

AS 22, Accounting for Taxes on Income



AS 22 applies in accounting for taxes on income

Establish principles for determination of *amount of expense or saving* related to taxes on income and *disclosure* of such amount in financial statements

Taxes on income includes all domestic and foreign taxes based on taxable income

Mandatory in nature for Level I, Level II and Level III enterprises

Do not specify accounting for taxes payable on distribution of dividends and other distributions by an enterprise

Notified by central government except **ASI 11** w.e.f accounting periods commencing on or after 7 Dec. 2006

'Mandatory for all companies'

- ***Tax expense (tax saving)***

Aggregate of current tax and deferred tax charged/credited to profit and loss

- ***Current tax***

Amount of income tax payable (recoverable) in respect of taxable income (loss) for a period

- ***Deferred tax***

Tax effect of timing differences

- ***Accounting income (loss)***

Net profit or loss for the period before deducting/adding income tax expense/saving

- ***Taxable income (tax loss)***

Amount of income (loss) for a period determined in accordance with the tax laws, based upon which income tax payable (recoverable) is determined

Timing differences

Differences between taxable income and accounting income originating in one period and capable of reversal in one or more subsequent periods

Examples

- **Conversion of capital assets into stock-in-trade**
- **Expenditure allowable in section 43B on payment basis but accrued in statement of profit and loss on mercantile basis**
- **If for any reason, recognition of income spread over a number of years in accounts but taxed fully in the year of receipt e.g., non-compete fees taxed u/s 28 in year of receipt but spread over a number of years in accounts**
- **Deduction u/s 33AB for tea development scheme allowed in one year for tax purposes on basis of deposit made under scheme but expenditure out of withdrawal from such deposit is debited to profit and loss in subsequent years**

Permanent Differences

Differences between taxable income and accounting income that originate in a period and do not reverse subsequently

Examples

- **Donations for which deduction is not available u/s 80G of the Income-tax Act, 1961**
- **Deductions available to exporters u/s 80HHC of the Income-tax Act, 1961**
- **Weighted deduction available for expenditure on scientific research u/s 35 of the Income-tax Act, 1961**

Recognition

**Tax
expense**

Tax expense, comprising current tax and deferred tax, should be included in determination of net profit or loss for the period

**Deferred
tax asset/
liability**

Deferred tax should be recognised for all timing differences, subject to consideration of prudence for deferred tax assets

Consideration of prudence in recognition of a deferred tax asset

For recognition of DTA, certain levels of certainty needs to be established with regard to availability of sufficient future taxable income against which the DTA can be realised

DTA that can be realised against DTL

Future reversal of DTL recognised at balance sheet date will give rise to taxable income for deduction of reversing DTA – recognise DTA to the extent of DTL

DTA that cannot be realised against DTL

Consider level of certainty as specified in AS 22

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Deferred tax assets should be recognised and carried forward only to the extent that there is *reasonable certainty* that sufficient future taxable income will be available against which they can be realised

Except, if under tax laws, an enterprise has

- unabsorbed losses or
- carry forward of losses

deferred tax asset should be recognised only to the extent that there is virtual certainty supported by convincing evidence of their realisation

Reasonable certainty vs. Virtual certainty supported by convincing evidence

Reasonable certainty would normally be achieved by

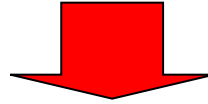
- examining past records of the enterprise; or
- making realistic estimates of profits for the future

Virtual certainty

- determination is a matter of judgement to be evaluated on a case to case basis
- should be supported by convincing evidence, i.e., evidence available at reporting date in concrete form
- cannot be based merely on forecasts of performance

Re-assessment of Unrecognised deferred tax assets

Unrecognised deferred tax assets should be re-assessed at each balance sheet date



If it is reasonably certain or virtually certain (as the case may be) that sufficient future taxable income will be available against which such deferred tax assets can be realised, recognise previously unrecognised deferred tax asset.

An improvement in trading conditions may make it reasonably certain that an enterprise will be able to generate sufficient taxable income in future

- ***Current tax***

- To be measured at the amount expected to be paid to the taxation authorities using applicable tax rates and tax laws

If different tax rates apply to different levels of taxable income, use average rates

- ***Deferred tax assets and liabilities***

- To be measured using the tax rates and tax laws enacted or **substantively enacted** by the balance sheet date

Announcements of tax rates and tax laws by government may have substantive effect of actual enactment (measure DTA/DTL using announced tax rates/laws)

Deferred tax assets and liabilities should not be discounted to their present value

Carrying amount of DTA should be reviewed at each balance sheet date

No longer reasonable certain /virtually certain that sufficient future taxable income would be available for realisation of DTA, write-down carrying amount of DTA to that extent

Reasonable certain/virtually certain that sufficient future taxable income would be available, no write-down is required

Any write-down may be subsequently reversed on satisfaction of condition of reasonable/virtual certainty

Presentation and Disclosure – Offsetting assets and liabilities

- ***Assets and liabilities representing current tax to be offset if an enterprise***

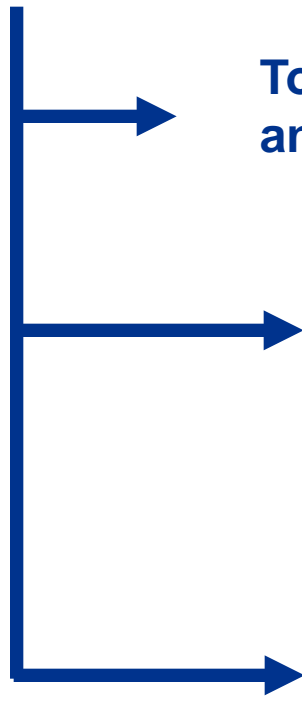
- has a legally enforceable right to set off and
- intends to settle the asset and the liability on a net basis

E.g. Advance payment of tax for a fiscal year should be set off against the provision for current tax for that year

- ***Deferred tax assets and liabilities to be offset if:***

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

Deferred tax assets and liabilities

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- To be distinguished from assets and liabilities representing current tax and to be disclosed separately from current assets and liabilities**
 - In case of company, DTA to be disclosed after the head 'Investments' and DTL to be disclosed after the head 'Unsecured Loans'**
 - Break-up into major components to be disclosed in notes to accounts. Nature of evidence to be disclosed for recognition of DTA, if an enterprise has unabsorbed depreciation or carry forward of losses**

Accounting for Taxes on Income in the situations of tax holiday under Sections 80-IA and 80-IB of the Income-tax Act, 1961



Should deferred tax be recognised for timing differences **arising during the tax holiday** period but which

- a. reverse during the tax holiday period
- b. reverse after the tax holiday period



What about timing differences which **originate before** the tax holiday but which

- a. reverse during the tax holiday period
- b. reverse after the tax holiday period

ASI 3, Accounting for Taxes on Income in the situations of tax holiday under Sections 80-IA and 80-IB of the Income-tax Act, 1961

Timing differences which reverse during the tax holiday period (whether originated in the tax holiday period or before that)

- Do not recognise deferred tax

Timing differences which reverse after the tax holiday period (whether originated in the tax holiday period or before that)

- Recognise deferred tax in the year in which the timing differences originate
 - subject to the consideration of prudence

For above purposes, timing differences originating first should be considered to reverse first

Illustration

ASI 4, Losses under the head capital gains

If for taxation purposes, 'loss' can be set-off in future only against the income under the head 'capital gains', deferred tax asset should be recognised and carried forward only to the extent that there is a **virtual certainty**, supported by convincing evidence, that sufficient future taxable income will be available under the head 'Capital Gains'.

- *Income under 'Capital gains' does not arise in the course of operating activities of an enterprise. Thus, for recognition of a DTA, the degree of certainty of such an income arising in future should be higher*
- *Virtual certainty is required for the availability of taxable income under the head "Capital gains" in future as per the Income-tax Act*

Examples of situations which satisfy the test are

- *sale of an asset giving rise to capital gain (eligible to be set-off against the capital loss) after the balance sheet date but before the financial statements are approved*
- *binding sale agreement which will give rise to capital gain (eligible to be set-off against the capital loss)*

If there is a difference between the amounts of 'loss' recognised for accounting purposes and tax purposes because of cost indexation under the Act in respect of long-term capital assets

- *the DTA should be recognised and carried forward (subject to the consideration of prudence) on the amount which can be carried forward and set-off in future years as per the provisions of the Act*

ASI 5, Accounting for Taxes on Income in the situations of tax holiday under Sections 10A and 10B of the Income-tax Act, 1961

Timing differences which reverse during the tax holiday period

- Do not recognise deferred tax

Timing differences which reverse after the tax holiday period

- Recognise deferred tax in the year in which the timing differences originate
 - subject to the consideration of prudence

For above purposes, timing differences originating first should be considered to reverse first

ASI 6, Accounting for taxes on income in the context of Section 115JB of the Income-tax Act, 1961

Tax paid under section 115JB is a current tax for the period

Deferred tax assets and liabilities in respect of timing differences arising in the period of payment of tax under section 115JB should be measured using regular tax rates and not tax rate under section 115JB

If an enterprise expects that timing differences arising in current period would reverse in a period in which it may pay tax under section 115JB, deferred tax assets and liabilities should be measured using regular tax rates and not tax rate under section 115JB

Measurement of DTA using tax rate u/s 115JB would involve assessment of future taxable income and accounting income and therefore, is considerably subjective.

Issue 1

In case of amalgamation in nature of purchase, whether deferred tax should be recognised for differences between values of assets/liabilities arrived at for accounting purposes on fair value basis and carrying amounts for tax purposes?

Solution

Recognition of individual assets/liabilities at fair values as per AS 14 does not affect the statement of profit and loss. If the carrying amounts for tax purposes continue to be the same as that of the transferor enterprise, deferred tax should not be recognised for such differences as this constitutes a permanent difference. Consequent differences in amounts of depreciation for such assets in subsequent years would also be a permanent difference.

Issue 2

If the transferor enterprise has not recognised any DTA including in respect of unabsorbed depreciation and carry forward of losses since conditions relating to prudence were not fulfilled, whether transferee enterprise can recognise it if conditions relating to prudence are satisfied on a subsequent date?

Solution

Yes, the transferee enterprise can recognise the DTA not recognised by transferor enterprise if the conditions relating to prudence as per AS 22 are satisfied. The accounting treatment depends on nature of amalgamation as well as the accounting treatment adopted for amalgamation in accordance with AS 14.

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Solution (Contd..)

Where ***amalgamation is in the nature of purchase***, DTA should be recognised by the transferee enterprise subject to timing of satisfaction of conditions of prudence as below:

- if at the time of amalgamation, recognise DTA that will automatically affect the amount of goodwill/capital reserve arising on amalgamation
- if by the first annual balance sheet date, recognise DTA with corresponding adjustment made to goodwill/capital reserve arising on amalgamation
- if subsequent to the first annual balance sheet date, recognise DTA with corresponding effect to the statement of profit and loss

If amalgamation is in the nature of purchase and the transferee enterprise incorporates assets/liabilities at their existing carrying amounts, DTA should not be recognised at amalgamation since as per AS 14, assets not appearing in balance sheet of transferor enterprise at amalgamation cannot be recognised.

Solution (Contd..)

Where ***amalgamation is in the nature of merger***, DTA should be recognised by the transferee enterprise subject to timing of satisfaction of conditions of prudence as below:

- If by the first annual balance sheet date, recognise DTA with corresponding adjustment made to revenue reserves arising on amalgamation
- If subsequent to the first annual balance sheet date, recognise DTA with corresponding effect to the statement of profit and loss

DTA should not be recognised at the time of amalgamation since AS 14 requires recognition of assets/liabilities at their existing carrying amounts in balance sheet of transferee enterprise and assets not appearing in balance sheet of transferor enterprise at amalgamation cannot be recognised.

Should deferred tax expense be considered for the purposes of declaring dividend as per the requirements of the Companies Act, 1956, and computing Earnings Per Share (EPS) as per Accounting Standard (AS) 20, 'Earnings Per Share'?

Solution

Yes, deferred tax expense should be considered as an expense in arriving at the profit for the year for the purposes of Section 205 of the Companies Act, 1956. Further, EPS should be computed after considering the tax expense comprising the current tax and deferred tax.

Issue

How should the diminution in the value of a current investment, recognised in the statement of profit and loss as per the requirements of AS 13, Accounting for Investments, be dealt with keeping in view the requirements of AS 22?

Solution

Diminution in the value of investments recognised in the statement of profit and loss is a timing difference. DTA for the said timing difference should be recognised when there is reasonable/virtual certainty that sufficient future taxable income will be available against which DTA can be realised. The normal tax rate should be applied for computation of deferred tax asset since the investment is classified as current investment.

Issue

What is the tax effect of an upward revaluation of fixed assets where increase in net book value arising on revaluation is credited directly to revaluation reserve as per AS 10?

Solution

If additional depreciation due to upward revaluation is met by transfer from revaluation reserve, no difference would arise.

If additional depreciation not adjusted against revaluation reserve, difference would arise between accounting income and taxable income since depreciation would be on revalued amount in accounts whereas for tax purposes, it would be on WDV, i.e. ignoring revaluation.

No deferred tax to be recognised since it would be a permanent difference.

Issue

Is it permissible not to recognise deferred tax liability on the ground that an enterprise intends to carry out a major capital expansion programme in near future?

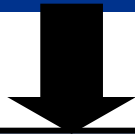
Solution

No, deferred tax should be recognised for all timing differences, subject to consideration of prudence in respect of deferred tax assets. The financial statements for a period should recognise the tax effect, whether current or deferred, of all transactions occurring in that period.

Major differences between AS 22 and IAS 12, Income Taxes

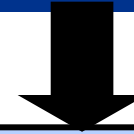
Difference in approach

Follows income statement approach



DTA/DTL created for timing differences between accounting income and taxable income subject to concept of prudence

Follows balance sheet approach



Basis for deferred tax assets and liabilities is the difference between carrying amounts and tax base of assets and liabilities

Deferred Tax Assets - Recognition

AS 22

More stringent criteria for recognition of deferred tax assets e.g., *virtual certainty* where tax losses and/or unabsorbed depreciation

IAS 12

Recognise deferred tax assets when recovery is probable.

The term 'probable' is understood to be similar to the term 'reasonable certainty' but at a lower level of likelihood than 'virtual certainty'. Thus, fewer deferred tax assets would be recognised under AS 22 as compared to IAS 12

Deferred tax expense in consolidated financial statements

IAS 12

In determining tax expense in consolidated financial statements, temporary differences arising from elimination of unrealised profits and losses resulting from intra-group transactions should be considered.

AS 22

No specific guidance. ASI 26 provides that tax expense to be shown in consolidated financial statements will be the aggregate of tax expense appearing in separate financial statements of parent and its subsidiaries

Additional Disclosures under IAS 12

- **Tax expense (income) relating to extraordinary items**
- **Explanation of relationship between tax expense (income) and accounting profit in a prescribed manner**
- **Explanation of changes in applicable tax rate compared to previous accounting period**
- **Amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no DTA is recognised in balance sheet**
- **Aggregate amount of temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, for which DTL have not been recognised**
- **For discontinued operations, tax expense relating to gain/loss on discontinuance and profit or loss from ordinary activities of that operation with corresponding amounts for each prior period presented**

Thank you

