disallowed under the income tax act.
- The company has made donation of Rs. 2,00,000 which has been debited to Profit and loss account and only 50% thereof will be allowed as deduction as per Income Tax law.

### Q.AS22.RMP.203: (Exam July21)

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

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



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

- Depreciation as per books was Rs. 70 Lakhs whereas Depreciation for Tax purposes was Rs. 42 Lakhs. There were no additions to Fixed Assets during the year.
- Expenses disallowed in 2019-20 and allowed for tax purposes in 2020-21 were Rs. 14 Lakhs.
- Share issue expenses allowed under section 35(D) of the Income Tax Act, 1961 for the year 2020-21 (1/10th of Rs. 70.00 lakhs incurred in 2019-20).

iv. Repairs to Plant and Machinery were made during the year for Rs. 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.

#### **Q.AS22.OM.204:**

Rama Ltd. started business on 1st April 1998. The following details are available from the books of accounts and other records of Rama Ltd.

Profit before depreciation and taxes

1998-1999	14,45,500
1999-2000	18,20,200
2000-2001	24,56,560
2001-2002	30,22,280



The company purchased the following machines

Date of Purchase	Amount (Rs.)
1.4.1998	3,45,000
1.4.1999	2,75,000
1.4.2000	10,00,000
1.4.2001	3,62,000

The Company charges depreciation on machines @ 15% p.a. whereas the rates as per tax is 25% p.a. Tax rates for five years is 50%, 45%, 40% 35% and 35 % respectively.

You are required to prepare the profit and loss statement showing the provision for taxes under the AS-22.

#### **Q.AS22.SM.205: (Similar in Exam Sep'24)**

Omega Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 20X0-20X1, 20X1-20X2 and 20X2-20X3 for Rs. 11,00,000, Rs. 16,00,000 and Rs. 21,00,000 respectively. However, for Income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of Rs. 7,00,000, Rs. 18,00,000 and Rs. 23,00,000 for the lews 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.

#### **Q.AS22.RMP.206: (RTP - May21 & EXAM Nov22)**

(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?

### Q.AS22.OM.207: (CA Final)

Ram Ltd. started its operations in 20X1-20X2 and gave you the following details:

Financial Year	Accounting Income	Permanent Difference	Timing Difference	Tax Rate	Remarks
20X1-20X2	80,000	+10,000	+9000	30%	Reversible in 20X4-20X5
20X2-20X3	90,000	+2,000	+6000	35%	Reversible in 20X3-20X4
20X3-20X4	1,10,000	+6,000	-2000	40%	Reversible in 20X4-20X5
20X4-20X5	40,000	+12,000	Nil	50%	Nil

Tax rate for the next year are known in current year itself. Plus represents disallowance of expense in Income Tax.

Prepare necessary parts of Profit and Loss account, Balance Sheet in accordance with AS-22.

### Q.AS22.SM.208: (RTP Jan'25)

ABC Ltd. prepares its accounts annually on 31st March. On 1st April, 2022, it purchases a machine at a cost of ₹ 1,50,000. The machine has a useful life of three years and an expected scrap value of zero. Although it is eligible for a 100% first year depreciation allowance for tax purposes, the straight line method is considered appropriate for accounting purposes. ABC Ltd. has profits before depreciation and taxes of ₹ 2,00,000 each year and corporate tax rate is 40 percent each year.

The purchase of machine at a cost of ₹ 1,50,000 in 2022 gives rise to a tax saving of ₹ 60,000. The corporate tax rate has been assumed to be same in each of the three years. Calculate deferred tax and pass necessary journal entries.

What will be the amount of deferred tax, if the substantively enacted tax rates for 2022, 2023 and 2024 are 40%, 35% and 38% respectively.

## SOLUTIONS OF ABOVE QUESTIONS OF SERIES 200

### SOLUTION: Q201

*Table showing calculation of deferred tax asset / liability*

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

### SOLUTION: Q202

Timing Difference Amount	DTA/DTL	Remarks
122500 Liability	42875 DTL	-
54300 Assets	19005 DTA	
623500 Assets	218225 DTA	
-	-	Permanent Difference
-	-	Permanent Difference of Rs. 100000
	<b>194355</b>	<b>Net DTA</b>

### SOLUTION Q203

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

Transactions	Analysis	Nature of difference	Effect	Amount (Rs.)
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 · 40% = Rs. 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 · 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 · 40% = Rs. 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 · 40% = 28 lakhs

### Solution Q204

*Working Note 1: Fixed Assets Schedule (in the Books)*

	1998	1999	2000	2001
Opening Asset	Nil	2,93,250	4,83,013	12,60,561
Purchases 1/4	3,45,000	2,75,000	10,00,000	3,62,000
Gross Total	3,45,000	5,68,250	14,83,013	16,22,561
Depreciation @ 15%	(51,750)	(85,238)	(2,22,452)	(2,43,384)
Closing 31/3	2,93,250	4,83,013	12,60,561	13,79,177

**Working Note 2: Fixed Assets Schedule (As per IT)**

	1998	1999	2000	2001
Opening Asset	Nil	2,58,750	4,00,312	10,50,234
Purchases 1/4	3,45,000	2,75,000	10,00,000	3,62,000
Gross Total	3,45,000	5,33,750	14,00,312	14,12,234
Depreciation @ 25%	(86,250)	(1,33,438)	(3,50,078)	(3,53,059)
Closing 31/3	2,58,750	4,00,312	10,50,234	10,26,175

**Working Note 3: Calculation of A/c Income, Taxable Income & Tax thereon: -**

	1998	1999	2000	2001
PBD&T	14,45,500	18,20,200	24,56,560	30,22,280
(-) Dep (Books) WN.1	(51,750)	(85,238)	(2,22,452)	(2,43,384)
A/c Income PBT	13,93,750	17,34,962	22,34,108	27,78,896
(+) Depreciation Disallowed	51,750	85,238	2,22,452	2,43,384
(-) Dep Allowed as per IT	(86,250)	(1,33,438)	(3,50,078)	(3,53,059)
Taxable Income	13,59,250	16,86,762	21,06,482	26,69,221
CT Rates	50%	45%	40%	35%
CT Expenses	6,79,625	7,59,043	8,42,593	9,34,227
Timing Difference	3,45,000	4,82,000	1,27,626	1,09,675
Cumulative Timing Difference	3,45,000	8,27,000	2,10,326	3,20,001
Tax Rate	45%	40%	35%	35%
DT Liability (B/S)	15,525	33,080	73,614	1,12,000
DT Liability (P&L)	15,525	17,555	40,534	38,386

**Statement of P&L**

	1998	1999	2000	2001
Profit Before Tax	13,93,750	17,34,962	22,34,108	27,78,896
(-) Tax Expense				
CT	6,79,625	7,59,043	8,42,593	9,34,227
+ DTL	15,525	17,555	40,534	38,386
Profit After Tax	6,98,600	9,58,364	13,50,981	18,06,283

**SOLUTION: Q205****Calculation of Deferred Tax Asset/Liability**

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

**ANSWER: Q206****(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%)		1,32,000	
Deferred tax (W.N.2)		NIL	(1,32,000)
Profit after tax	(A-B)		1,98,000

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

	Amount (Rs.)
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	$(2,80,000 - 1,90,000) \times 40\% = (36,000)$ $(1,20,000 - 30,000) \times 40\% = 36,000$
(ii)	Depreciation on new Machinery Net impact	Due to allowance of full amount as expenditure under IT Act, tax payable in the earlier years is less.	Timing difference	Creation of DTL	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.

**SOLUTION Q207**

WN - 1:

**Deferred Taxes**

	20X1-X2	20X2-X3	20X3-X4	20X4-X5
Opening Time Difference	-	9000 (A)	15000 (A)	7000 (A)
Timing Difference arise during the years	9000 (A)	6000 (A)	2000 (L)	-
Closing Timing Difference	-	-	6000-R)	- 9000 (A-R) + 2000 (L-R)
	9000 (A)	15000 (A)	7000 (A)	Nil
Deferred Tax Rate	35%	40%	50%	-
Deferred Tax Amount (B/S Value)	3150 (Asset)	6000 (Asset)	3500 (Asset)	0

Deferred Tax Amount (P&L Value)	3150 Income	2850 Incomes	2500 Exp. (Asset Reversal)	3500 Exp. (Asset Reversal)
Journal entry	DTA Dr. 3150 To P&L	DTA Dr. 2850 To P&L	P&L Dr. 2500 To DTA	P&L Dr. 3500 To DTA
	3150	2850	2500	3500

WN - 2: -

## Calculation of Taxable Income &amp; Tax thereon

	20X1-X2	20X2-X3	20X3-X4	20X4-X5
A/C Income	80,000	90,000	1,10,000	40,000
(+) Disallowed: -				
Permanent Differences	1,00,000	2,000	6,000	12,000
Timing Differences	9,000	6,000	0	2,000
(-) Allowances: -				
Timing Differences	-	-	(6,000)	(9,000)
Timing Differences	-	-	(2,000)	
<b>Taxable Income</b>	<b>99000</b>	<b>98000</b>	<b>108000</b>	<b>45000</b>
<b>Tax Rates Current %</b>	<b>30%</b>	<b>35%</b>	<b>40%</b>	<b>50%</b>
<b>Current Tax Exp.</b>	<b>29700</b>	<b>34300</b>	<b>43200</b>	<b>22500</b>

**SOLUTION Q208**

If the cost of machine is spread over three years of its life for accounting purposes, the amount of the tax saving should also be spread over the same period as shown below:

**Statement of Profit and Loss**  
(for the three years ending 31st March, 2022, 2023, 2024)

		(₹ in thousand)		
		2022	2023	2024
	Profit before depreciation and taxes	200	200	200
Less:	Depreciation for accounting purposes	50	50	50
	Profit before taxes	150	150	150
Less:	Tax expense			
	Current tax:			
	0.40 x (200 - 150)	20		
	0.40 x 200		80	80
	Deferred tax:			
	Tax effect of timing differences originating during the year leading to DTL			
	0.40 (150 - 50)	40		
	Tax effect of timing differences reversing during the year			
	0.40 (0 - 50)	-	(20)	(20)
	Tax expense	60	60	60
	Profit after tax	90	90	90
	Net timing differences	100	50	0
	Deferred tax liability balance	40	20	0

In 2022, the amount of depreciation allowed for tax purposes exceeds the amount of depreciation charged for accounting purpose by ₹ 1,00,000 and, therefore, taxable income is lower than the accounting income. This gives rise to a deferred tax liability of ₹ 40,000. In 2023 and 2024 accounting income is lower than taxable income because the amount of depreciation charged for accounting purposes exceeds the amount of depreciation allowed for tax purposes by ₹ 50,000 each year. Accordingly, deferred tax liability is reduced by ₹ 20,000 each in both the years. As may be seen, tax expense is based on the accounting income of each period.

In 2022, the profit and loss account is debited and deferred tax liability account is credited with the amount of tax on the originating timing difference of ₹ 1,00,000 while in each of the following two years, deferred tax liability account is debited and profit and loss account is credited with the amount of tax on the reversing timing difference of ₹ 50,000.

The following Journal entries will be passed:

<b>Year 2022</b>			
Profit and Loss A/c To Current tax A/c (Being the amount of taxes payable for the year 2022 provided for)	Dr.	20,000	20,000
Profit and Loss A/c To Deferred tax liability A/c (Being the deferred tax liability created for originating timing difference of ₹ 1,00,000)	Dr.	40,000	40,000
<b>Year 2023</b>			
Profit and Loss A/c To Current tax A/c (Being the amount of taxes payable for the year 2023 provided for)	Dr.	80,000	80,000
Deferred tax liability A/c To Profit and Loss A/c (Being the deferred tax liability adjusted for reversing timing difference of ₹ 50,000)	Dr.	20,000	20,000
<b>Year 2024</b>			
Profit and Loss A/c To Current tax A/c (Being the amount of taxes payable for the year 2024 provided for)	Dr.	80,000	80,000
Deferred tax liability A/c To Profit and Loss A/c (Being the deferred tax liability adjusted for reversing timing difference of ₹ 50,000)	Dr.	20,000	20,000

#### Presentation:

In the year 2022, the balance of deferred tax account i.e. ₹ 40,000 would be shown separately from the current tax payable for the year in terms of paragraph 30 of AS 22. In the year 2023, the balance of deferred tax liability account would be ₹ 20,000 and be shown separately from the current tax payable for the year as in year 2022. In year 2024, the balance of deferred tax liability account would be nil.

If the rate of tax changes, it would be necessary for the enterprises to adjust the amount of deferred tax liability carried forward by applying the tax rate that has been enacted or substantively enacted by the balance sheet date on accumulated timing differences at the end of the accounting year

The amount of deferred tax liability would be computed as follows:

The deferred tax liability carried forward each year would appear in the balance sheet as under:

31st March, 2022 = 0.40 (1,00,000) = ₹ 40,000

31st March, 2023 = 0.35 (50,000) = ₹ 17,500

31st March, 20224 = 0.38 (Zero) = ₹ Zero

Accordingly, the amount debited (credited) to the profit and loss account (with corresponding credit or debit to deferred tax liability) for each year would be as under:

31st March, 2022 Debit = ₹ 40,000

31st March, 2023 (Credit) = ₹ (22,500)

31st March, 2024 (Credit) = ₹ (17,500)

**SERIES 300 - QUESTIONS ON MINIMUM ALTERNATE TAX (MAT)****Q.AS22.SM.301:**

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.

Book Profit for MAT purpose	Rs. 3,50,000	
Accounting Income	Rs. 6,00,000	
Taxable Income	Rs. 60,000	
Rate of Tax	Regular	20%
	MAT	7.5%

**Q.AS22.RMP.302: (RTP – May21 & Nov20 Exam)**

From the following details of Aditya Limited for accounting year ended on 31st March, 2020:



Particular	Rs.
Accounting profit	15,00,000
Book profit as per MAT	7,50,000
Profit as per Income tax Act	2,50,000
Tax Rate	20%
MAT Rate	7.5%

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.

## SOLUTIONS OF ABOVE QUESTIONS OF SERIES 300

### SOLUTION Q301

Tax as per accounting profit	$6,00,000 \times 20\%$	Rs. 1,20,000
Tax as per Income-tax Profit	$60,000 \times 20\%$	Rs. 12,000
Tax as per MAT	$3,50,000 \times 7.50\%$	Rs. 26,250

Tax expense = Current Tax + Deferred Tax Liability

Rs. 1,20,000 = Rs. 12,000 + Deferred tax Liability

Therefore, Deferred Tax liability as on 31-03-2017 =  $1,20,000 - 12,000 = 1,08,000$

Amount of tax to be debited in Profit and Loss account for the year 31-03-2017

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

### SOLUTION: Q302

Tax as per accounting profit  $15,00,000 \times 20\% = \text{Rs. } 3,00,000$

Tax as per Income-tax Profit  $2,50,000 \times 20\% = \text{Rs. } 50,000$

Tax as per MAT  $7,50,000 \times 7.50\% = \text{Rs. } 56,250$

Tax expense = Current Tax + Deferred Tax

Rs. 3,00,000 = Rs. 50,000 + Deferred tax

Therefore, Deferred Tax liability as on 31-03-2020

=  $\text{Rs. } 3,00,000 - \text{Rs. } 50,000 = \text{Rs. } 2,50,000$

Amount of tax to be debited in Profit and Loss account for the year 31-03-2020

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

=  $\text{Rs. } 50,000 + \text{Rs. } 2,50,000 + \text{Rs. } 6,250$  ( $56,250 - 50,000$ ) = Rs. 3,06,250

**SERIES 400 - TAX HOLIDAY PERIOD****Q.AS22.SM.401:**

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 resulting in a tax liability in year 1 and 2 is Rs.200 lakhs and Rs. 400 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by Rs.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.

**Q.AS22.RMP.402: (RTP Nov18)**

Beta 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 resulting in tax liability in year 1 and 2 is Rs. 1,000 lakhs and Rs. 2,000 lakhs respectively. From the third year it is expected that the timing difference would reverse each year by Rs. 50 lakhs. Assuming tax rate of 40%, you are required to compute the deferred tax liability at the end of the second year and any charge to the Profit and Loss account.

**SOLUTIONS OF ABOVE QUESTIONS OF SERIES 400****SOLUTION Q401**

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 Rs. 200 lakhs timing difference due to depreciation, difference amounting Rs. 80 lakhs (Rs. 10 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognised. However, for Rs. 120 lakhs (Rs. 200 lakhs – Rs. 80 lakhs), deferred tax liability will be recognised for Rs. 48 lakhs (40% of Rs. 120 lakhs) in first year. In the second year, the entire amount of timing difference of Rs. 400 lakhs will reverse only after tax holiday period and hence, will be recognised in full. Deferred tax liability amounting Rs. 160 lakhs (40% of Rs. 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 Rs. 208 lakhs (48 lakhs + 160 lakhs).

**SOLUTION Q402**

As per para 13 of Accounting Standard (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 recognized 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 recognized 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 Rs. 1,000 lakhs depreciation, timing difference amounting Rs. 400 lakhs (Rs. 50 lakhs x 8 years) will reverse in the tax holiday period and therefore, should not be recognized. However, for Rs. 600 lakhs (Rs. 1,000 lakhs – Rs. 400 lakhs), deferred tax liability will be recognized for Rs. 240 lakhs (40% of Rs. 600 lakhs) in first year. In the second year, the entire amount of timing difference of Rs. 2,000 lakhs will reverse only after-tax holiday period and hence will be recognized in full. Deferred tax liability amounting Rs. 800 lakhs (40% of Rs. 2,000 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 Rs. 1,040 lakhs (240 lakhs + 800 lakhs).

**SERIES 500 - QUESTIONS ON VIRTUAL CERTAINTY IN RESPECT OF DTA****Q.AS22.SM.501: (CA Final book) (DTA subject to Virtual Certainty)**

Trimurthy Pan Masala was incurring heavy losses in the last several years since it could not withstand the competition in the market. The state in which the company had its Registered Office and Also its major sales, had moved a bill in the state assembly to ban manufacture and sale of all kinds of pan masalas in the state. While finalizing the accounts for the year ended 31.03.20X1, the CFO of the company created a Deferred Tax Assets for the tax benefits that would arise in future year from earlier year's losses that had remained unabsorbed in income tax. Comment.

**Q.AS22.SM.502**

ABC Company limited had an investment in Venture Capital amounting ₹10Crores. 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
<b>Total</b>	<b>10</b>

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".

**Q.AS22.SM.503:**

PQR Ltd.'s accounting ends on 31.03.20X1. The company made a loss of Rs. 2,00,000 for the year ending 31.03.20X1. For the year ending 31.03.20X2 and 31.03.20X3, it made profits of Rs.



1,00,000 and Rs. 1,20,000 respectively. It is assumed that the loss of a year can be carried forward for the eight years and tax rate is 40%. By the end of 31.03.20X1, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be setoff. There is no difference between taxable income and accounting income expect that the carry forward loss is allowed in the years ending 20X2 and 20X3 for the tax purposes. Prepare a statement of Profit and Loss for the years ending 20X1, 20X2 and 20X3.

## SOLUTIONS OF ABOVE QUESTIONS OF SERIES 500

### ANSWER: Q501

As per Para 17 of AS 22, where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, DTA should be recognized only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such DTA can be realized. In this case, the Company may not be in a position to carry out its activities on account of the possible banning of its Pan Masala Sales, by the State's legislation. Since the Virtual Certainty condition of Para 17 is not satisfied. The Company should not recognize any DTA on the unabsorbed losses. Hence the Company's accounting treatment is improper.

### SOLUTION Q502

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 recognise only current tax

liability of ₹ 0.8 Crores.

### SOLUTION Q503

	31.03.20X1	31.03.20X2	31.03.20X3
Profit (Loss)	(200000)	1,00,000	1,20,000
Less Current Tax (20000 x 40%)	-	-	(8,000)
Deferred Tax:			
Tax Effect of Timing differences originating during the year (200000 x 40%)	80000	-	-
Tax Effect of Timing differences reversed/adjusted during the year (100000 x 40%)	-	(40,000)	(40,000)
Profit/(Loss) after Tax Effect	(1,20,000)	60,000	72,000

**SERIES 600 - MISC. QUESTIONS****Q.AS22.OM.601:**

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Profit Before Tax	8,00,000
Bonus not yet Paid	20,000
Provisions for doubtful debts	30,000
Tax Rate	
Up to 1,80,000	Nil
Next 1,20,000	10%
Next 2,00,000	20%
Next	30%
Surcharge	10%

Prepare profit and Loss account.

(Answer: DTA – Rs. 10160/-)

**Q.AS22.RMP.602: (RTP Nov21)**

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.

