INCOME TAX AND ACCOUNTING STANDARDS

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Corporate Reporting is a core business activity. An Accountant necessarily to play an important role every year during the course of finalization of annual accounts regarding various disclosures for the use of stakeholders.

For this purpose, the country has GAAP, Accounting Standards, Companies Act 2013, Income Tax Act 1961 and other guidelines.

In our country, separate set of books of accounts are not maintained, i.e., that is one for Financial Reporting and another for Income Tax purposes.

In the United States, laws allow companies to maintain two sets of books for financial and tax purposes. Because the rules that govern financial and tax accounting differ.

Differences in tax liabilities are simply temporary imbalances between a reported amount of income and its tax basis: The accounting disparities appear when there are differences between the taxable income and the pre-tax financial income or when the bases of assets or liabilities differ for financial accounting and tax purposes.

A simple example, amount due on a current receivable account cannot be taxed until collection is actually made, but the sale needs to be reported in the current period as per the financial reporting practices.

In order to comply with the corporate reporting practices, we have accounting standards. There bound tooccur differences in the Income as per financial accounts and Income Tax Act.

The purpose of both Accounting Standards is to find out the True and Fair View of the financial statements and the purpose of Income Tax Act 1961 determine the income the real income and not fictitious.

Under the disclosure requirement in financial statements vis-à-vis that of income and its tax liability, we have important accounting standards, viz.,

- Accounting Standard 22
- Indian Accounting Standard 12
- International Accounting Standard 12

The above Accounting Standards requires recognition of tax consequences of difference between carrying amounts of assets and liabilities and its tax bases.

Two important disclosures, are the Deferred Tax Asset and Deferred Tax Liability which are necessarily to be reported in the financial statements.

Deferred Tax liability is the amount of income tax payable in future periods with respect to the taxable temporary differences.

Deferred tax asset is the income tax amount recoverable in future periods in respect of the deductible temporary differences, carry forward of unused tax losses, and carry forward of unused tax credits.

Tax differences occur on account of difference between the books of accounts and income tax provisions.

The objective of Ind AS 12 is to prescribe the accounting treatment for income taxes. The important issue in accounting for income taxes is how to account for the current and future tax consequences of:

(a) the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's balance sheet; and

(b) transactions and other events of the current period that are recognised in an entity's financial statements.

A deferred tax asset is an item on a company's Profit & Loss Account reduces its taxable income in the future.

Deferred tax liability arises when there is a difference between what a company can deduct as tax and the tax that is there for accounting purposes. A deferred tax liability signifies that a company may in the future pay more income tax because of a transaction in the present.

Financial Reporting Statements necessarily require to report future events for the information of stakeholders

keeping in view the reporting concept of Going Concern for a continued relationship with the entity. Compliance required as per Ind AS 37 (AS 29) regarding provisions and contingencies.

However, the provisions of Income Tax Act 1961 considers only current year transactions for deductions in computing the taxable income of an entity in accordance with Sec.37 of the Income Tax Act 1961. Though Sec.145 of the Income Tact 1961 provides for accrual method of accounting, future losses are not allowed as deductions.

In view of this there bound happen difference in the tax liability as per Financial Statements and Income Tax.

Ind AS 12 (IAS 12) or AS 22 require reporting of the impact of income taxes on income in the form of Deferred Tax Asset and Deferred Tax Liabilities. This is mainly because of timing differences between reporting date and income tax.

Deferrred Tax Asset results in excess payment of income tax and Deferred Tax Liability results in liability of income tax in future period. This two important accounting disclosures is explained with the following examples.

Deferred Tax Asset

As per Financial Statements	
Particulars	Amount in Rs.
Revenue as per P & L Account	1,00,00,000
Less:	
Expenses Debited	70,00,000
(Expenses including Selling and Distribution Expenses	
including Provision for Warranty for after sales service	
amounting to Rs.15,00,000	
Profit Before Tax	30,00,000
Tax Liability at 30%	9,00,000
Profit After Tax	21,00,000
As per Income Tax	
Revenue as per P&L Account	1,00,00,000
Less: Expenses	
(Rs.70,00,000 - Rs.15,00,000 - Not allowed under IT Act)	45,00,000
Taxable Income	55,00,000
Tax Liability at 30%	16,50,000
Tax Difference - Deferred Tax Asset	7,50,000

Deferred Tax Liability

Deferred Tax Liability arises due to timing differences. The company will pay lower taxes in the current year resulting increased tax liability in the future years.

Company Acquires a Capital Asset for Rs.100000 with a life of 5 years			
Details	As per Books	As per Income Tax	Difference
Profit Before Depreciation and Tax	1,00,000	1,00,000	
Less: Depreciation	20,000	40,000	
Profit Before Tax	80,000	60,000	20,000
Tax Liability at 30%	24,000	18,000	6,000
Profit After Tax	6,000	42,000	14,000
Deferred Tax Liability will be saving in Tax (Rs.24,000 - Rs.18,000)			

It is to be noted that both deferred tax asset and deferred tax liability are created for the temporary differences only. These differences are temporary in nature and with the lapse of time the impact of these differences gets eliminated.Other Items in financial statements that results in DTA/DTL, in addition to depreciation, are provisions bad and doubtful debts /unrealized receivables, employee benefits, when goods are sold on instalments, etc.

Impact of Book Profit (Sec.115JB)

In computing the Book Profit, the Deferred Tax Asset credited to P&L Account will result in reduction in Book Profit and Deferred Tax Liability debited to P&L Account will result in increase of book profit. The tax impact will be at 15%.

Conclusion

It is emphasised that there is no need to calculate deferred tax on each and every item of financial statement. The Deferred Tax is calculated yearlybycomparing book profit and taxable income. The Deferred Tax Liability or Deferred Tax Asset is derived from the Profit& Loss A/c and Balance sheet.

Inadmissible expenses as per Income Tax debited to Profit& Loss A/c will create Deferred Tax Asset. Admissible expenses willresult in Deferred Tax Liability.

The net difference of DTA / DTL is computed and transferred to Profit & Loss A/c. The Balance of DTLA/ DTL is reflected in Balance sheet under Current Assets/ Current Liabilities respectively.