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PROFESSIONAL PROFILE

- ▶ Amit Garg is a Fellow Chartered accountant and leads the Audit and Assurance practice in his firm RNBP & Co. .
- ▶ 20+ years of professional experience in Assurance & Advisory Services; previously with **S.R. Batliboi & Co. LLP** (EY member firm) for over 12 years in Audit & Assurance.
- ▶ Extensive experience in **IFRS, Ind AS, IGAAP**, Ind AS implementation, ICFR, SOX Testing, Business Process re-engineering, statutory audits, tax audits, Capital Market transactions and due diligence.
- ▶ Faculty for IFRS / Ind AS courses at **ICAI, Indian Corporate Law Service Academy (MCA) and Delhi University**. Corporate trainer on Ind AS and IFRS.
- ▶ **Developed and launched FinSoEasy360** — financial reporting software that generates Schedule III compliant Ind AS / AS standalone and consolidated financial statements along with related-party auto-elimination entries, lease accounting and dashboard reports. (www.finsensor.ai)

REFRESHER COURSE ON ACCOUNTING STANDARDS

AS 22

Accounting for Taxes on Income

A deep-dive workshop for Chartered Accountants — timing vs permanent differences, deferred tax assets & liabilities, virtual certainty, and contentious judgement areas

BY AMIT GARG

What we will cover

- 1 Scope & regulatory context
- 2 Accounting income vs Taxable income — the mismatch
- 3 Current tax + Deferred tax = Total tax expense
- 4 Timing differences vs Permanent differences
- 5 DTA vs DTL — examples & journal entries
- 6 Reasonable certainty test for DTA
- 7 Virtual certainty — convincing evidence standard
- 8 Measurement — enacted / substantively enacted rates
- 9 Review & reassessment at each balance sheet date
- 10 Nuance: Tax holidays & SEZ units
- 11 Nuance: MAT credit entitlement
- 12 Audit pitfalls & disclosure requirements
- Q & A

Scope, regulatory context & who must apply



Notified under Companies (AS) Rules, 2021

AS 22 was issued in 2001 and applied in phases — Level I from FY02-03, Level II from FY03-04, Level III from FY04-05. Applies to enterprises following Indian GAAP — Ind AS entities apply Ind AS 12 instead (balance-sheet / temporary-difference approach rather than AS 22's timing-difference approach).



The objective

To prescribe accounting treatment for taxes on income. Taxes on income are a SIGNIFICANT item in the P&L. AS 22 applies the matching concept — taxes should be accrued in the same period as the revenues and expenses to which they relate. This is achieved through current tax PLUS deferred tax accounting.



Interplay with other standards & ASIs

Interacts with AS 5 (changes in accounting estimates), AS 21/23/27 (consolidated deferred tax), the ICAI's Guidance Note on MAT credit, and four ASIs (3, 5, 6, 9) which are integrated as Explanations in the standard.

WHY IT MATTERS

The Two P&Ls

Every Indian company prepares TWO separate profit & loss statements:

1. Under Companies Act / AS — the accounting P&L you see in the annual report.
2. Under the Income-tax Act, 1961 — computed with tax-specific rules (higher depreciation rates, Section 43B, disallowances, exemptions).

AS 22 reconciles these two worlds in the financial statements so that reported tax expense reflects economic reality — not merely cash tax paid.

THE MISMATCH

Accounting income \neq Taxable income

Para 4 — AS 22 distinguishes between (a) accounting income, the net profit before tax as per the books, and (b) taxable income, the amount on which income tax is payable under the Income-tax Act, 1961. The two will almost NEVER be equal for an operating company.



ACCOUNTING INCOME

Book profit before tax

Based on: Companies Act 2013, AS.

Principles: Accrual, matching, prudence, going concern, substance over form.

Typical items: Depreciation per Schedule II / company policy. Provisions for bonus, gratuity, leave encashment. Doubtful Debts provisions. Revenue under AS 9.



TAXABLE INCOME

Income on which tax is payable

Based on: Income-tax Act, 1961 + Rules + Circulars + judicial precedent.

Principles: Specific statutory provisions; ICDS; S.43B cash-basis items; S.40(a) disallowances.

Typical divergences: Tax depreciation (WDV at IT Act rates). S.43B: bonus/gratuity/leave/interest on payment. TDS default disallowance. Exempt income (agricultural income).

The equation — current tax + deferred tax

PARA 9 • CORE EQUATION

$$\text{Tax Expense (P\&L)} = \text{Current Tax} + \text{Deferred Tax}$$



CURRENT TAX

Tax actually payable for the period

Definition: The amount of tax payable on taxable income for the period, applying prevailing tax rates.

Computation: Taxable income × applicable rate.

Cash impact: Direct — this is what the company pays.



DEFERRED TAX

Tax effect of timing differences

Definition: Tax effect of differences between taxable income and accounting income that originate in one period and reverse in future periods.

Purpose: Match tax expense with the period in which revenues / expenses are recognised. Not cash tax — an ACCOUNTING concept.

Balance sheet: Creates DTA or DTL — a carrying item, not cash.

Timing differences vs Permanent differences

Para 5-7: Every difference between accounting and taxable income is either a **TIMING** difference (reverses in future periods) or a **PERMANENT** difference (never reverses). Only timing differences create deferred tax.

TIMING DIFFERENCES

Reverse in future → create DTA or DTL

- **Depreciation differences** — SLM per Sch II vs higher WDV rates under IT Act
- **S.43B items** — bonus, gratuity, leave encashment, interest on bank loans (allowed on payment only)
- **Bad debt provisions** — allowed only on write-off
- **S.40(a)(ia) TDS default** — disallowed now, allowed on deposit
- **Unabsorbed depreciation / business losses** (carry-forward under IT Act)
- **Revenue timing divergences** (POCM vs completed-contract)

PERMANENT DIFFERENCES

Never reverse → NO deferred tax

- **Donations not qualifying for 80G** — permanently disallowed
- **Penalties and fines** for statutory violations (S.37(1) Explanation)
- **Income-tax paid** — not deductible from taxable income (S.40(a)(ii))
- **CSR expenses** — disallowed under S.37(1) Explanation 2
- **Tax-free income** — agricultural income
- **Personal / non-business expenses** under S.37(1)

Deferred Tax Asset vs Deferred Tax Liability

When a timing difference causes taxable income to be HIGHER than accounting income in the current year (reversing later) → DTA. When accounting income is HIGHER than taxable income (taxable later) → DTL.



DEFERRED TAX ASSET (DTA)

Tax already paid now, will save tax later

When arises: Taxable income > accounting income (difference reverses later).

Classic examples:

- Gratuity provision not yet paid (S.43B)
- Doubtful debts provision not yet written off
- Unabsorbed depreciation / business loss c/f
- TDS default disallowance (S.40(a)(ia))

Entry: Dr. DTA / Cr. Deferred Tax Income (P&L)



DEFERRED TAX LIABILITY (DTL)

Tax saved now, will be paid later

When arises: Accounting income > taxable income (difference reverses later).

Classic example — depreciation:

Tax WDV depreciation is front-loaded at higher rates; book SLM depreciation is spread evenly. Net tax saving in early years reverses in later years.

Entry: Dr. Deferred Tax Expense (P&L) / Cr. DTL

Reasonable certainty – the default test

Para 15-16: DTAs are recognised only to the extent there is **REASONABLE CERTAINTY** of sufficient future taxable income.

WHAT REASONABLE CERTAINTY MEANS IN PRACTICE



Past record of profitability

Consistent profits over recent years. An enterprise with 3-5 years of book profits has a solid basis for reasonable certainty about near-term future profitability.



Realistic future estimates

Budgets, business plans, and projections that are supportable — not optimistic 'hockey stick' forecasts. Must be corroborated by recent trends.



Lower threshold than VC

'Reasonable' is a lower bar than 'virtual' certainty. Prudence is built in — where future is uncertain, recognise less; where clear, recognise fully.



Exception: When the enterprise has carry-forward losses or unabsorbed depreciation, the higher bar of **Virtual Certainty** applies (Slide 10).

Virtual certainty — convincing evidence standard

Para 17: Where an enterprise has **UNABSORBED DEPRECIATION OR CARRY-FORWARD LOSSES** under tax laws, DTA is recognised only to the extent of **virtual certainty supported by convincing evidence**.

WHAT COUNTS AS CONVINCING EVIDENCE

- **Binding sales orders / long-term contracts** with creditworthy customers that will generate taxable income
- Regulatory-granted **monopoly / exclusive licence** with assured revenue (e.g., 25-year power purchase agreement)
- **Recent turnaround** with profits in current year + documented evidence the loss-causing factor is eliminated
- **Current-year profit against which losses can be offset** — DTA becomes virtually certain to that extent

WHAT DOES NOT COUNT

- **Business plans / budgets alone** — aspiration is not evidence
- **Management's perception** or subjective views about future profitability
- **General economic trend** or industry outlook
- **Pattern of alternating profits and losses** over recent years

Guidance: *Virtual certainty must be available in a concrete form on a specific date — not merely subjective management views.*

MEASUREMENT

Tax rates — enacted or substantively enacted

Para 21: DTA / DTL should be measured using the tax rates and laws that have been ENACTED or SUBSTANTIVELY ENACTED by the balance sheet date. The rate should reflect when the timing difference is expected to reverse.

Enacted rates

Tax rates passed by Parliament and notified in the Official Gazette. Applicable from the date specified — typically 1-April of the assessment year.

Substantively enacted

In India, the Finance Bill is 'substantively enacted' when it receives Presidential assent and is notified. Before assent, existing rates apply.

Expected reversal rate

If the enterprise expects to reverse a timing difference over a period with different rates (e.g., under S.115BAA vs regular), use the rate applicable to the reversal period.

IMPORTANT — SECTION 115BAA / 115BAB CONCESSIONAL RATES

Companies that have opted for the concessional tax regime (22% under S.115BAA or 15% under S.115BAB for new manufacturing) **must measure their DTA / DTL at these concessional rates** once the option is exercised. On first-time exercise, restate existing DTA / DTL with the impact flowing through P&L in the period of change.

Review at each balance sheet date

CORE PRINCIPLE (Para 26)

The carrying amount of DTAs must be reviewed at each balance sheet date. If circumstances have changed such that reasonable / virtual certainty is no longer met, DTA must be WRITTEN DOWN. Conversely, an unrecognised DTA may be RECOGNISED in a later period if certainty criteria now exist.

WRITE-DOWN SCENARIO

When circumstances worsen

Trigger events:

- Sustained losses in recent years
- Loss of major customer / contract
- Industry downturn / regulatory disruption
- Expiry of carry-forward period (losses have only 8 years under IT Act)

Entry: Dr. Deferred Tax Expense (P&L)
Cr. Deferred Tax Asset

RE-RECOGNITION SCENARIO

When circumstances improve

Trigger events:

- Return to profitability after sustained losses
- Newly-signed long-term contracts providing convincing evidence of future taxable income
- Regulatory or structural change eliminating the cause of past losses

Entry: Dr. Deferred Tax Asset
Cr. Deferred Tax Income (P&L)

Tax holidays, SEZ units & ASI-3, ASI-5

Certain tax holiday / exemption provisions (Sections 10A/10B for STPI/SEZ before sunset, 80-IA, 80-IB, 80-IC) create complex deferred tax interplay.



SECTION 80-IA / 80-IB

Reversals within vs after tax holiday

Core principle: Create deferred tax ONLY for timing differences that reverse AFTER the tax holiday period.

Why: Timing differences that reverse within the holiday have no tax effect — the reversal happens in a tax-free period.

Practical impact: Companies in the last years of tax holiday must carefully split timing differences between those reversing within vs after the exemption period.



SECTION 10A / 10B

STPI / SEZ units — similar logic

Scope: Enterprises whose income is exempt under S.10A / 10B (historically applicable for STPI units / export-oriented units).

Treatment: Deferred tax is NOT created for timing differences reversing within the tax-exempt period.

Current relevance: S.10A/10B have sunsetted (most STPI benefits ended). SEZ benefits under S.10AA continue for existing units — same logic applies.

MAT credit entitlement — NOT deferred tax

Guidance Note on MAT Credit: MAT credit is an ASSET, but it is NOT deferred tax under AS 22. It is accounted separately.



Origin of MAT

S.115JB — if a company's tax payable on book profits (at 15%) exceeds tax on taxable income computed normally, the HIGHER amount is paid. The excess paid over normal tax becomes MAT Credit, carryforward for up to 15 years under S.115JAA.



Recognition test

Recognise MAT credit as an asset ONLY when there is virtual certainty (supported by convincing evidence) that the credit will be adjusted against future normal-tax liability within the 15-year carry-forward window.



Presentation

Shown separately on the face of the balance sheet as 'MAT Credit Entitlement' under Loans & Advances / Other Non-Current Assets. NOT netted against DTA / DTL. Discount to present value is NOT required.

Presentation, offsetting & classification

Paras 29-30 govern balance-sheet presentation. The rules are specific — and routinely mis-applied in practice.



Separate presentation

DTA and DTL may be netted off if permitted and offsetting criteria are met, else separate presentation.



Offsetting — strict criteria

Para 29 permits offsetting only when: (a) the enterprise has a LEGALLY ENFORCEABLE right to set off assets against liabilities representing current tax, AND (b) the DTA / DTL relate to taxes on income levied by the SAME governing taxation laws.



Non-current classification

DTA / DTL are ALWAYS classified as non-current under Schedule III — regardless of when the underlying timing difference reverses. This is a fixed classification rule, not a judgement-based one.



Most common presentation error: companies net DTA against DTL by component (e.g., offsetting depreciation DTL against gratuity DTA) when in fact the net figure cannot be presented unless the strict Para 30 criteria are met. Most groups present DTA and DTL gross on a standalone basis.

Where AS 22 goes wrong in practice



COMMON AUDIT FINDINGS

Top seven issues inspectors raise

- 1 DTA on carry-forward losses without convincing evidence** — most common finding; based on optimistic projections, not concrete evidence.
- 2 Permanent differences treated as timing** — or vice versa; e.g., creating DTA on CSR disallowance (permanent, not timing).
- 3 Stale tax rates used** — company opted for S.115BAA but DTA / DTL still at old 30%+ rates.
- 4 DTA not written down despite sustained losses** — annual reassessment missed; DTA carried on balance sheet without justification.
- 5 MAT credit shown as deferred tax** — incorrect classification; MAT credit is a separate asset.
- 6 DTA / DTL netted only if Para 30 criteria** — net presentation with out meeting criteria.
- 7 Break-up of DTA / DTL not disclosed** — Schedule III requires major components to be shown separately.



DISCLOSURE

Key disclosures required

- Break-up of DTA and DTL into major components
- Nature of evidence supporting DTA recognition (where virtual certainty test applies)
- Tax rate(s) used for measurement
- Deferred tax expense / income for the period with separate break-up
- Unrecognised DTA — disclose amount of tax losses and unabsorbed depreciation where DTA not recognised
- MAT credit shown separately — amount + virtual certainty basis

Key Takeaways

01

Tax Expense = Current Tax + Deferred Tax. Deferred tax brings the matching principle to tax accounting — it is NOT cash tax.

02

Only TIMING differences create deferred tax. Permanent differences (CSR, penalties, exempt income) affect only current tax — no DTA or DTL.

03

DTA recognition requires reasonable certainty of future taxable income. For carry-forward losses, the higher bar of virtual certainty with convincing evidence applies.

04

Measure DTA / DTL at enacted or substantively enacted tax rates expected to apply when the timing difference reverses. Update for S.115BAA / 115BAB option.

05

Review DTA carrying amount at each balance sheet date. Write down if circumstances deteriorate; recognise previously unrecognised DTA if they improve.

06

MAT credit is NOT deferred tax — it's a separate asset.

Discussion & Questions

Thank You

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