

Exposure Draft
Accounting Standard (AS) 12
Income Taxes

Last date for the comments: June 10,
2021

Objective

Comments:

The objectives may be broken down into parts for realizing the importance instead of a running 'Para' as below:

- determine whether a tax is an income tax
- identify the assets and liabilities that would be expected to affect taxable profit if they were recovered or settled for their present carrying amounts
- determine the tax basis of assets, liabilities and other items that have a tax basis although they are not recognised as assets or liabilities
- identify and compute temporary differences, unused tax losses and unused tax credits
- assess when it is necessary to recognise a valuation allowance against a deferred tax asset
- allocate current and deferred tax to the related components of comprehensive income and equity
- present and disclose income tax in financial statements
- demonstrate an understanding of significant estimates and other judgements that are required in accounting for income tax.

[Reason: The 'objectives' are the base for Revised AS 12 and hence if very specific it is more receptive]

Scope

Comments:

Para:1 may be re-worded as below:

1. This Standard shall be applied in accounting for **Income tax on income**. This includes the determination of the amount of the expense or saving related to **Income tax on income** in respect of an accounting period and the disclosure of such an amount in the financial statements.

[Reasons: 'Taxes on income' are many: personal income tax, Corporate tax, Capital gain tax, wealth tax (repealed). Title of AS 12 itself is 'Income taxes' and not 'tax on income'.]

Para:2 to be reworded as below:

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

Para:5 to be reworded as below:

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

principles applied to determine accounting income. The effect of this difference is that the taxable income and accounting income may not be the same.

[Reason: Accounting policies are the specific principles and procedures implemented by a company's management team that are used to prepare its financial statements. These include any accounting methods, measurement systems, and procedures for presenting disclosures. Accounting policies differ from accounting principles in that the principles are the accounting rules and the policies are a company's way of adhering to those rules.]

Para: 7 to be merged with para:6

[Reason: Para 6 deals with 'permanent differences' and 'timing differences' and hence 'timing difference' cannot be a separate Para.]

Para: 6 to 'add'-

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. **Taxable income may be different from the accounting income due to various reasons like: Some items which are debited in profit and loss account are not allowed as expenses as per Income Tax or Some expenses which are wholly debited in Profit and loss account but are allowed as expenses in part or amortized over some years.**

Permanent differences between the financial profit and taxable profit arise when income is not taxable or expenses are not allowed for tax.

A government grant may be a gift that is not taxed. Government bonds often provide tax-free interest income, or may be taxed at a lower rate than the standard income tax rate for companies.

Fines paid by an undertaking may not be tax-deductible.

The tax computation for the period will calculate the impact of these transactions.

No further accounting is needed and no deferred asset or liability will be recorded.

Amortization of goodwill considered as disallowable expense for computing Taxable income

Personal expenditure disallowed by tax authorities

Penalty (Not being compensatory) is disallowable expense for computing Taxable income

Payments disallowed U/s 40(A)(3) of Income Tax Act, 1961

Donations to the extent not allowed for computing Taxable income

Remuneration to partners disallowed U/s 40(b) of Income Tax Act

'Timing difference' arises when the recognition of certain item in the financial statements occurs in a different time than its recognition in tax return, for example, interest received is taxed deductible only when cash is received. Timing difference also arises when the recognition of certain item in the financial statements occurs in a different time than its recognition in tax return, for example-

accrued expenses are tax deductible only when paid.

Provision for Bad/Doubtful debts

Expense allowable on payment basis, like expense u/s 43B of Income Tax Act, 1961

Allowance of Excessive depreciation u/s 32 and 32AC of Income Tax Act, 1961.

Preliminary expenses

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 Illustration 1. **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 probability (see paragraphs 15-19).**

Para:8 to be deleted since it is merged with para:7

[Reason: Unabsorbed depreciation and carry forward of losses are 'timing differences and hence to continue under Para:6/7]

Para:8 All timing differences result in temporary differences, since the carrying amount of assets and liabilities are affected by the income and expenses that are recognised in respect of them, and the tax base is generally affected by tax deductions. Because it addresses all timing differences, the temporary difference approach ensures that the total tax expense recognised in a period generally equals the standard rate of tax applied to pre-tax income, except for the effect of items that have no tax consequence and the

impact of tax rate changes. This relatively stable relationship may be useful in assessing the likely future reported effective tax rate that will apply to the entity's income.

All temporary differences are timing differences. For example, where an asset is acquired in a business combination, its carrying value will reflect its fair value at the time of acquisition, while its tax base may be only the lower cost incurred less any tax depreciation taken by the acquired entity. The position is the same as if the difference related to accelerated depreciation allowed for tax—the carrying amount of the asset is not fully deductible for tax purposes. Advocates of the temporary difference approach would suggest that, because the economic position is similar in these two cases, comparability requires that the financial reporting reflect that similarity. The temporary difference approach achieves that.

[Reason: one more para added to stress the importance of 'timing differences']

Definitions

Comments:

'Definitions' must precede 'Scope'

[Reasons: The Para 'Definition' starts from Serial No.4. This head must be independent and not to be under the Para 'Scope'. It would be better if 'Definitions' precede para 'Scope']

Measurement

Comments:

This Para may add-

Deferred taxes and income taxes should always be recognized on the income statement unless they relate to:

- (i) taxes or deferred taxes that are charged directly to equity; or
- (ii) a possible provision for deferred taxes that is related to a business combination.

If there is doubt that the deferral will be recovered, the carrying amount should be reduced to the expected recoverable amount. The reduction may, however, be reversed in the event that circumstances subsequently change and suggest that recovery of the deferral will occur in the future.

If an item which gives rise to a deferred tax liability is taken directly to equity, the same should apply to the resulting deferred tax.

A suitable adjustment should be made once it is determined that a deferred tax liability will not be reversed. In this event, the deferred tax liability will be reduced by an amount that is taken directly to equity. Deferred taxes related to a business combination must also be recognized in equity.

Review of Deferred Tax Assets

Comments:

This para may add-

Deferred tax assets and liabilities are defined as the current statutory corporate tax rate times the historical sum of the firm's temporary differences.

Firms/Organizations for which taxable income has exceeded book income will have a deferred tax asset. A firm with a net operating loss carry forward would have a DTA.

For many firms/Organizations, and for many but not all components of deferred taxes, a reduction in the statutory corporate tax rate would reduce the value of deferred tax assets and therefore reduce current earnings.

Presentation and Disclosure

Comments:

Para: 31 may add-

Firms/Organizations must report both deferred tax assets and deferred tax liabilities, not just a net deferred tax position. Deferred tax positions are presented on the balance sheet based on current/non-current classification, as determined by the current/non-current status of the underlying asset or liability that gave rise to the deferred tax position.

Organizations/Firms must adjust their reported DTAs and DTLs when laws change. Changes in statutory corporate tax rates, for example, must be reflected in a firm's DTAs or DTLs. This can link tax policy changes to reported earnings in a way that goes beyond the taxation of current income. For many Organizations/Firms, and for many but not all components of deferred taxes, a reduction in the statutory corporate tax rate would reduce the value of deferred tax assets and therefore reduce current earnings.

Transitional Provisions

Comments:

Para: 35 says 'for the purpose of determining accumulated deferred tax in the period in which this Standard 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, shall be recognised as deferred tax assets or liabilities, if these differences are timing differences.'

Indirectly AS 12 to be applied retrospectively. Applying it retrospectively would require an entity to identify transactions that gave rise to asset and liability of equal amounts on initial recognition from the date of first transaction in the history of an entity and see whether, in such a case, the deferred tax liability was recognised only to the extent of deferred tax asset.

Any retrospective exercise will be tedious and the costs of applying it to already recognised assets and liabilities is likely to exceed the benefits that would be derived from such an exercise which could be impracticable in some cases.

Comments in General:

The proposed revision of AS 12 is based on differences between taxable income and accounting income that are classified into permanent and timing differences. This is not in line with IFRS for Small and Medium-Sized Entities that follows a temporary difference approach, similar to IAS 12.

The proposed revision of AS 12 is based on income statement approach. It requires recognition of tax consequences of differences between taxable income and accounting income. Revised AS 12 does not specifically deal with current and deferred tax that are recognised as 'income' or an 'expense' and included in profit or loss for the period under Ind AS 12.

Tax Holiday is a benefit provided to new undertakings established in free trade zones, 100% export oriented undertakings etc., under section 10A, 10B of the Income Tax Act, 1961. To encourage the production and consumption of certain items, the government exempts certain taxes for a temporary period subject to certain condition. Deferred tax from the timing difference that reverses during the tax holiday period should not be recognised during the enterprise's tax holiday period. Deferred tax related to the timing difference that reverses after the tax holiday has to be recognised in the year of origination. The deferred tax in respect of timing differences which reverse during the tax holiday period is not recognised to the extent the entity's gross total income is subject to the deduction during the tax holiday period as per the requirements of sections 80IA/80IB/10A/10B. Since revised AS 12 does not specifically deal with deferred tax in respect of timing differences, the AS 12 has to explain the effect of such exclusion on Tax Holiday for EOUs, FTZ, SEZ and like. Deferred tax asset and deferred tax liability impacts MAT. When the revised AS 12 not intending to deal with deferred tax, the impact on MAT u/s:115JB of Income Tax Act, 1961 is to be further explained.

In terms of analysis of user needs there can be gap between the information provided under Revised AS 12 and that required by users to enable them to predict future tax cash flows. That said it may not be appropriate to satisfy such needs through additional disclosures in the – Financial statements but other parts of the corporate report may provide a better location for such information.

The amount of income tax relating to each component of other comprehensive income (including re-classification adjustments) is required to be disclosed either in the statement of comprehensive income or in the notes. An entity may present items of other comprehensive income either net of related tax effects, or before related tax effects with one amount shown for the aggregate amount of income tax relating to those components.

The following information must be disclosed about the components of tax expense for each year for which a statement of comprehensive income is presented. The components of tax expense (income), which may include some or all of the following:

- In respect of current tax:

- The current tax expense (income).
- Any adjustments recognised in the period for current tax of prior periods.
- The amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is to reduce current tax expense.
- The amount of tax expense (income) relating to those changes in accounting policies and errors, because they cannot be accounted for retrospectively.

- In respect of deferred tax:

- The amount of deferred tax expense (income) relating to the origination and reversal of temporary differences.
- The amount of deferred tax expense (income) relating to the changes in tax rates or the imposition of new taxes.
- The amount of the benefit arising from previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce deferred tax expense.
- The amount of tax expense (income) relating to those changes in accounting policies and errors that are included in profit or because they cannot be accounted for retrospectively.

Another important disclosure requirement relates to an explanation of the relationship between tax expense (tax income) and accounting profit. An explanation of such matters should enable users of financial statements to understand whether the relationship between tax expense and accounting profit is unusual and to understand the significant aspects that could affect that relationship in the future.

The challenge of reconciling accounting profit with tax income begins with identifying 'whose book income', single entities or consolidated group of entities.

Users are interested in clear and transparent tax notes and other disclosures that explain the reconciliation of the income tax expense without technical complexity. The proposed revised AS 12 neither requires a specific structure for such reconciliation nor identifies any reconciliation items. As a result, the wide variation across entities in the level of detail and the terms used to describe their reconciling items potentially introduces a problem for the

users of financial statements. Differences in characterisation and aggregation across entities reduce understanding and make the comparison difficult because similar transactions are reported differently and different transactions are reported similarly. To solve the problems associated with divergent classifications across entities, there may be some benefit in providing some standardisation by grouping similar items together and by using the same terms for the main categories. For categorising the typical items that needed to be reconciled, the following seven main categories may be considered:

Exposure Draft

Accounting Standard (AS) 12

Income Taxes

Last date for the comments: June 10, 2021



Issued by
Accounting Standards Board
The Institute of Chartered Accountants of India

Exposure Draft

Accounting Standard (AS) 12, *Income Taxes*

The Indian Accounting Standards (Ind AS), as notified by the Ministry of Corporate Affairs in February 2015, are applicable to the specified class of companies. Accounting Standards notified under Companies (Accounting Standards) Rules, 2006, and those issued by the ICAI are applicable to entities to whom Ind AS are not applicable. However, on the basis of the discussions held at various standard setting forums, such as, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI), NACAS¹ and the Ministry of Corporate Affairs (MCA), it has been decided to revise the Accounting Standards. Accordingly, the Accounting Standards Board of ICAI has initiated the process of upgradation of these standards which will be applicable to the entities to whom Ind AS are not applicable. While formulating these Standards, it was decided to maintain the consistency with the numbering of Standards of the Ind AS.

In the above background, the ASB has finalised AS 12, *Income Taxes*, taking AS 22, *Accounting for Income Taxes*, notified by MCA as the base. Major differences between draft of revised AS 12 and Ind AS 12, *Income Taxes*, are included in the Appendix 1 of the Standard. Major differences between draft of revised AS 12 and AS 22 are given in Appendix 2 of the Standard.

This is the Exposure Draft of the revised Accounting Standard (AS) 12, *Income Taxes*, issued by the ASB, for comments. Revised AS 12 refers to provisions of various revised AS which are under formulation.

The ASB invites comments on any aspect of this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

How to Comment:

*Comments can be submitted using one of the following methods so as to receive not later than **June 10, 2021**.*

| | |
|-----------------|--|
| Electronically: | click on http://www.icai.org/comments/asb/ to submit comments online |
| Email: | Comments can be sent at commentsasb@icai.in |
| Postal: | Secretary, Accounting Standards Board, The Institute of Chartered Accountants of India ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002 |

Further clarifications on any aspect of this Exposure Draft may be sought by e-mail to asb@icai.in.

¹Prior to the constitution of National Financial Reporting Authority (NFRA) on October 1, 2018, NACAS was advisory/recommendatory body to MCA for prescribing Accounting Standards under Section 133 of the Companies Act, 2013.

Accounting Standard (AS) 12

Income Taxes

*[This Accounting Standard includes paragraphs set in **bold** type and plain type, which have equal authority. Paragraphs in bold type indicate the main principles.]*

Objective

The objective of this Standard 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 entity. 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 Standard shall 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.**
2. For the purposes of this Standard, taxes on income include all domestic and foreign taxes which are based on taxable income.
3. This Standard does not specify when, or how, an entity shall account for taxes that are payable on distribution of dividends and other distributions made by the entity.

Definitions

- 4. For the purpose of this Standard, 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 requirements of 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 does 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 Illustration 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 probability (see paragraphs 15-19).

Recognition

9. **Tax expense for the period, comprising current tax and deferred tax, shall be included in the determination of the profit or loss for the period.**
10. Taxes on income are considered to be an expense incurred by the entity 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 probability as set out in paragraphs 15-19) 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 **result neither in deferred tax assets nor in deferred tax liabilities.**
13. **Deferred tax shall be recognised for all the timing differences, subject to the consideration of probability in respect of deferred tax assets as set out in paragraphs 15-19.**

Explanation:

- (a) **The deferred tax in respect of timing differences which reverse during the tax holiday period is not recognised to the extent the entity's gross total income is subject to the deduction during the tax holiday period as per the requirements of sections 80IA/80IB of the Income-tax Act, 1961.**

To the extent of the sum of timing differences reversing during the tax holiday period, the timing differences originating during the tax holiday period is also not recognized (see Note 1 to Table 3 in the Standard).

During the tax holiday period, the net originating timing differences (timing differences originating during the tax holiday period less timing differences reversing during the tax holiday period itself) would be accounted for as a debit to tax expense account as against the corresponding credit to deferred tax liability account.

In case of sections 10A/10B of the Income-tax Act, 1961 (covered under Chapter III of the Income-tax Act, 1961 dealing with incomes which do not form part of total income), the deferred tax in respect of timing differences which reverse during the tax holiday period is not recognised to the extent deduction from the total income of an entity is allowed during the tax holiday period as per the provisions of the said sections.

Deferred tax in respect of timing differences which reverse after the tax holiday period is recognised in the year in which **which these reversing timing differences arise.**

- (b) **However, recognition of deferred tax assets is subject to the consideration of probability as laid down in paragraphs 15 to 19.**
- (c) **For the above purposes, the timing differences which originate first are considered to reverse first.**

The application of the above explanation is illustrated in the Illustration I attached to the Standard.

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

- 15. Deferred tax assets shall be recognised and carried forward only to the extent that it is probable that sufficient future taxable income will be available against which such deferred tax assets can be realised.**
16. The reversal of timing differences results in deductions in determining future taxable income. However, economic benefits in the form of reductions in tax payments will flow to the entity only if it earns sufficient future taxable income against which the deductions can be offset. Therefore, an entity recognises deferred tax assets only when it is probable that future taxable income will be available against which the timing differences can be realised.
- 17. Where an entity has unabsorbed depreciation or carry forward of losses under tax laws,**

deferred tax assets shall be recognised only to the extent that it is probable that sufficient future taxable income will be available against which such deferred tax assets can be realised.

Explanation:

1. (a) As per the relevant provisions of the Income-tax Act, 1961, the 'loss' arising under the head 'Capital gains' can be carried forward and set-off in future years, only against the income arising under that head as per the requirements of the Income-tax Act, 1961.
 - (b) Where an entity's statement of profit and loss includes an item of 'loss' which can be set-off in future for taxation purposes, only against the income arising under the head 'Capital gains' as per the requirements of the Income-tax Act, 1961, that item is a timing difference to the extent it is not set-off in the current year and is allowed to be set-off against the income arising under the head 'Capital gains' in subsequent years subject to the provisions of the Income-tax Act, 1961. In respect of such 'loss', deferred tax asset is recognised and carried forward subject to probability that sufficient future taxable income will be available against which such deferred tax assets can be realised. Accordingly, in respect of such 'loss', deferred tax asset is recognised and carried forward only to the extent that it is probable that sufficient future taxable income will be available under the head 'Capital gains' against which the loss can be set-off as per the provisions of the Income-tax Act, 1961. The examples of situations in which it is probable that sufficient future taxable income for the purposes of the recognition of deferred tax asset in respect of loss arising under the head 'Capital gains' is available, are a sale of an asset giving rise to capital gain (eligible to set-off the capital loss as per the provisions of the Income-tax Act, 1961) after the balance sheet date but before the financial statements are approved, and a binding sale agreement which will give rise to capital gain (eligible to set-off the capital loss as per the provisions of the Income-tax Act, 1961).
 - (c) In cases where there is a difference between the amounts of 'loss' recognised for accounting purposes and tax purposes because of cost indexation under the Income-tax Act, 1961 in respect of long-term capital assets, the deferred tax asset is recognised and carried forward (subject to the probability) on the amount which can be carried forward and set-off in future years as per the provisions of the Income-tax Act, 1961.
18. The criteria for recognising deferred tax assets arising from unabsorbed depreciation and carry forward of losses are the same as the criteria for recognising deferred tax assets arising from timing differences. However, 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 entity has a history of recent losses, the entity recognises deferred tax assets only to the extent either 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, paragraph 33 requires disclosure of the amount and nature of the evidence supporting its recognition.
 19. An entity considers the following criteria in assessing the probability that future taxable income will be available against which the unabsorbed depreciation or carry forward of losses under tax laws can be realised:

- (a) whether the entity has sufficient taxable timing differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unabsorbed depreciation or carry forward of losses under tax laws can be utilised before *these* expire;
- (b) whether it is probable that the entity will have future taxable income before the unabsorbed depreciation or carry forward of losses under tax laws expire;
- (c) whether the unabsorbed depreciation or carry forward of losses under tax laws result from identifiable causes which are unlikely to recur; and
- (d) whether tax planning opportunities are available to the entity that will create taxable profit in the period in which the unabsorbed depreciation or carry forward of losses under tax laws can be utilised.

To the extent that it is not probable that future taxable income will be available against which the unabsorbed depreciation or carry forward of losses under tax laws can be realised, the deferred tax asset is not recognised.

Re-assessment of Unrecognised Deferred Tax Assets

- 20. At each balance sheet date, an entity re-assesses unrecognised deferred tax assets. The entity recognises previously unrecognised deferred tax assets to the extent that it has become probable (see paragraphs 15 to 19), 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 more probable that the entity will be able to generate sufficient taxable income in the future.

Measurement

- 21. **Current tax shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws.**
- 22. **Deferred tax assets and liabilities shall be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.**

Explanation:

- (a) **The payment of tax under section 115JB of the Income-tax Act, 1961 is a current tax for the period.**
 - (b) **In a period in which a company pays tax under section 115JB of the Income-tax Act, 1961, the deferred tax assets and liabilities in respect of timing differences arising during the period, tax effect of which is required to be recognised under this Standard, is measured using the regular tax rates and not the tax rate under section 115JB of the Income-tax Act, 1961.**
 - (c) **In case an entity expects that the timing differences arising in the current period would reverse in a period in which it may pay tax under section 115JB of the Income-tax Act, 1961, the deferred tax assets and liabilities in respect of timing differences arising during the current period, tax effect of which is required to be recognised under AS 12, is measured using the regular tax rates and not the tax rate under section 115JB of the Income-tax Act, 1961.**
- 23. Deferred tax assets and liabilities are usually measured using the tax 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.

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

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

26. 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 entities. Therefore, this Standard **neither requires nor permits** the discounting of deferred tax assets and liabilities.

Review of Deferred Tax Assets

27. The carrying amount of deferred tax assets should be reviewed at each balance sheet date. An entity shall write-down the carrying amount of a deferred tax asset to the extent that it is no longer probable (see paragraphs 15 to 19), 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 probable (see paragraphs 15 to 19), that sufficient future taxable income will be available.

Presentation and Disclosure

28. An entity shall offset assets and liabilities representing current tax if the entity:

(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.**

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

30. An entity shall offset deferred tax assets and deferred tax liabilities if:

(a) **the entity 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.**

31. Deferred tax assets and liabilities shall be distinguished from assets and liabilities representing current tax for the period. Deferred tax assets and liabilities shall be disclosed under a separate heading in the balance sheet of the entity, separately from current assets and current liabilities.

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

33. **The amount of deferred tax asset and nature of the evidence supporting its recognition shall be disclosed, if an entity has unabsorbed depreciation or carry forward of losses under tax laws.**

Transitional Provisions

34. **On the first occasion that the taxes on income are accounted for in accordance with this Standard the entity shall recognise, in the financial statements, the deferred tax balance that has accumulated prior to the adoption of this Standard as deferred tax asset/liability with a corresponding credit/charge to the revenue reserves, subject to the consideration of probability in case of deferred tax assets (see paragraphs 15-19). The amount so credited/charged to the revenue reserves shall be the same as that which would have resulted if this Standard had been in effect from the beginning.**
35. For the purpose of determining accumulated deferred tax in the period in which this Standard 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, shall be recognised as deferred tax assets or liabilities, if these differences are timing differences. For example, in the year in which an entity adopts this Standard, the opening balance of a fixed asset is Rs. 100 for accounting purposes and Rs. 60 for tax purposes. The difference is because the entity 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 $[(Rs. 100 - Rs. 60) \times 40\%]$ 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 probability (see paragraphs 15 – 19).

Illustration I

Examples of Timing Differences

Note: This illustration does not form part of the Accounting Standard. The purpose of this illustration 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 from time to time.

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 for tax purposes 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.

Illustration II

Note: This illustration does not form part of the Accounting Standard. Its purpose 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 | <u>50</u> | <u>50</u> | <u>50</u> |
| Profit before taxes | <u>150</u> | <u>150</u> | <u>150</u> |
| 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) | | <u>(20)</u> | <u>(20)</u> |
| Tax expense | <u>60</u> | <u>60</u> | <u>60</u> |
| Profit after tax | <u>90</u> | <u>90</u> | <u>90</u> |
| Net timing differences | <u>100</u> | <u>50</u> | <u>0</u> |
| Deferred tax liability | <u>40</u> | <u>20</u> | <u>0</u> |

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 or loss is debited and deferred tax liability 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 is debited and profit or loss 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 or Loss | Dr. | 20,000 | |
| | | | To Current tax |
| | | | 20,000 |

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

| | | | |
|----------------|-----|--------|-----------------|
| Profit or Loss | Dr. | 40,000 | |
| | | | To Deferred tax |
| | | | 40,000 |

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

Year 20x2

| | | | |
|----------------|-----|--------|----------------|
| Profit or Loss | Dr. | 80,000 | |
| | | | To Current tax |
| | | | 80,000 |

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

| | | | |
|--------------|-----|--------|-------------------|
| Deferred tax | Dr. | 20,000 | |
| | | | To Profit or Loss |
| | | | 20,000 |

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

Year 20x3

| | | | |
|----------------|-----|--------|----------------|
| Profit or Loss | Dr. | 80,000 | |
| | | | To Current tax |
| | | | 80,000 |

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

| | | | |
|--------------|-----|--------|-------------------|
| Deferred tax | Dr. | 20,000 | |
| | | | To Profit or Loss |
| | | | 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 Standard. 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.

Following 5 tables and 2 Summary Explanations may be inserted:

TABLE - 1

Calculation of Originating & Reversing Timing Differences based on tax and book profit amounts

(Rupees in thousands)

| | 20x1 | 20x2 | 20x3 |
|--|-------------|-------------|-------------|
| 1) PBDT | 200 | 200 | 200 |
| 2) Less : Depreciation Allowance | 150 | 0 | 0 |
| ----- | | | |
| 3) Tax Profit or Taxable Income | 50 | 200 | 200 |
| ===== | | | |
| 4) PBDT | 200 | 200 | 200 |
| 5) Straight-line book depreciation for 3 years | 50 | 50 | 50 |
| ----- | | | |
| 6) Book Profit before tax or accounting income | 150 | 150 | 150 |
| ===== | | | |
| 7) Originating Timing Difference Excess of book profit over tax profit | 100 | | |
| 8) Reversing Timing Difference Excess of tax profit over book profit | | 50 | 50 |

TABLE - 2

**Method 1 - Entries as per Definitions :
for deferred tax
(see TABLE - 1)**

(Rupees in thousands)

20X1 20X2 20X3

Logic underlying the entries to make for deferred tax:

| | | | | |
|---|---|-----|----|----|
| 1 | Book depreciation less by & Book profit more by | 100 | | |
| 2 | Tax payable on book profit more by 40% thereof | 40 | | |
| 3 | Book depreciation more by & Book profit less by | | 50 | 50 |
| 4 | Tax payable on book profit less by 40% thereof | | 20 | 20 |

Deferred tax entries:

| | | | | |
|---|---|-----------|-----------|-----------|
| 1 | Deferred tax liability a/c Credit | 40 | | |
| | (since tax payable on book profit is more by this sum on account of the tax on originating timing difference) (see entry line 5 in TABLE - 4 below) | | | |
| 2 | Deferred tax liability a/c Debit | 20 | | 20 |
| | (since tax expense is more by this sum on account of the tax on reversing timing difference) (see entry line 6 in TABLE - 4 below) | | | |
| 3 | Deferred tax expense a/c Debit | 40 | | |
| | (contra debit completed in this account which is part of the tax expense) (see entry line 2 in TABLE - 4 below) | | | |
| 4 | Deferred tax expense a/c Credit | | 20 | 20 |
| | (contra credit completed in this account which is part of the tax expense) (see entry line 3 in TABLE - 4 below) | | | |
| 5 | Tax Expense a/c Debit | 40 | 20 | 20 |
| | (see entry line 7 in TABLE - 4 below) | | | |
| 6 | Deferred tax expense a/c Credit / Debit | 40 | 20 | 20 |
| | (transfer to tax expense - see entry line 9 in TABLE - 4 below) | | | |

Summary Explanation for the deferred tax entries in respect of the sums of tax on originating and reversing timing difference sums :

- 1 If the originating timing difference is the tax sum that increases the tax payable on book profit, **credit deferred tax liability account, debiting the deferred tax account** (which debit is later transferred to tax expense account, of which it is a part).
- 2 An example of the situation set out in (1) above, is when the depreciation allowance sum is more than the book depreciation sum, which results in a bigger sum of book profit, increasing the tax payable on the same.
- 3 In the situation set out in (1) above, the tax payable on book profit would decrease in the succeeding years, in which the originating timing difference would reverse and hence, **debit the deferred tax liability account** (in order to cancel the credit given under item 1 above), **crediting the deferred tax account** (which credit is later transferred to tax expense account, of which it is a part).
- 4 An example of the situation set out in (3) above, is when the depreciation allowance is less than the book depreciation, which results in a smaller sum of book profit, decreasing the tax payable on the same.
- 5
 - a) **If the tax payable on book profit increases due to the originating timing difference, credit deferred tax liability account debiting the tax expense account (routing the entry through the deferred tax account, first debiting and then crediting the same); and,**
 - b) **if the tax payable on book profit decreases due to the originating timing difference, debit deferred tax asset account, crediting tax expense account (routing the entry through the deferred tax account, first crediting and then debiting the same)**
- 6
 - a) **If the tax payable on book profit decreases due to the reversing timing difference, debit deferred tax liability account [because this account was first credited under item 5(a) above] crediting the tax expense account (routing the entry through the deferred tax account, first crediting and then debiting the same); and,**
 - b) **if the tax payable on book profit increases due to the reversing timing difference, credit the deferred tax asset account [because this account was first debited under item 5(b) above] debiting the tax expense account (routing the entry through deferred tax account, first debiting and then crediting the same)**

TABLE - 3**Method 2¹ - Entries on the basis that tax expense**

is based on accounting income: **(Rupees in thousands)**
(see TABLE - 1) **20x1** **20x2** **20x3**

Logic underlying the entries to make for deferred tax:

| | | | | |
|---|---|-----|----|----|
| 1 | Book depreciation less by & Book profit more by | 100 | | |
| 2 | Tax payable on book profit more by 40% thereof | 40 | | |
| 3 | Book depreciation more by & Book profit less by | | 50 | 50 |
| 4 | Tax payable on book profit less by 40% thereof | | 20 | 20 |

-----**Deferred tax entries:**

| | | | | |
|---|--|-----------|-----------|-----------|
| 1 | Deferred tax liability a/c Credit | 40 | | |
| | (since tax payable on book profit is more by this sum on account of the tax on originating timing difference) (see entry line 5 in TABLE - 4 below) | | | |
| 2 | Deferred tax liability a/c Debit | | 20 | 20 |
| | (since tax expense is more by this sum on account of the tax on reversing timing difference) (see entry line 6 in TABLE - 4 below) | | | |
| 3 | Tax Expense a/c Debit | 40 | 20 | 20 |
| | (see entry line 7 in TABLE - 4 below) | | | |

Footnote:

- ¹ It is obvious that Method 2 is more concise, as compared to Method 1 set out in TABLE - 2 above.

| TABLE - 4 | | 20x1 | 20x2 | 20x3 |
|--|--|------------------------------|-------------|-------------|
| Method 1 - Entries as per Definitions : | | (Rupees in thousands) | | |
| 1 | Current tax expense a/c Debit With the amount of PBDT Less Depreciation Allowance * 40% tax rate | 20 | 80 | 80 |
| 2 | Deferred Tax expense a/c Debit Originating timing difference * 40% tax rate (cancelled by credit as per line item 9) (see entry line 3 in TABLE-2 above) | 40 | | |
| 3 | Deferred Tax expense a/c Credit Reversing timing difference * 40% tax rate (cancelled by debits as per line item 10) (see entry line 4 in TABLE-2 above) | | 20 | 20 |
| 4 | Current Tax Payable a/c Credit | 20 | 80 | 80 |
| 5 | Deferred Tax Liability A/c Credit (see entry line 1 in TABLE-2 above) | 40 | | |
| 6 | Deferred Tax Asset A/c Debit (cancelled by credit as per line item 11) (see entry line 2 in TABLE-2 above) | | 20 | 20 |
| 7 | Tax Expense or P/L a/c Debit (Total / Net of current tax and Deferred tax) (see entry line 5 in TABLE-2 above) | 60 | 60 | 60 |
| 8 | Current tax expense a/c Credit | 20 | 80 | 80 |
| 9 | Deferred tax expense a/c Cr / Dr (cancellation of debit as per line item 2 and of credits as per line item 3) (see entry line 6 in TABLE-2 above) | 40 | 20 | 20 |
| 10 | Deferred Tax Liability a/c Debit¹ | | 20 | 20 |
| 11 | Deferred Tax Asset a/c Credit (cancellation of debit as per line item 6) | | 20 | 20 |

¹ As per paragraph 30, deferred tax assets and liabilities can be set off only if the entity has the right under the tax laws to set off current tax assets against current tax liabilities. **Under the Income Tax Act, the brought forward prior year tax losses can be set off against the subsequent year tax profits. This means that the current tax asset on the brought forward prior tax losses can be set off against the current tax liability on the current year tax profits.** Additionally, the tax on profits is levied only through the Income Tax Act. Consequently, the deferred tax asset has been set off against the deferred tax liability through this transfer entry.

Summary Explanation for the double entries in Table 4 above:

- Since the tax expense is the aggregate of current and deferred taxes as per the definition reproduced below, the balances in these 2 accounts are to be transferred to tax expense account (**see line items 7 to 9 in Table – 4 above**).
- Since current tax amount is the tax amount payable or recoverable, the **current tax payable account is to be credited or current tax recoverable account is to be debited**, and
 - the contra debit or credit is to be given to current tax account (which gets transferred to tax expense account as aforesaid)..
- Since deferred tax is the tax effect of the timing differences,-whether originating or reversing,-
 - 1) a) **if the tax payable on book profit increases due to the originating timing difference, credit deferred tax liability account debiting the tax expense account (routing the entry through the deferred tax account, first debiting and then crediting the same); and,**
 - b) **if the tax payable on book profit decreases due to the originating timing difference, debit deferred tax asset account, crediting tax expense account (routing the entry through the deferred tax account, first crediting and then debiting the same): and**
 - 2) a) **if the tax payable on book profit decreases due to the reversing timing difference, debit deferred tax liability account [because this account was first credited under item 5(a) above] crediting the tax expense account (routing the entry through the deferred tax account, first crediting and then debiting the same); and,**

- b) if the tax payable on book profit increases due to the reversing timing difference, credit the deferred tax asset account [**because this account was first debited under item 5(b) above**] debiting the tax expense account (routing the entry through deferred tax account, first debiting and then crediting the same)

TABLE - 5 (Rupees in thousands)

Method 2¹ - Entries on the basis that tax expense

is based on accounting income : 20x1 20x2 20x3

| | 20x1 | 20x2 | 20x3 |
|--|------|------|------|
| Tax Expense or P/L a/c Debit | | | |
| With the amount of PBT as per P/L Statement | | | |
| • 40% tax rate | 60 | 60 | 60 |
| (see item 7 in Table - 4) | | | |
| Current Tax Payable a/c Credit | | | |
| With the amount of PBDT Less Depreciation Allowance | | | |
| • 40% tax rate | 20 | 80 | 80 |
| (see item 4 in Table - 4) | | | |
| Deferred Tax Liability a/c Credit | | | |
| Originating timing difference | | | |
| • 40% tax rate | 40 | | |
| (see item 5 in Table - 4) | | | |
| Deferred Tax Liability a/c Debit² | | 20 | 20 |
| (see item 10 in Table - 4) | | | |
| (instead of debiting first the deferred tax asset a/c and then transferring the debit to deferred tax liability a/c) | | | |

Footnote:

¹ It is obvious that Method 2 is more concise as compared to Method 1 set out in TABLE - 5

Paragraph 30 reproduced below for ready reference :

- 30. An entity shall offset, deferred tax assets and deferred tax liabilities, if:**
- (a) the entity 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.

² As per paragraph 30, deferred tax assets and liabilities can be set off only if the entity has the right under the tax laws to set off current tax assets against current tax liabilities. **Under the Income Tax Act, the brought forward prior year tax losses can be set off against the subsequent year tax profits. This means that the current tax asset on the brought forward prior tax losses can be set off against the current tax liability on the current year tax profits.** Additionally, the tax on profits is levied only through the Income Tax Act. Consequently, the deferred tax asset has been set off against the deferred tax liability through this transfer entry.

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 entity 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 or loss (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)

Following 2 Tables and 1 Summary Explanation may be inserted :

TABLE - 6

Accounting Entries :

| Method 1 - Entries as per Definitions, where there is tax-rate-change: | | (Rupees in thousands) | | |
|---|--|------------------------------|----------------|----------------|
| | | 20x1 | 20x2 | 20x3 |
| 1 | Current tax expense a/c Debit With the amount of PBDT Less Depreciation Allowance * 40%, 35% & 38% tax rates | 20 Dr | 70 Dr | 76 Dr |
| 2 | Deferred Tax expense a/c Debit Originating timing difference * 40% tax rate | 40 Dr | | |
| 3 | Deferred Tax expense a/c Credit Reversing timing difference * 35% & 38% tax rates for Years 20x2 & 20x3 | | 17.5 Cr | 19.0 Cr |
| 4 | Current Tax Payable a/c Credit | 20 Cr | 70 Cr | 76 Cr |
| 5 | Deferred Tax Liability A/c Credit | 40 Cr | | |
| 6 | Deferred Tax Asset A/c Debit | | 17.5 Dr | 19.0 Dr |
| 7 | Tax Expense or P/L a/c Debit (Total / Net of current tax and Deferred tax) | 60 Dr | 52.5 Dr | 57.0 Dr |
| 8 | Current tax expense a/c Credit | 20 Cr | 70 Cr | 76 Cr |
| 9 | Deferred tax expense a/c Cr / Dr | 40 Cr | 17.5 Dr | 19.0 Dr |
| 10 | Deferred Tax Liability a/c Debit¹ | 0 Dr | 17.5 Dr | 19.0 Dr |
| 11 | Deferred Tax Asset a/c Credit | | 17.5 Cr | 19.0 Cr |
| 12 | Deferred Tax Liability C/fwd | 40 Cr | 40.0 Cr | 17.5 Cr |
| 13 | Adjustment to C/fwd DTL by applying the tax rate substantively enacted by the balance sheet date DTL B/Fwd / 40% * 5% decr DTL B/Fwd / 35% * 3% incr [DTL A/c Debit Deferred Tax A/c Credit] | 0 Dr | 5.0 Dr | 1.5 Cr |
| 14 | Adjusted Deferred Tax Liab B/fwd | 40 Cr | 35.0 Cr | 19.0 Cr |
| 15 | CY DTL Debit on reversing TD | 0 Dr | 17.5 Dr | 19.0 Dr |
| 16 | DTL C/fwd on Accumulated Timing Differences at year-end | 40 Cr | 17.5 Cr | 0 Cr |
| 17 | Total Cr/Dr to DTL with (line items 5 + 10 + 13) | 40 Cr | 22.5 Dr | 17.5 Dr |

¹ As per paragraph 30, deferred tax assets and liabilities can be set off only if the entity has the right under the tax laws to set off current tax assets against current tax liabilities. **Under the Income Tax Act, the brought forward prior year tax losses can be set off against the subsequent year tax profits. This means that the current tax asset on the brought forward prior tax losses can be set off against the current tax liability on the current year tax profits.** Additionally, the tax on profits is levied only through the Income Tax Act. Consequently, the deferred tax asset has been set off against the deferred tax liability through this transfer entry.

Summary Explanation in respect of adjustments to be made to DTL brought forward from previous year, where there is a change in the tax rate substantively enacted by the current year balance sheet date :

- Check if DTL has been brought forward from the previous year
- Check if there has been a change in the tax rate substantively enacted by the current year balance sheet date
- Adjust the brought forward DTL as set out in line item 13 of Table – 6.

TABLE - 7**Method 2¹ -**

Entries on the basis that tax expense is based on accounting income, where there is tax-rate-change:

| | | (Rupees in thousands) | | |
|-------|---|-----------------------|---------|---------|
| | | 20x1 | 20x2 | 20x3 |
| 1 | Tax Expense or P/L a/c Debit With the amount of PBT as per P/L Statement * 40%, 35% & 38% tax rates (see line item 7 in Table - 6) | 60 Dr | 52.5 Dr | 57.0 Dr |
| 2 | Current Tax Payable a/c Credit With the amount of PBDT Less Depreciation Allowance * 40%, 35% & 38% tax rates (see line item 4 in Table - 6) | 20 Cr | 70 Cr | 76 Cr |
| 3 | Deferred Tax Liability a/c Credit Originating timing difference • 40% tax rate | 40 Cr | | |
| 4 | Deferred Tax Liability a/c Debit² (see line items 5 & 10 in Table - 6) (instead of debiting first the deferred tax asset a/c and then transferring the debit to deferred tax liability a/c) | 0 Dr | 17.5 Dr | 19.0 Dr |
| <hr/> | | | | |
| 5 | Deferred Tax Liability C/fwd | 40 Cr | 40.0 Cr | 17.5 Cr |
| 6 | Adjustment to C/fwd DTL by applying the tax rate substantively enacted by the balance sheet date DTL B/Fwd / 40% * 5% decr DTL B/Fwd / 35% * 3% incr [DTL A/c Debit Deferred Tax A/c Credit] | 0 Dr | 5.0 Dr | 1.5 Cr |
| 7 | Adjusted Deferred Tax Liab B/Fwd | 40 Cr | 35.0 Cr | 19.0 Cr |
| 8 | CY DTL Debit on reversing TD | 0 Dr | 17.5 Dr | 19.0 Dr |
| 9 | DTL C/fwd on Accumulated Timing Differences at year-end | 40 Cr | 17.5 Cr | 0 Cr |
| 10 | Total Cr/Dr to DTL with (line items 3 + 4 + 6) | 40 Cr | 22.5 Dr | 17.5 Dr |

Footnote:

¹ It is obvious that Method 2 is more concise as compared to Method 1 set out in TABLE - 6

² As per paragraph 30, deferred tax assets and liabilities can be set off only if the entity has the right under the tax laws to set off current tax assets against current tax liabilities. **Under the Income Tax Act, the brought forward prior year tax losses can be set off against the subsequent year tax profits. This means that the current tax asset on the brought forward prior tax losses can be set off against the current tax liability on the current year tax profits.** Additionally, the tax on profits is levied only through the Income Tax Act. Consequently, the deferred tax asset has been set off against the deferred tax liability through this transfer entry.

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 probable, 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) |
| <u>Deferred tax</u> | | | |

| | | | |
|---|------|------|------|
| 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 |

Following 4 Tables and 2 Summary Explanation may be inserted :

TABLE - 8 :

Calculation of Originating & Reversing Timing Differences based on tax and book profit amounts

(Rupees in thousands)

| | 20x1 | 20x2 | 20x3 |
|--|--------------|-------------|-------------|
| 1) P/(L)BDT | (100) | 50 | 60 |
| 2) Less : B/fwd Loss Set off | | (50) | (50) |
| ----- | | | |
| 3) Tax Profit / (Loss) or Taxable Income or (Loss) | (100) | 0 | 10 |
| ===== | | | |
| 4) P/(L)BDT | (100) | 50 | 60 |
| ----- | | | |
| 5) Book Profit / (Loss) before tax or accounting income / (loss) | (100) | 50 | 60 |
| ===== | | | |
| 6) Originating Timing Difference | (100) | | |
| Carried forward loss to be set off against future taxable income as per paragraph 8 | | | |
| 7) Reversing Timing Difference | | 50 | 50 |
| Brought forward loss set off against current taxable income | | | |

Summary Explanation in respect of Table – 8:

There is **no difference between taxable income and accounting income in 20x1.**

Yet, we have an **originating tax loss** that would get set off in 20x2 and 20x3 against taxable incomes. Thus, there would be **reversing tax losses** in 20x2 and 20x3.

In this case, we would have a **current tax recoverable in respect of tax loss for 20x1** as per the definition of current tax and a **deferred tax asset for the same amount for 20x1** as per paragraph 8.

This is thus a **peculiar case where deferred tax asset account would be credited** giving the **corresponding debit** (NOT to tax income account through deferred tax income account) **to current tax recoverable account.**

Thus, **where there is a tax loss and book loss, the tax expense is the sum of current tax recoverable credit and deferred tax asset debit / credit (see line item 1 in Table – 9 below).**

But, where there is a tax profit and book profit, the tax expense is the sum of current tax expense and deferred tax expense (see line items 7 to 9 in Table – 6 above).

TABLE - 9

Accounting Entries :

| Method 1 - Entries as per Definitions, | | (Rupees in thousands) | | |
|---|---|------------------------------|--------------|--------------|
| where there is tax loss for set off: | | 20x1 | 20x2 | 20x3 |
| 1 | Current tax income a/c Cr / Dr With the amount of P/(L)BDT * 40% tax rate (Current tax recoverable + Deferred tax liability) | 0 | 20 Dr | 16 Dr |
| 2 | Current tax recoverable a/c Cr / Dr | 40 Cr | 0 | 4 Dr |
| 3 | Deferred Tax Asset A/c Debit (Originating tax loss and not-timing-difference * 40% tax rate) (see paragraph 8) | 40 Dr | | |
| 4 | Deferred Tax Liability A/c Credit (Reversing tax loss and timing difference * 40% tax rate) | | 20 Cr | 20 Cr |
| 5 | Tax Expense or P/L a/c Debit (Total / Net of current tax and Deferred tax) | 0 | 20 Dr | 16 Dr |
| 6 | Current tax income a/c Dr / Cr | | 20 Cr | 16 Cr |
| 7 | Deferred Tax Asset A/c Credit | | 20 Cr | 20 Cr |
| 8 | Deferred Tax Liability A/c Debit | | 20 Dr | 20 Dr |

¹ As per paragraph 30, deferred tax assets and liabilities can be set off only if the entity has the right under the tax laws to set off current tax assets against current tax liabilities. **Under the Income Tax Act, the brought forward prior year tax losses can be set off against the subsequent year tax profits. This means that the current tax asset on the brought forward prior tax losses can be set off against the current tax liability on the current year tax profits.** Additionally, the tax on profits is levied only through the Income Tax Act. Consequently, the deferred tax asset has been set off against the deferred tax liability through this transfer entry.

Summary Explanation for the double entries in Table 9 above:

- Since the tax expense is the aggregate of current and deferred taxes as per the definition reproduced below, the balances in these 2 accounts are to be transferred to tax expense account (**see line items 8 to 10 in Table - 9 above**).
- Since current tax amount is the tax amount payable or recoverable, the **current tax payable account is to be credited or current tax recoverable account is to be debited**, and
 - the contra debit or credit is to be given to current tax account (which gets transferred to tax expense account as aforesaid)..
- Since deferred tax is the tax effect of the timing differences,-whether originating or reversing,-
 - 1) **since the tax credit receivable on tax loss only increases due to the originating timing difference, debit deferred tax asset account crediting the tax income account (routing the entry through the deferred tax income account, first crediting and then debiting the same); and**
 - 2) **since the tax credit receivable on tax loss only decreases due to the reversing timing difference, credit deferred tax asset account [because this account was first debited under item (1) above] debiting the tax income account (routing the entry through the deferred tax income account, first crediting and then debiting the same).**

TABLE – 10 :

Method 2¹ –

**Entries on the basis that tax expense
is based on accounting income,**

(Rupees in thousands)

| | 20x1 | 20x2 | 20x3 |
|---|-------------|-------------|-------------|
| 1 | | | |
| Tax Income or P/L a/c Credit / Debit | | | |
| With the amount of P/(L)BT as per P/L Statement | | | |
| * 40% tax rate | 0 | 20 Dr | 16 Dr |
| (Current tax recoverable + Deferred tax liability) | | | |
| (see line item 5 in Table - 9) | | | |
| 2 | | | |
| Current Tax Recoverable a/c Credit / Debit | | | |
| With the amount of P/(L)BT Less B/fwd Loss Set Off | | | |
| * 40% tax rate | 40 Cr | 0 Dr | 4 Dr |
| (see line item 2 in Table - 9) | | | |
| 3 | | | |
| Deferred Tax Asset a/c Debit | | | |
| (Originating tax loss and not-timing-difference | | | |
| • 40% tax rate | 40 Dr | | |
| (see line item 3 in Table - 9) | | | |
| 4 | | | |
| Deferred Tax Asset a/c Credit² | 0 Dr | 20 Cr | 20 Cr |
| (Reversing tax loss and timing difference | | | |
| * 40% tax rate) (see line item 7 in Table - 9) | | | |
| (instead of debiting first the deferred tax liability a/c and then transferring the debit to deferred tax asset a/c) | | | |

TABLE – 9 (recast to match with the P/L Statement above)

Accounting Entries :

| Method 1 - Entries as per Definitions, | | (Rupees in thousands) | | |
|---|--|------------------------------|----------------|----------------|
| where there is tax loss for set off: | | 20x1 | 20x2 | 20x3 |
| 1 | Current tax expense a/c Cr / Dr With the amount of P/(L)BDT * 40% tax rate Current tax payable a/c Cr | 0 | 0 | 4 Dr |
| 2 | Deferred Tax Income A/c Credit Deferred Tax Asset A/c Debit (Originating tax loss and not-timing-difference * 40% tax rate) (see paragraph 8) | 40 Cr 40 Dr | | 4 Cr |
| 3 | Deferred Tax Income A/c Debit Deferred Tax Asset A/c Credit (Reversing tax loss and timing difference * 40% tax rate) | | 20 Dr 20 Cr | 20 Dr 20 Cr |
| 4 | Tax Expense or P/L a/c Debit (Total / Net of current tax and Deferred tax) | 0 | 0 | 4 Dr |
| 5 | Current tax income a/c Dr / Cr | 0 | 0 | 4 Cr |
| 6 | Deferred Tax Asset A/c Credit | | 20 Cr | 20 Cr |
| 7 | Deferred Tax Liability A/c Debit | | 20 Dr | 20 Dr |

In the above solution, current tax income in respect of the tax loss for 20x1 has not been recognized. Because, as per the definition, *Current tax includes even* the amount of income tax determined to be recoverable in respect of the tax loss for a period.

I have not attempted to recast Table 10 to match with the P/L Statement in the preceding page, for the reason set out in the preceding paragraph.

Illustration 4

Note: The purpose of this illustration is to assist in clarifying the meaning of the explanation to paragraph 13 of the Standard.

Facts:

1. The income before depreciation and tax of an entity for 15 years is Rs. 1000 lakhs per year, both as per the books of account and for income-tax purposes.
2. The entity is subject to 100 percent tax-holiday for the first 10 years under section 80-IA. Tax rate is assumed to be 30 percent.
3. At the beginning of year 1, the entity has purchased one machine for Rs. 1500 lakhs. Residual value is assumed to be nil.
4. For accounting purposes, the entity follows an accounting policy to provide depreciation on the machine over 15 years on straight-line basis.
5. For tax purposes, the depreciation rate relevant to the machine is 25% on written down value basis.

The following computations are made, ignoring the provisions of section 115JB (MAT), in this regard:

Table 1
Computation of depreciation on the machine for accounting purposes and tax purposes
(Amounts in Rs. lakhs)

| Year | Depreciation for accounting purposes | Depreciation for tax purposes |
|------|--------------------------------------|-------------------------------|
| 1 | 100 | 375 |
| 2 | 100 | 281 |
| 3 | 100 | 211 |
| 4 | 100 | 158 |
| 5 | 100 | 119 |
| 6 | 100 | 89 |
| 7 | 100 | 67 |
| 8 | 100 | 50 |
| 9 | 100 | 38 |
| 10 | 100 | 28 |

| | | |
|----|-----|----|
| 11 | 100 | 21 |
| 12 | 100 | 16 |
| 13 | 100 | 12 |
| 14 | 100 | 9 |
| 15 | 100 | 7 |

At the end of the 15th year, the carrying amount of the machinery for accounting purposes would be nil whereas for tax purposes, the carrying amount is Rs. 19 lakhs which is eligible to be allowed in subsequent years.

Following 2 Tables may be inserted :

TABLE – 11 :
Calculation of Originating &
Reversing Timing Differences
based on tax & book profit sums **(Rupees in lakhs)**

| Year | PBDT | SLM Depn | WDV Depn | Gross | | | | Orig /Rvsg Cum | | |
|------|-------|----------|----------|-----------|---------|-------------|----------|----------------|-----------|------------------------|
| | | | | Acctg Inc | Tax Inc | S8o-IA Dedn | Txbl Inc | Perm Diff | Depn Diff | Depn Diff |
| Y1 | 1,000 | 100 | 375 | 900 | 625 | 625 | 0 | 625 | 275 | 275 |
| Y2 | 1,000 | 100 | 281 | 900 | 719 | 719 | 0 | 719 | 181 | 456 |
| Y3 | 1,000 | 100 | 211 | 900 | 789 | 789 | 0 | 789 | 111 | 567 |
| Y4 | 1,000 | 100 | 158 | 900 | 842 | 842 | 0 | 842 | 58 | 625 |
| Y5 | 1,000 | 100 | 119 | 900 | 881 | 881 | 0 | 881 | 19 | 644¹ |
| Y6 | 1,000 | 100 | 89 | 900 | 911 | 911 | 0 | 911 | -11 | 633 |
| Y7 | 1,000 | 100 | 67 | 900 | 933 | 933 | 0 | 933 | -33 | 600 |
| Y8 | 1,000 | 100 | 50 | 900 | 950 | 950 | 0 | 950 | -50 | 550 |
| Y9 | 1,000 | 100 | 38 | 900 | 962 | 962 | 0 | 962 | -62 | 488 |
| Y10 | 1,000 | 100 | 28 | 900 | 972 | 972 | 0 | 972 | -72 | 416² |
| Y11 | 1,000 | 100 | 21 | 900 | 979 | 0 | 979 | 0 | -79 | 337 |
| Y12 | 1,000 | 100 | 16 | 900 | 984 | 0 | 984 | 0 | -84 | 253 |
| Y13 | 1,000 | 100 | 12 | 900 | 988 | 0 | 988 | 0 | -88 | 165 |
| Y14 | 1,000 | 100 | 9 | 900 | 991 | 0 | 991 | 0 | -91 | 74 |
| Y15 | 1,000 | 100 | 7 | 900 | 993 | 0 | 993 | 0 | -93 | -19³ |

Note 1:

Timing differences originating during the tax holiday period are Rs. 644¹ lakhs, out of which Rs. 228^{1 & 2} (**644 lakhs less 416 lakhs**) lakhs are reversing during the tax holiday period and Rs. 416² lakhs are reversing after the tax holiday period. **Timing difference of Rs. 19 lakhs³ is originating in the 15th year which would reverse in subsequent years when for accounting purposes depreciation would be nil but for tax purposes the written down value of the machinery of Rs.19 lakhs would be eligible to be allowed as depreciation.**

Note 2:

As per the Standard, deferred tax on timing differences which reverse during the tax holiday period should not be recognized. For this purpose, timing differences which originate first are considered to reverse first. Therefore, **the reversal of timing difference of Rs. 228^{1 & 2} (644 lakhs less 416 lakhs) during the tax holiday period, would be considered to be out of the timing difference which originated in year 1. The rest of the timing difference originating in year 1 and timing differences originating in years 2 to 5 would be considered to be reversing after the tax holiday period.** Therefore, in year 1, deferred tax would be recognized on the timing difference of Rs. 47 lakhs (Rs. 275 lakhs Less Rs. 228 lakhs) which would reverse after the tax holiday period. Similar computations would be made for the subsequent years. The deferred tax assets/liabilities to be recognized during different years would be computed as per the following Table.

TABLE – 12 :

Accounting Entries : Method 1 - Entries on the basis that tax expense is based on accounting income, where there is tax holiday u/s 80-IA:(Rupees in lakhs)

| <u>Year</u> | <u>Acctg Inc</u> | <u>Txbl Inc</u> | <u>Perm Diff</u> | <u>Orig /Rvsg Depn Diff</u> | <u>Cum Depn Diff</u> | <u>Cum Orig/ Rvsg Diff</u> | <u>Rvsg Out of</u> | <u>Net Orig/ Rvsg Diff</u> | <u>Dr CTE Cr</u> | <u>Cr DTL Dr</u> | <u>TE/DTE</u> |
|-------------|------------------|-----------------|------------------|-----------------------------|----------------------|----------------------------|--------------------|----------------------------|------------------|------------------|---------------|
| Y1 | 900 | 0 | 625 | 275 | 275 | | -228 | 47 | 0 | 14 | |
| Y2 | 900 | 0 | 719 | 181 | 456 | | | 181 | 0 | 54 | |
| Y3 | 900 | 0 | 789 | 111 | 567 | | | 111 | 0 | 33 | |
| Y4 | 900 | 0 | 842 | 58 | 625 | | | 58 | 0 | 17 | |
| Y5 | 900 | 0 | 881 | 19 | 644 | 644 | | 19 | 0 | 6 | |
| Y6 | 900 | 0 | 911 | -11 | 633 | | | | 0 | | |
| Y7 | 900 | 0 | 933 | -33 | 600 | | | | 0 | | |
| Y8 | 900 | 0 | 950 | -50 | 550 | | | | 0 | | |
| Y9 | 900 | 0 | 962 | -62 | 488 | | | | 0 | | |
| Y10 | 900 | 0 | 972 | -72 | 416 | -228 | | | 0 | | |
| Y11 | 900 | 979 | 0 | -79 | 337 | | -79 | -79 | 294 | -24 | |
| Y12 | 900 | 984 | 0 | -84 | 253 | | -84 | -84 | 295 | -25 | |
| Y13 | 900 | 988 | 0 | -88 | 165 | | -88 | -88 | 296 | -26 | |
| Y14 | 900 | 991 | 0 | -91 | 74 | | -91 | -91 | 297 | -27 | |
| Y15 | 900 | 993 | 0 | -93 ³ | -19 | -416 | -74 ³ | -74 ³ | 298 | -22 | |
| Y15-End | | | | | | | | -19 ³ | -19 ³ | -6 ⁵ | |

Footnotes:

- 4 No DTA / DTL has been recognized in respect of the permanent differences as per paragraph 12 of the Standard.
- 5 **Deferred tax asset of Rs. 6 lakhs would be recognized at the end of year 15 subject to probability as per AS 12. If it is so recognized, the said deferred tax asset would be realized in subsequent periods when for tax purposes depreciation would be allowed but for accounting purposes no depreciation would be recognized.**

Glossary of Abbreviations used in Table - 12

| | |
|-----|------------------------|
| CTE | Current Tax Expense |
| CTP | Current Tax Payable |
| DTL | Deferred Tax Liability |
| TE | Tax Expense |
| DTE | Deferred Tax Expense |

Note 1:

Timing differences originating during the tax holiday period are Rs. 644¹ lakhs, out of which Rs. 228^{1&2} (644 lakhs less 416 lakhs) lakhs are reversing during the tax holiday period and Rs. 416² lakhs are reversing after the tax holiday period. **Timing difference of Rs. 19 lakhs³ is originating in the 15th year which would reverse in subsequent years** when for accounting purposes depreciation would be nil but **for tax purposes the written down value of the machinery of Rs.19 lakhs would be eligible to be allowed as depreciation.**

Note 1-a:

Rs. 74 lakhs remaining to be reversed at the beginning of Y15 (out of the balance Rs 416 lakhs which remained to be reversed after the tax holiday period), would be deemed to have gotten reversed during Y15, and the balance of Rs 19 lakhs pertaining to Y15 out of the total reversing difference of Rs 93 lakhs (accounting income of Rs 900 lakhs less taxable income of Rs 993 lakhs), would be deemed to have gotten reversed during Y16.

Table 2
Computation of Timing differences

(Amounts in Rs. lakhs)

| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
|------|--|--------------------------------------|---|-------------------------------|----------------------|---|--|--|
| Year | Income before Depreciation and tax (both for accounting purposes and tax purposes) | Accounting Income after depreciation | Gross Total Income after deducting depreciation under tax laws) | Deduction Under section 80-IA | Taxable Income (4-5) | Total Difference between accounting income and taxable income (3-6) | Permanent Difference (deduction pursuant to section 80-IA) | Timing Difference (due to different amounts of depreciation for accounting purposes and tax purposes) (O= Originating and R=Reversing) |
| 1 | 1000 | 900 | 625 | 625 | Nil | 900 | 625 | 275 (O) |
| 2 | 1000 | 900 | 719 | 719 | Nil | 900 | 719 | 181 (O) |
| 3 | 1000 | 900 | 789 | 789 | Nil | 900 | 789 | 111 (O) |
| 4 | 1000 | 900 | 842 | 842 | Nil | 900 | 842 | 58 (O) |
| 5 | 1000 | 900 | 881 | 881 | Nil | 900 | 881 | 19(O) |
| 6 | 1000 | 900 | 911 | 911 | Nil | 900 | 911 | 11 (R) |
| 7 | 1000 | 900 | 933 | 933 | Nil | 900 | 933 | 33 (R) |
| 8 | 1000 | 900 | 950 | 950 | Nil | 900 | 950 | 50 (R) |
| 9 | 1000 | 900 | 962 | 962 | Nil | 900 | 962 | 62 (R) |
| 10 | 1000 | 900 | 972 | 972 | Nil | 900 | 972 | 72 (R) |
| 11 | 1000 | 900 | 979 | Nil | 979 | -79 | Nil | 79 (R) |
| 12 | 1000 | 900 | 984 | Nil | 984 | -84 | Nil | 84 (R) |
| 13 | 1000 | 900 | 988 | Nil | 988 | -88 | Nil | 88 (R) |
| 14 | 1000 | 900 | 991 | Nil | 991 | -91 | Nil | 91 (R) |
| 15 | 1000 | 900 | 993 | Nil | 993 | -93 | Nil | 74 (R) |
| | | | | | | | | 19 (O) |

Accounting for Taxes on Income

Notes:

1. Timing differences originating during the tax holiday period are Rs. 644 lakhs, out of which Rs. 228 lakhs are reversing during the tax holiday period and Rs. 416 lakhs are reversing after the tax holiday period. Timing difference of Rs. 19 lakhs is originating in the 15th year which would reverse in subsequent years when for accounting purposes depreciation would be nil but for tax purposes the written down value of the machinery of Rs.19 lakhs would be eligible to be allowed as depreciation.

2. As per the Standard, deferred tax on timing differences which reverse during the tax holiday period should not be recognised. For this purpose, timing differences which originate first are considered to reverse first. Therefore, the reversal of timing difference of Rs. 228 lakhs during the tax holiday period, would be considered to be out of the timing difference which originated in year 1. The rest of the timing difference originating in year 1 and timing differences originating in years 2 to 5 would be considered to be reversing after the tax holiday period. Therefore, in year 1, deferred tax would be recognised on the timing difference of Rs. 47 lakhs (Rs. 275 lakhs- Rs. 228 lakhs) which would reverse after the tax holiday period. Similar computations would be made for the subsequent years. The deferred tax assets/liabilities to be recognised during different years would be computed as per the following Table.

Table 3
Computation of current tax and deferred tax

(Amounts in Rs. lakhs)

| Year | Current tax (Taxable Income x 30%) | Deferred tax (Timing difference x 30%) | Accumulated Deferred tax (L= Liability and A = Asset) | Tax expense |
|------|--|--|--|-------------|
| 1 | Nil | 47 × 30%= 14 (see note 2 above) | 14 (L) | 14 |
| 2 | Nil | 181 × 30%=54 | 68 (L) | 54 |
| 3 | Nil | 111 × 30%=33 | 101 (L) | 33 |
| 4 | Nil | 58 × 30%= 17 | 118 (L) | 17 |
| 5 | Nil | 19 × 30%=6 | 124 (L) | 6 |
| 6 | Nil | Nil ¹ | 124 (L) | Nil |
| 7 | Nil | Nil ¹ | 124 (L) | Nil |
| 8 | Nil | Nil ¹ | 124 (L) | Nil |
| 9 | Nil | Nil ¹ | 124 (L) | Nil |
| 10 | Nil | Nil ¹ | 124 (L) | Nil |
| 11 | 294 | -79 × 30%=-24 | 100 (L) | 270 |
| 12 | 295 | -84 × 30%=-25 | 75 (L) | 270 |
| 13 | 296 | -88 × 30%=-26 | 49 (L) | 270 |
| 14 | 297 | -91 × 30%=-27 | 22 (L) | 270 |
| 15 | 298 | -74 × 30%=-22 -19 × 30%=-6 | Nil 6(A) ² | 270 |

¹ No deferred tax is recognised since in respect of timing differences reversing during the tax holiday period, no deferred tax was recognised at their origination.

² Deferred tax asset of Rs. 6 lakhs would be recognised at the end of year 15

subject to probability as per AS 12. If it is so recognised, the said deferred tax asset would be realised in subsequent periods when for tax purposes depreciation would be allowed but for accounting purposes no depreciation would be recognised.

Appendix 1

Note 1: This Appendix is not a part of the Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between revised Accounting Standard (AS) 12 and Indian Accounting Standard (Ind AS) 12, Income Taxes.

Note 2: Paragraph numbers appearing in revised AS 12 may be different as compared to those in Ind AS 12.

Comparison with Ind AS 12, Income Taxes

1. Ind AS 12 is based on balance sheet approach. It requires recognition of tax consequences of differences between the carrying amounts of assets and liabilities and their tax base. However, revised AS 12 is based on income statement approach. It requires recognition of tax consequences of differences between taxable income and accounting income. For this purpose, differences between taxable income and accounting income are classified into permanent and timing differences.
2. As per Ind AS 12, current and deferred tax are recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from a transaction or event which is recognised outside profit or loss, either in other comprehensive income or directly in equity, in those cases tax is also recognised in other comprehensive income or in equity, as appropriate. However, revised AS 12 does not specifically deal with this aspect.
3. As per Ind AS 12, deferred tax liability is recognised for all taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, if certain conditions are satisfied. Revised AS 12 does not deal with this aspect.
4. As per Ind AS 12, deferred tax should be recognised on temporary differences that arise from the elimination of profit and losses resulting from the intra-group transactions. While revised AS 12 does not deal with this aspect.
5. Ind AS 12 requires that deferred tax asset/liability arising from revaluation of non-depreciable assets shall be measured on the basis of tax consequences from the sale of asset rather than through use. Revised AS 12 does not deal specifically with this aspect.
6. Ind AS 12 provides guidance as to how an entity should account for the tax consequences of a change in its tax status or that of its shareholders. Revised AS 12 does not deal with this aspect.
7. Revised AS 12 specifically provides guidance regarding recognition of deferred tax in the situations of Tax Holiday under Sections 80-IA and 80-IB and Tax Holiday under Sections 10A and 10B of the Income Tax Act, 1961. Similarly, revised AS 12 provides guidance regarding recognition of deferred tax asset in case of loss under the head 'capital gains'.

Ind AS 12 does not specifically deal with these situations.

8. Revised AS 12 specifically provides guidance regarding tax rates to be applied in measuring deferred tax assets/liabilities in a situation where a company pays tax under section 115JB. Ind AS 12 does not specifically deal with this aspect.
9. Ind AS 12 specifically provides guidance on Uncertainty over Income Tax treatment whereas revised AS 12 does not contain such guidance.
10. Disclosure requirements given in Ind AS 12 are more detailed as compared to revised AS 12.

Appendix 2

Note 1: This Appendix is not a part of the Accounting Standard. The purpose of this Appendix is only to bring out the major differences, if any, between revised Accounting Standard (AS) 12 and existing Accounting Standard (AS) 22, Accounting for Taxes on Income.

Note 2: Paragraph numbers appearing in revised AS 12 may be different as compared to those in AS 22.

Comparison with existing AS 22, *Accounting for Taxes on Income*

1. As per revised AS 12, deferred tax asset is recognised for all timing differences to the extent that it is probable that sufficient taxable profit will be available against which the timing difference can be realised. The criteria for recognising deferred tax assets arising from unabsorbed depreciation and carry forward of losses are the same that for recognising deferred tax assets arising from timing differences. However, the existence of unabsorbed depreciation and carry forward of losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unabsorbed depreciation and carry forward of losses 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.

While, as per existing AS 22, deferred tax assets are 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. Where deferred tax asset is recognised against unabsorbed depreciation or carry forward of losses under tax laws, it is recognised only to the extent that there is virtual certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised.