Accounting for Taxes on Income

AS -22

Scope & Objectives

- To account for Taxes on Income
  - Include Domestic & Foreign taxes

- To determine DTL/DTA in Financial Statements

- To redress the distortions caused by traditional method of accounting for income-taxes by requiring the adoption of deferred tax accounting in respect of timing differences

Introduction

- Liability of Income tax is computed on Taxable profit
- Accounting Profit and taxable profit for a period are rarely the same
- Differences between the two are on account of:
  - Permanent Differences
  - Timing Differences

Permanent Differences

Permanent differences are those which Originate in one period and do not reverse subsequently

– Cash expenditure above Re. 20,000 is considered for Accounting profit but the same is partially disallowed for calculation of Taxable profit

Timing Differences

- Timing differences are those which originate in one period and are capable of reversal in subsequent periods.

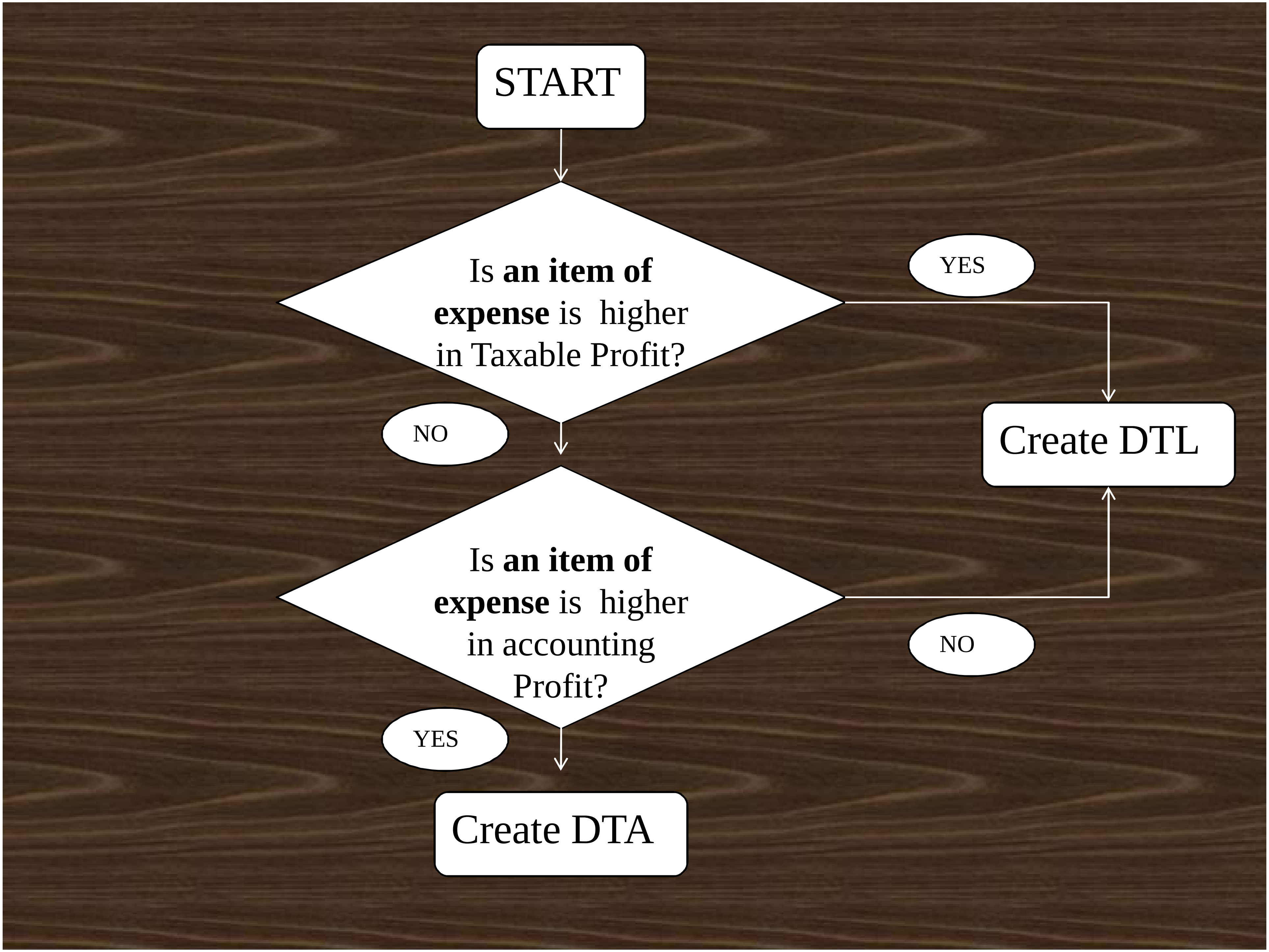
  - Difference due to
    - rate of depreciation
    - method of depreciation
    - Expenditure mentioned in 43 B
    - expenditure deferred in accounts but allowed fully for tax purposes in year of incurrence

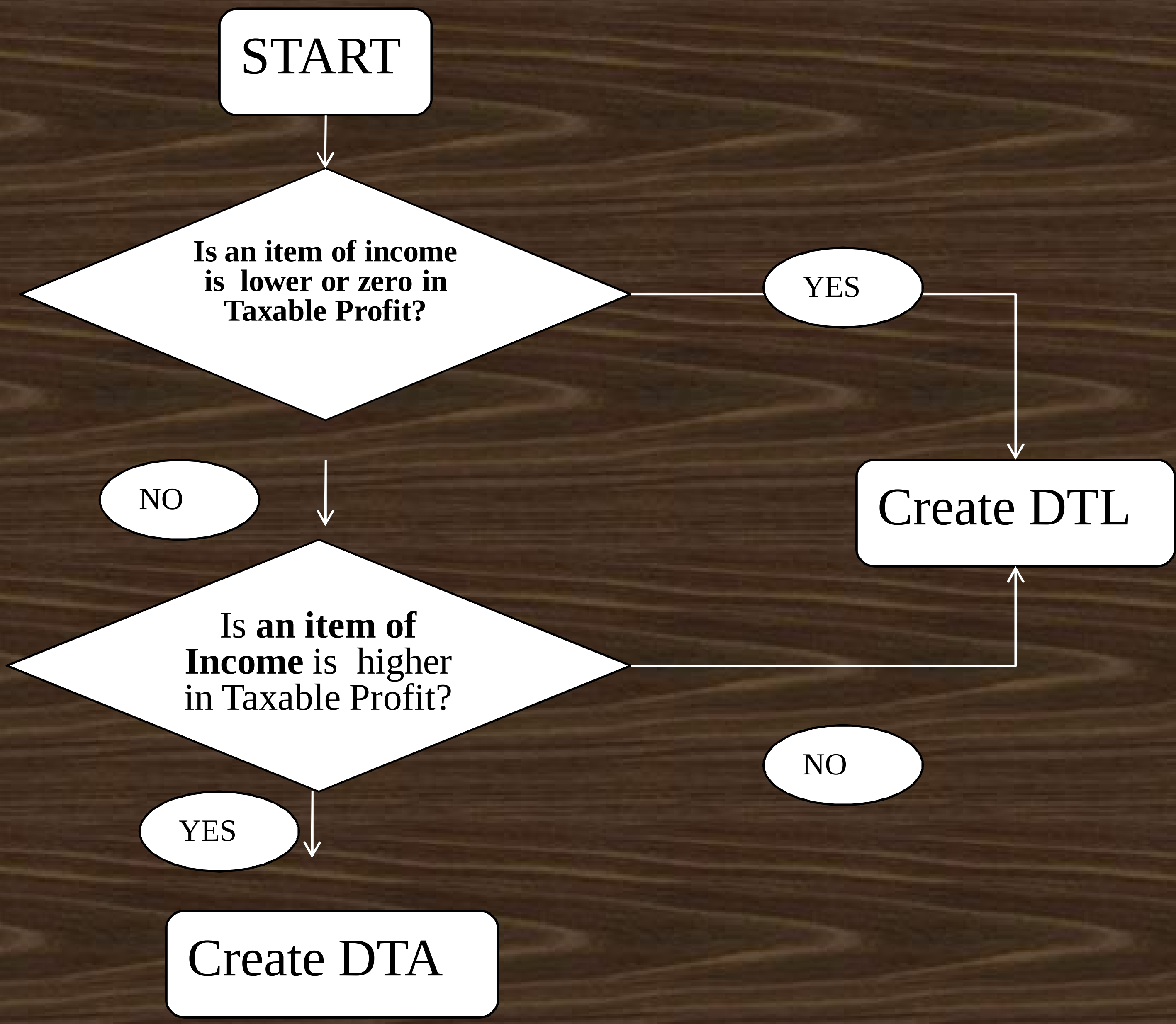
Accounting for Timing Difference

- Foreseeable Future Liability – Charge against current P/L
- Timing difference gives rise to FFL
- Excess allowance = Exp Allowed for IT – Exp charged for accounting profit
- Excess Allowance is “ Originating Timing difference”
- Subsequent disallowance is “Reversing Timing difference”

- In the yr of OTD Business knows the consequent additional liability in future
- Provide for “additional tax liability anticipated” in the P/L of year of originating.
- Name “additional tax liability anticipated” as DTL (Deferred Tax Liability)
- Write back DTL in the year of Reversal

DTL / DTA


START
Is **an item of expense** is higher in Taxable Profit?
YES
Create DTL
NO
Is **an item of expense** is higher in accounting Profit?
NO
YES
Create DTA


START
Is an item of income is lower or zero in Taxable Profit?
YES
NO
Create DTL
Is an item of Income is higher in Taxable Profit?
NO
YES
Create DTA

Example

- D.O.A. Of Machine – 01.04. 07
- Cost = Re. 320000,
- (Depn Rate) tax purpose =25 %
- (Depn Rate) Accounting purpose =15 %
- Find OTD / RTD & DTL for year 07-08,08-09,09-10

(Depn) =Item of Expense

PARTICULAR	07-08	08-09	09-10
Accounting Depn @15% SLM	48	48	48
Depn for Tax purpose @ 25% WDV	80	60	45
Origin of Time Difference -OTD	32	12	------
Reversing Time Difference - RTD	-------	-------	3
Closing balance of Timing Difference	32	44	41
Tax rate	35%	45%	40%
Closing balance of DTL	11.2	19.8	16.4
Creation of DTL by Debiting P/L	11.2	8.6	-----
Reversal of DTL by Crediting P/L	------	------	3.4

Recognition of Timing Differences

- Recognize & Carry forward Deferred tax assets if only if their realization is <u>reasonably</u> certain, I.e., sufficient future taxable income is likely to be available for offset.
- Recognize unabsorbed depreciation or carried forward tax losses, deferred tax assets if only if their realization is <u>virtually </u>certain based on convincing evidence
- Re-assess unrecognized deferred tax assets at each balance sheet date.
- Recognize previously unrecognized assets if reasonable/virtual certainty, is now available

- Re calculate tax effect of accumulated timing differences every year using tax rates and tax laws that have been enacted or substantially enacted
- In case of slab rates, average rate to be used.
- Discounting of deferred tax assets/liabilities not permitted
- Tax expenses should be included in determination of Net Profit & Loss
- Tax effect of Timing differences are included in Profit & Loss and as DTA/DTL in Balance Sheet
- Permanent Differences do not effect in DTA/DTL
- Deferred tax should be recognized for all Timing Differences

FIND Tax Expenses

- Tax expense should comprise
  - Current tax (I.e., provision for tax payable as computed traditionally), and
    - Prepare statement of current Tax
    - Current Tax measured at the amount expected to be paid using applicable Tax rates
  - Deferred Tax, Tax effects of all timing differences, subject to consideration of prudence in recognition of deferred tax assets
    - Prepare statement of deferred tax
    - DTA/DTL measured using tax rates enacted by Balance Sheet date

STATEMENT OF CURRENT TAX				
PARTICULAR	**01-02**	**02-03**	**03-04**	**04-05**
PBT as Given	258000	275400	260520	245000
Add :Accounting Depn @20% WDV, COA=160000	32000	25600	20480	16384
Less : Depn for Tax purpose @ 25% WDV	(40000)	(30000)	(22500)	-
Less : Accounting profit on sale of machinery (SP- CL WDV)	-----	------	--------	(3464)
Find Business Profit	250000	271000	258500	258520
Tax				
-----------------on business Profit@40%	100000	108400	103400	103408
-----------------STCG	-------	--------	--------	600
Current Tax	100000	108400	103400	104008

STATEMENT OF DEFERRED TAX				
PARTICULAR	**01-02**	**02-03**	**03-04**	**04-05**
1.Closing WDV- ACT	160000-32000	102400	81928	NIL
2.Closing WDV- TAX WAY	120000	90000	67500	NIL
3.CLOSING BALANCE OF time difference = 1-2	8000	12400	14428	------
Closing balance of DTL @ 40%	3200	4960	5768	------
Creation of DTL by debiting P/L	**3200**	**4960-3200**	**5768-4960**	**--------**
Reversal of DTL by crediting P/L	**---------**	**---------**	**--------------**	**5768**

Presentation & Disclosure

- Offset Assets and Liabilities representing Current Tax and DTA/DTL if the enterprise have Legally enforceable Right
- Disclose DTA/DTL under the separate heading in B/S
- Disclose major components of DTA/DTL in Notes to Accounts