Chapter – Decision Making – CA Final – Costing

CASE - To Understand following line & implication

"The after tax incremental profit will be shared by all as follows:

30% to be ploughed back, 40% to be shared by workers and 30% to be shared by staff"

Profit before tax (After all expenses) as per books of accounts under Company Act is Rs.100
Payment made to workers is tax deductible.
Income Tax Rate is 50%
Distribute the above profit among above beneficiaries & Government ?

Solution

First understand following points:-

- We know that profit before tax under books of accounts (Company Act) and profit before tax under income tax are different.
- An item which is deductible as expense under income tax act may not be treated as expense under company' Act e.g. donation paid to political party is tax deductible at higher rate 150%. In such case **extra 50%** is deductible as an expense under income tax but not treated as expense under company Act.
- In our question also, share of profit distributed to worker will be treated as expense under income tax act but shall not be treated as expense under company Act.

Statement showing Profit After Tax under **Income Tax Act**

Particulars	Amount (Rs.)
Profit before tax (**After all expenses** but before reducing worker share) – As per books under company Act	100
Less worker share in profit after tax – 40%	
Profit before tax (**After all expenses** & after reducing worker share)	
Less Tax to Govt – 50%	
Profit after all expenses & Tax	

Let us assume Profit after all expenses & Tax be Rs. P

Then let us re-state above table –

Sl.	Particulars	Amount (Rs.)
1	Profit before tax (**After all expenses** but before reducing worker share)	100
2	Less worker share in profit after tax – 40%	0.40P
3	Profit before tax (**After all expenses** & after reducing worker share)	100 – 0.40P
4	Less Tax to Govt – 50% of [100 – 0.40P]	50 – 0.20P
5	Profit after all expenses & Tax	P

Please keep in mind "Do Not calculate Profit after all expenses & Tax as [Sl. No. 4 – Sl. No. 5] since we have assumed Profit after all expenses & Tax be Rs. P"

Equation showing profit after tax under company Act

Profit before tax (**After all expenses**) **as per company Act – Actual Paid Tax =** Profit after all expenses & Tax

100 – [50 – 0.20P] = P

50 + 0.20P = P

50 = 0.80P

P = Rs. 62.50

Implication of above is that if
Profit before tax (**After all expenses**) **=** Rs.100
Then Profit after all expenses & Tax = Rs.62.50
Hence Tax = Rs. 100 – 62.50 = Rs. 37.50

Distribution table as follows

Particulars	Amount (Rs.)
Profit before tax (**After all expenses**) **– A**	100
Tax – B	37.50
Profit after all expenses & Tax – [A – B]	62.50
30% **of Profit after all expenses & Tax** to be ploughed back	62.50 X 30% = 18.75
40% **of Profit after all expenses & Tax** to be shared by workers	62.50 X 40% = 25.00
30% **of Profit after all expenses & Tax** to be shared by staff	62.50 X 30% = 18.75

If we wishes to convert all distribution to Profit before tax (**After all expenses**) then table shall be as follows:

Particulars	Amount (Rs.)	% to Profit before tax (**After all expenses**)
Profit before tax (**After all expenses**)	100	100%
Tax	37.50	37.50%
30% to be ploughed back	18.75	18.75%
40% to be shared by workers	25.00	25.00%
30% o be shared by staff	18.75	18.75%