Accounting Standard (AS) 22
(issued 2001)

Accounting for Taxes on Income

Contents

OBJECTIVE	
SCOPE	**Paragraphs 1-3**
DEFINITIONS	**4-8**
RECOGNITION	**9-19**
Re-assessment of Unrecognised Deferred Tax Assets	19
MEASUREMENT	**20-26**
Review of Deferred Tax Assets	26
PRESENTATION AND DISCLOSURE	**27-32**
TRANSITIONAL PROVISIONS	**33-34**
APPENDICES	

The following Accounting Standards Interpretations (ASIs) relate to AS 22:

- Revised
  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
- Revised
  ASI 4 - Losses under the head Capital Gains
- ASI 5 - Accounting for Taxes on Income in the situations of Tax Holiday under Sections 10A and 10B of the Income-tax Act, 1961
- ASI 6 - Accounting for Taxes on Income in the context of Section 115JB of the Income-tax Act, 1961

Continued../..

- ASI 7 - Disclosure of deferred tax assets and deferred tax liabilities in the balance sheet of a company
- ASI 9 - Virtual Certainty Supported by Convincing Evidence
- ASI 11 - Accounting for Taxes on Income in case of an Amalgamation

The above Interpretations are published elsewhere in this Compendium.

Accounting Standard (AS) 22

(issued 2001)

Accounting for Taxes on Income

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the Preface to the Statements of Accounting Standards[1].)*

Accounting Standard (AS) 22, 'Accounting for Taxes on Income', issued by the Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 1-4-2001. It is mandatory in nature[2] for:

(a) All the accounting periods commencing on or after 01.04.2001, in respect of the following:

i) Enterprises whose equity or debt securities are listed on a recognised stock exchange in India and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognised stock exchange in India as evidenced by the board of directors' resolution in this regard.

ii) All the enterprises of a group, if the parent presents consolidated financial statements and the Accounting Standard is mandatory in nature in respect of any of the enterprises of that group in terms of (i) above.

(b) All the accounting periods commencing on or after 01.04.2002, in respect of companies not covered by (a) above.

---

[1] Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

[2] Reference may be made to the section titled 'Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India' appearing at the beginning of this Compendium for a detailed discussion on the implications of the mandatory status of an accounting standard.

(c) All the accounting periods commencing on or after 01.04.2006, in respect of all other enterprises.[3]

The Guidance Note on Accounting for Taxes on Income, issued by the Institute of Chartered Accountants of India in 1991, stands withdrawn from 1.4.2001. The following is the text of the Accounting Standard.

Objective

The objective of this Statement is to prescribe accounting treatment for taxes on income. Taxes on income is one of the significant items in the statement of profit and loss of an enterprise. In accordance with the matching concept, taxes on income are accrued in the same period as the revenue and expenses to which they relate. Matching of such taxes against revenue for a period poses special problems arising from the fact that in a number of cases, taxable income may be significantly different from the accounting income. This divergence between taxable income and accounting income arises due to two main reasons. Firstly, there are differences between items of revenue and expenses as appearing in the statement of profit and loss and the items which are considered as revenue, expenses or deductions for tax purposes. Secondly, there are differences between the amount in respect of a particular item of revenue or expense as recognised in the statement of profit and loss and the corresponding amount which is recognised for the computation of taxable income.

Scope

1. This Statement should be applied in accounting for taxes on income. This includes the determination of the amount of the expense or saving related to taxes on income in respect of an accounting period and the disclosure of such an amount in the financial statements.

[3] It may be noted that for enterprises covered by this clause, AS 22 was originally made mandatory in respect of accounting periods commencing on or after 1-4-2003. The Council at its meeting held on June 24-26, 2004, decided to defer the applicability of the Standard so as to make it mandatory to such enterprises in respect of accounting periods commencing on or after 1-4-2006. [For full text of the Announcement, reference may be made to the section titled 'Announcements of the Council regarding status of various documents issued by the Institute of Chartered Accountants of India' appearing at the beginning of this Compendium.]

2. For the purposes of this Statement, taxes on income include all domestic and foreign taxes which are based on taxable income.

3. This Statement does not specify when, or how, an enterprise should account for taxes that are payable on distribution of dividends and other distributions made by the enterprise.

Definitions

4. For the purpose of this Statement, the following terms are used with the meanings specified:

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.

Tax expense (tax saving) is the aggregate of current tax and deferred tax charged or credited to the statement of profit and loss for the period.

Current tax is the amount of income tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.

Deferred tax is the tax effect of timing differences.

Timing differences are the 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.

Permanent differences are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently.

5. Taxable income is calculated in accordance with tax laws. In some circumstances, the requirements of these laws to compute taxable income differ from the accounting policies applied to determine accounting income. The effect of this difference is that the taxable income and accounting income may not be the same.

6. The differences between taxable income and accounting income can be classified into permanent differences and timing differences. Permanent differences are those differences between taxable income and accounting income which originate in one period and do not reverse subsequently. For instance, if for the purpose of computing taxable income, the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.

7. 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. Timing differences arise because the period in which some items of revenue and expenses are included in taxable income do not coincide with the period in which such items of revenue and expenses are included or considered in arriving at accounting income. For example, machinery purchased for scientific research related to business is fully allowed as deduction in the first year for tax purposes whereas the same would be charged to the statement of profit and loss as depreciation over its useful life. The total depreciation charged on the machinery for accounting purposes and the amount allowed
as deduction for tax purposes will ultimately be the same, but periods over which the depreciation is charged and the deduction is allowed will differ. Another example of timing difference is a situation where, for the purpose
of computing taxable income, tax laws allow depreciation on the basis of the written down value method, whereas for accounting purposes, straight line method is used. Some other examples of timing differences arising under the Indian tax laws are given in Appendix 1.

8. Unabsorbed depreciation and carry forward of losses which can be set-off against future taxable income are also considered as timing differences and result in deferred tax assets, subject to consideration of prudence (see paragraphs 15-18).

Recognition

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

10. Taxes on income are considered to be an expense incurred by the enterprise in earning income and are accrued in the same period as the

revenue and expenses to which they relate. Such matching may result into timing differences. The tax effects of timing differences are included in the tax expense in the statement of profit and loss and as deferred tax assets (subject to the consideration of prudence as set out in paragraphs 15-18) or as deferred tax liabilities, in the balance sheet.

11. An example of tax effect of a timing difference that results in a deferred tax asset is an expense provided in the statement of profit and loss but not allowed as a deduction under Section 43B of the Income-tax Act, 1961. This timing difference will reverse when the deduction of that expense is allowed under Section 43B in subsequent year(s). An example of tax effect of a timing difference resulting in a deferred tax liability is the higher charge of depreciation allowable under the Income-tax Act, 1961, compared to the depreciation provided in the statement of profit and loss. In subsequent years, the differential will reverse when comparatively lower depreciation will be allowed for tax purposes.

12. Permanent differences do not result in deferred tax assets or deferred tax liabilities.

13. Deferred tax should be recognised for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets as set out in paragraphs 15-18.

14. This Statement requires recognition of deferred tax for all the timing differences. This is based on the principle that the financial statements for a period should recognise the tax effect, whether current or deferred, of all the transactions occurring in that period.

15. Except in the situations stated in paragraph 17, 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.

16. While recognising the tax effect of timing differences, consideration of prudence cannot be ignored. Therefore, deferred tax assets are recognised and carried forward only to the extent that there is a reasonable certainty of their realisation. This reasonable level of certainty would normally be achieved by examining the past record of the enterprise and by making realistic estimates of profits for the future.

17. Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence[4] that sufficient future taxable income will be available against which such deferred tax assets can be realised.

18. The existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available. Therefore, when an enterprise has a history of recent losses, the enterprise recognises deferred tax assets only to the extent that it has timing differences the reversal of which will result in sufficient income or there is other convincing evidence that sufficient taxable income will be available against which such deferred tax assets can be realised. In such circumstances, the nature of the evidence supporting its recognition is disclosed.

Re-assessment of Unrecognised Deferred Tax Assets

19. At each balance sheet date, an enterprise re-assesses unrecognised deferred tax assets. The enterprise recognises previously unrecognised deferred tax assets to the extent that it has become reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available against which such deferred tax assets can be realised. For example, an improvement in trading conditions may make it reasonably certain that the enterprise will be able to generate sufficient taxable income in the future.

Measurement

20. Current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.

21. Deferred tax assets and liabilities should be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

22. Deferred tax assets and liabilities are usually measured using the tax

[4] See also Accounting Standards Interpretation (ASI) 9, published elsewhere in this Compendium.

rates and tax laws that have been enacted. However, certain announcements of tax rates and tax laws by the government may have the substantive effect of actual enactment. In these circumstances, deferred tax assets and liabilities are measured using such announced tax rate and tax laws.

23. When different tax rates apply to different levels of taxable income, deferred tax assets and liabilities are measured using average rates.

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

25. The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each timing difference. In a number of cases such scheduling is impracticable or highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities which would not be comparable between enterprises. Therefore, this Statement does not require or permit the discounting of deferred tax assets and liabilities.

Review of Deferred Tax Assets

26. The carrying amount of deferred tax assets should be reviewed at each balance sheet date. An enterprise should write-down the carrying amount of a deferred tax asset to the extent that it is no longer reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available against which deferred tax asset can be realised. Any such write-down may be reversed to the extent that it becomes reasonably certain or virtually certain, as the case may be (see paragraphs 15 to 18), that sufficient future taxable income will be available.

Presentation and Disclosure

27. An enterprise should offset assets and liabilities representing current tax if the enterprise:

(a) has a legally enforceable right to set off the recognised amounts; and

(b) intends to settle the asset and the liability on a net basis.

28. An enterprise will normally have a legally enforceable right to set off an asset and liability representing current tax when they relate to income taxes levied under the same governing taxation laws and the taxation laws permit the enterprise to make or receive a single net payment.

29. An enterprise should offset deferred tax assets and deferred tax liabilities if:

(a) the enterprise has a legally enforceable right to set off assets against liabilities representing current tax; and

(b) the deferred tax assets and the deferred tax liabilities relate to taxes on income levied by the same governing taxation laws.

30. 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.[5]

31. The break-up of deferred tax assets and deferred tax liabilities into major components of the respective balances should be disclosed in the notes to accounts.

32. 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.

Transitional Provisions

33. On the first occasion that the taxes on income are accounted for in accordance with this Statement, the enterprise should recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this Statement as deferred tax asset/liability with a corresponding credit/charge to the revenue reserves, subject to the consideration of prudence in case of deferred tax assets (see paragraphs 15-18). The amount so credited/charged to the revenue

[5] See also Accounting Standards Interpretation (ASI) 7, published elsewhere in this Compendium.

reserves should be the same as that which would have resulted if this Statement had been in effect from the beginning.[6]

34. For the purpose of determining accumulated deferred tax in the period in which this Statement is applied for the first time, the opening balances of assets and liabilities for accounting purposes and for tax purposes are compared and the differences, if any, are determined. The tax effects of these differences, if any, should be recognised as deferred tax assets or liabilities, if these differences are timing differences. For example, in the year in which an enterprise adopts this Statement, the opening balance of a fixed asset is Rs. 100 for accounting purposes and Rs. 60 for tax purposes. The difference is because the enterprise applies written down value method of depreciation for calculating taxable income whereas for accounting purposes straight line method is used. This difference will reverse in future when depreciation for tax purposes will be lower as compared to the depreciation for accounting purposes. In the above case, assuming that enacted tax rate for the year is 40% and that there are no other timing differences, deferred tax liability of Rs. 16 [(Rs. 100 - Rs. 60) x 40%] would be recognised. Another example is an expenditure that has already been written off for accounting purposes in the year of its incurrence but is allowable for tax purposes over a period of time. In this case, the asset representing that expenditure would have a balance only for tax purposes but not for accounting purposes. The difference between balance of the asset for tax purposes and the balance (which is nil) for accounting purposes would be a timing difference which will reverse in future when this expenditure would be allowed for tax purposes. Therefore, a deferred tax asset would be recognised in respect of this difference subject to the consideration of prudence (see paragraphs 15 - 18).

---

[6] It is clarified that an enterprise, which applies AS 22 for the first time in respect of accounting period commencing on 1st April, 2001, should determine the amount of the opening balance of the accumulated deferred tax by using the rate of income tax applicable as on 1st April, 2001. (See 'The Chartered Accountant', October 2001, pp.471-472).

Appendix 1

Examples of Timing Differences

Note: This appendix is illustrative only and does not form part of the Accounting Standard. The purpose of this appendix is to assist in clarifying the meaning of the Accounting Standard. The sections mentioned hereunder are references to sections in the Income-tax Act, 1961, as amended by the Finance Act, 2001.

1. Expenses debited in the statement of profit and loss for accounting purposes but allowed for tax purposes in subsequent years, e.g.

a) 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 but allowed for tax purposes in subsequent years on payment basis.

b) Payments to non-residents accrued in the statement of profit and loss on mercantile basis, but disallowed for tax purposes under section 40(a)(i) and allowed for tax purposes in subsequent years when relevant tax is deducted or paid.

c) Provisions made in the statement of profit and loss in anticipation of liabilities where the relevant liabilities are allowed in subsequent years when they crystallize.

2. Expenses amortized in the books over a period of years but are allowed for tax purposes wholly in the first year (e.g. substantial advertisement expenses to introduce a product, etc. treated as deferred revenue expenditure in the books) or if amortization for tax purposes is over a longer or shorter period (e.g. preliminary expenses under section 35D, expenses incurred for amalgamation under section 35DD, prospecting expenses under section 35E).

3. Where book and tax depreciation differ. This could arise due to:

a) Differences in depreciation rates.

b) Differences in method of depreciation e.g. SLM or WDV.

c) Differences in method of calculation e.g. calculation of

depreciation with reference to individual assets in the books but on block basis for tax purposes and calculation with reference to time in the books but on the basis of full or half depreciation under the block basis for tax purposes.

d) Differences in composition of actual cost of assets.

4. Where a deduction is allowed in one year for tax purposes on the basis of a deposit made under a permitted deposit scheme (e.g. tea development account scheme under section 33AB or site restoration fund scheme under section 33ABA) and expenditure out of withdrawal from such deposit is debited in the statement of profit and loss in subsequent years.

5. Income credited to the statement of profit and loss but taxed only in subsequent years e.g. conversion of capital assets into stock in trade.

6. If for any reason the recognition of income is spread over a number of years in the accounts but the income is fully taxed in the year of receipt.

Appendix 2

Note: This appendix is illustrative only and does not form part of the Accounting Standard. The purpose of this appendix is to illustrate the application of the Accounting Standard. Extracts from statement of profit and loss are provided to show the effects of the transactions described below.

Illustration 1

A company, ABC Ltd., prepares its accounts annually on 31st March. On 1st April, 20x1, it purchases a machine at a cost of Rs. 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 Rs. 2,00,000 each year and the corporate tax rate is 40 per cent each year.

The purchase of machine at a cost of Rs. 1,50,000 in 20x1 gives rise to a tax saving of Rs. 60,000. If the cost of the 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, 20x1, 20x2, 20x3)

	(Rupees in thousands)		
	20x1	20x2	20x3
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 (200 – 150)	20		
0.40 (200)		80	80

Deferred tax			
Tax effect of timing differences originating during the year			
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	40	20	0

In 20x1, the amount of depreciation allowed for tax purposes exceeds the amount of depreciation charged for accounting purposes by Rs. 1,00,000 and, therefore, taxable income is lower than the accounting income. This gives rise to a deferred tax liability of Rs. 40,000. In 20x2 and 20x3, 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 Rs. 50,000 each year. Accordingly, deferred tax liability is reduced by Rs. 20,000 each in both the years. As may be seen, tax expense is based on the accounting income of each period.

In 20x1, 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 Rs. 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 Rs. 50,000.

The following Journal entries will be passed:

Year 20x1

Profit and Loss A/c	Dr.	20,000	
To Current tax A/c			20,000

(Being the amount of taxes payable for the year 20x1 provided for)

Profit and Loss A/c	Dr.	40,000	
To Deferred tax A/c			40,000

(Being the deferred tax liability created for originating timing difference of Rs. 1,00,000)

Year 20x2

Profit and Loss A/c	Dr.	80,000	
To Current tax A/c			80,000

(Being the amount of taxes payable for the year 20x2 provided for)

Deferred tax A/c	Dr.	20,000	
To Profit and Loss A/c			20,000

(Being the deferred tax liability adjusted for reversing timing difference of Rs. 50,000)

Year 20x3

Profit and Loss A/c	Dr.	80,000	
To Current tax A/c			80,000

(Being the amount of taxes payable for the year 20x3 provided for)

Deferred tax A/c	Dr.	20,000	
To Profit and Loss A/c			20,000

(Being the deferred tax liability adjusted for reversing timing difference of Rs. 50,000)

In year 20x1, the balance of deferred tax account i.e., Rs. 40,000 would be shown separately from the current tax payable for the year in terms of paragraph 30 of the Statement. In Year 20x2, the balance of deferred tax account would be Rs. 20,000 and be shown separately from the current tax

payable for the year as in year 20x1. In Year 20x3, the balance of deferred tax liability account would be nil.

Illustration 2

In the above illustration, the corporate tax rate has been assumed to be same in each of the three years. If the rate of tax changes, it would be necessary for the enterprise 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 (see paragraphs 21 and 22). For example, if in Illustration 1, the substantively enacted tax rates for 20x1, 20x2 and 20x3 are 40%, 35% and 38% respectively, 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, 20x1 =	0.40 (1,00,000)	= Rs. 40,000
31st March, 20x2 =	0.35 (50,000)	= Rs. 17,500
31st March, 20x3 =	0.38 (Zero)	= Rs. 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, 20x1	Debit	= Rs. 40,000
31st March, 20x2	(Credit)	= Rs. (22,500)
31st March, 20x3	(Credit)	= Rs. (17,500)

Illustration 3

A company, ABC Ltd., prepares its accounts annually on 31st March. The company has incurred a loss of Rs. 1,00,000 in the year 20x1 and made profits of Rs. 50,000 and 60,000 in year 20x2 and year 20x3 respectively. It is assumed that under the tax laws, loss can be carried forward for 8 years and tax rate is 40% and at the end of year 20x1, it was virtually certain, supported by convincing evidence, that the company would have sufficient taxable income in the future years against which unabsorbed depreciation and carry forward of losses can be set-off. It is also assumed that there is

no difference between taxable income and accounting income except that set-off of loss is allowed in years 20x2 and 20x3 for tax purposes.

Statement of Profit and Loss
(for the three years ending 31st March, 20x1, 20x2, 20x3)

	(Rupees in thousands)		
	20x1	20x2	20x3
Profit (loss)	(100)	50	60
Less: Current tax	—	—	(4)
Deferred tax:			
Tax effect of timing differences originating during the year	40		
Tax effect of timing differences reversing during the year	—	(20)	(20)
Profit (loss) after tax effect	(60)	30	36