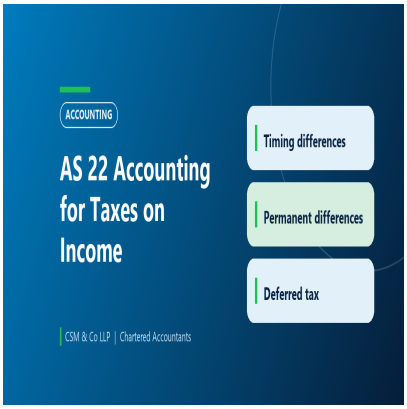

AS 22 Accounting for Taxes on Income

Description

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Quick summary

- Profits in your accounts rarely match taxable profits, and AS 22 governs how the difference is accounted for.
- Differences are either timing differences (they reverse in later years) or permanent differences (they never reverse).
- Timing differences create deferred tax assets or deferred tax liabilities.
- This guide covers when and how to apply AS 22, the deferred tax computation, and the comparison with Ind AS 12 and IFRIC 23.

How AS 22 is applied at a glance

1. Compare accounting income with taxable income

?

2. Split the difference into timing differences (reversible) and permanent differences (not reversible)

?

3. Ignore permanent differences, they create no deferred tax

?

4. Taxable income higher than accounting income gives a deferred tax asset, recognised only with reasonable certainty (virtual certainty if there are losses or unabsorbed depreciation)

?

5. Accounting income higher than taxable income gives a deferred tax liability

?

6. Report tax expense as current tax plus deferred tax in the profit and loss statement

Profits as per your financial statements rarely match with your taxable profits. And it would be incorrect to ignore to account for the difference between these two profits. To govern the accounting for such differences, we cover the following topics in this article w.r.t. AS 22 Accounting for Taxes on Income:

Introduction - Accounting Standard

Accounting Standard 22 has been prescribed by ICAI to be applied in accounting for taxes on income. This AS is applied to match the differences between accounting income and taxable income. 1. Accounting income is the net profit before tax for a period, as reported in the profit and loss statement. 2. Taxable income is the income on which income tax is payable, computed by applying provisions of the Income Tax Act, 1961 & Rules.

Types of differences and why they appear

The differences can be of two types:

Timing difference

Timing differences are those differences between accounting income and taxable income which can be reversed in one or more subsequent periods. For example, Depreciation allowed as per WDV method for computing taxable income and as per SLM method for computing accounting income.

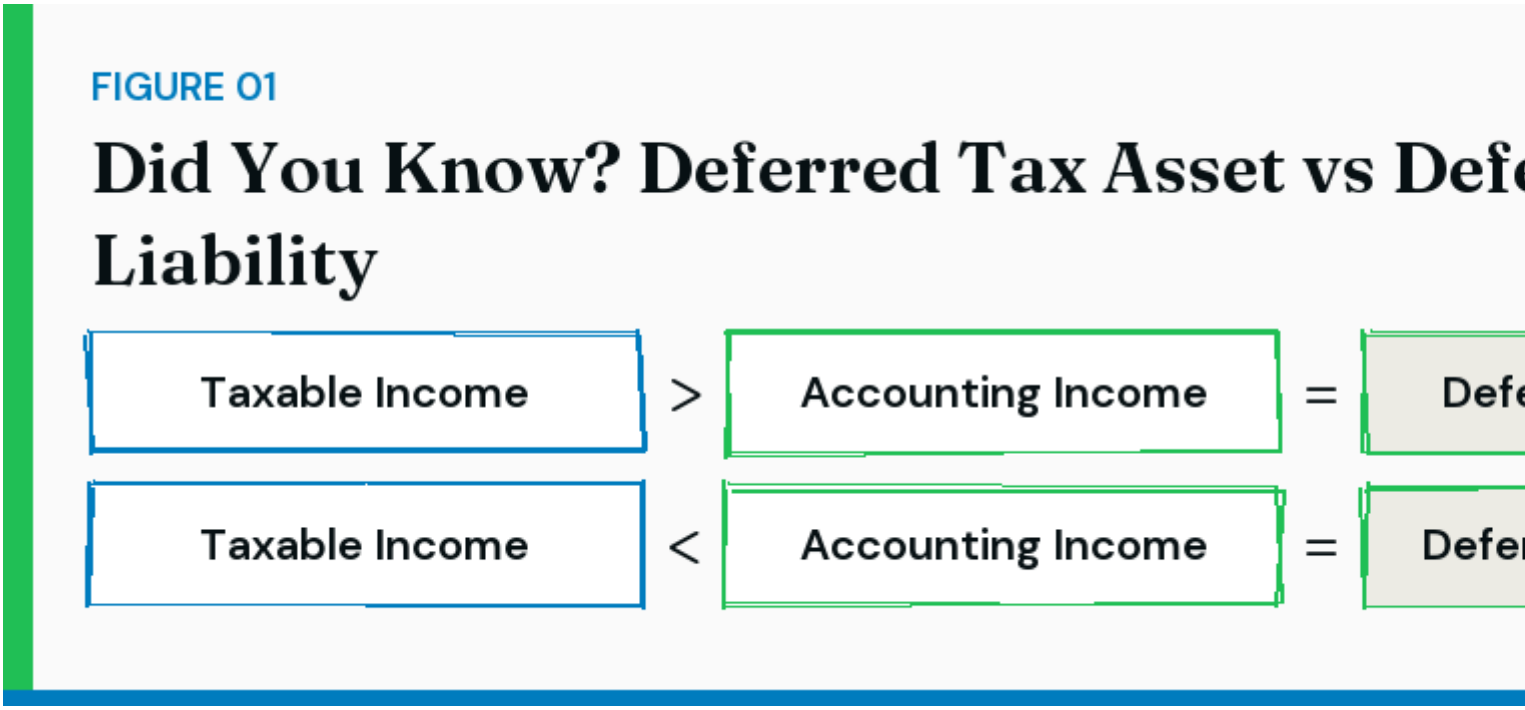
Permanent difference

Permanent differences are those differences between accounting income and taxable income which cannot be reversed any subsequent period. For example, Donation paid in cash is disallowed in computing taxable income whereas it is allowed as expenditure while computing accounting income. There can be differences between accounting income and taxable income because of the following reasons:

1. Expenses debited in profit and loss statement, but disallowed as per Income Tax Act 1961, while computing taxable income
2. Provision for Bad/doubtful debts allowed while computing accounting income, but disallowed while computing taxable income
3. Charging depreciation using different rates as per Companies Act 2013 and Income Tax Act 1961
4.

Any income recognized on an accrual basis in profit and loss statement but recognized on receipt basisin subsequent period for computing taxable income. In order to account for these kinds of differences, AS22 needs to be applied.

When to apply AS 22 Accounting for Taxes on Income



AS 22 needs to be applied when there are differences between taxable income and accounting income. If taxable income is greater than accounting income, then it will result in deferred tax asset. And if accounting income is greater than taxable income, then it will result in deferred tax liability.

When the difference is resulting in deferred tax asset, then it should be recognized only when there is a reasonable certainty of its realization. The recognition of deferred tax asset should be to the extent of the reasonable certainty of the expected realization. The reasonable certainty can be determined by making the realistic estimates of future profits based on the examination of profits and loss statement of earlier periods.

Say, an entity has unabsorbed depreciation or carry forward of losses. In such a case, deferred tax asset should be recognized to the extent there is a virtual certainty supported by convincing evidence. Virtual certainty is a matter of judgment of convincing evidence, which should be available in a concrete form at a particular date.

How to apply AS 22 Accounting for Taxes on Income

The application of AS 22 can be explained with the help of examples: **Example of timing difference:**

Particulars	Year 1	Year 2	Year 3
Profit before tax (A)	100,000	200,000	180,000

Particulars	Year 1	Year 2	Year 3
Depreciation as per Companies Act (B)	25,000	25,000	25,000
Accounting income (A-B)	75,000	175,000	125,000
Depreciation as per Income tax Act (C)	50,000	0	10,000
Taxable income (A-C)	50,000	200,000	170,000
Timing difference (D)	25,000	-25,000	-15,000
Current tax @ 30%	15,000	60,000	51,000
Deferred tax (D * 30%)	7,500	-7,500	-4,500
Total tax expense	22,500	52,500	46,500
Profit after tax	52,500	122,500	78,500

Deferred tax computation

Particulars	Year 1	Year 2	Year 3
Opening balance of timing difference	0	25,000	0
Addition	25,000	0	15,000
Deletion	0	25,000	0
Closing balance of timing difference	25,000	0	15,000
Deferred tax @ 30%	7,500	7,500	4,500
DTA/DTL	Creation of DTL	Reversal of DTL	Creation of DTA
Journal Entry	P&L A/c Dr. To DTL	DTL Dr. To P&L A/c	DTA Dr. To P&L A/c

Comparison between AS 22 and IND AS 12

Basis	AS 22 Accounting for Taxes on Income	IND AS 12 (Income taxes)
Recognitior	AS 22 recognized tax effect of differences between taxable income and accounting income.	IND AS 12 recognized tax effect of differences between assets and/or liabilities and their tax base.
Approach	AS 22 is based on profit or loss statement approach.	IND AS 12 is based on balance sheet approach.
Differences	The types of differences on which AS 22 is applied are timing differences and permanent differences.	The types of differences on which IND AS 12 is applied are taxable temporary differences and deductible temporary differences. Permanent differences are not dealt in by this standard.
Recognitior of Deferred tax asset/deduc temporary differences	DTA is recognized only when and to the extent there is a reasonable certainty of its realization	Deductible temporary differences are recognized to the extent of the probability of taxable profits in future periods.
Disclosure	AS 22 deals with the disclosure of DTA/DTL in the balance sheet.	IND AS 12 deals with the recognition of current or deferred tax as income or expense in profit and loss statement. It also deals with the disclosure of out of profit and loss transaction in the balance sheet as current or non-current assets/liability.
Revaluatior of assets	AS 22 does not cover the difference arising between taxable income and accounting income due to the revaluation of assets.	IND AS 12 deals with the difference between carrying the amount of revalued asset and its tax base.
Goodwill	AS 22 does not cover the difference arising due to goodwill arising a business combination.	As per IND AS 12, the difference between carrying the amount of goodwill and its tax base (which will be NIL) is the taxable temporary difference. It does not allow the recognition of such difference because goodwill is measured as a residual and its recognition would increase the carrying amount of goodwill.

Basis	AS 22 Accounting for Taxes on Income	IND AS 12 (Income taxes)
The concept of virtual certainty	When an entity has unabsorbed depreciation or carry forward of losses then in such a case deferred tax asset should be to the extent there is a virtual certainty supported by convincing evidence.	There is no concept of virtual certainty in IND AS 12. Deductible temporary differences are recognized to the extent of the probability of taxable profits in future periods.
Tax holiday	AS 22 specifically provides guidance regarding recognition of deferred tax in the situations of Tax Holiday under Sections 80-IA, 80-IB, 10A and 10B of Income-tax Act.	IND AS 12 does not specifically deal with the situations of the tax holiday.
Capital Loss	AS 22 provides guidance regarding recognition of DTA in case of loss under the head of 'capital gains'.	IND AS 12 does not specifically provide for the same.

IFRIC 23

IFRIC 23 also provides for Uncertainty over Income Tax Treatments. It requires an entity to treat uncertain tax treatments depending on which method will be best suited for its resolution. The major difference between AS 22 and IFRIC 23 is that IFRIC 23 requires an entity, while determining the current and deferred income tax assets and liabilities, to make an assessment whether it is probable that taxation authority will accept an uncertain tax treatment.

If it is not probable, then entity should reflect that uncertainty through either expected value approach or most likely approach. IFRIC 23 will be applicable for annual reporting periods beginning on or after 01.01.2019.

Frequently asked questions

What is AS 22?

AS 22 is the Accounting Standard issued by ICAI that prescribes how taxes on income, including current tax and deferred tax, are accounted for in financial statements.

What is the difference between a timing difference and a permanent difference?

A timing difference arises in one period and reverses in later periods, for example depreciation under different methods. A permanent difference never reverses, for example an expense disallowed by the Income Tax Act.

Does AS 22 create deferred tax on permanent differences?

No. Deferred tax is recognised only for timing differences, not for permanent differences.

How is AS 22 different from Ind AS 12?

AS 22 applies to companies following the Companies (Accounting Standards) Rules and uses the income statement approach based on timing differences, while Ind AS 12 follows a balance sheet approach based on temporary differences.

Official sources

- ICAI: Accounting Standard (AS) 22, full text
- ICAI: Amendments to AS 22 (Pillar Two exception)
- MCA: AS 22 as notified

Related reading

- Indian Accounting Standard 12: Income Taxes
- Deferred Tax Asset and Deferred Tax Liability

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