Accounting Standards Interpretation (ASI) 2[1]

Accounting for Machinery Spares

Accounting Standard (AS) 2, Valuation of Inventories and AS 10, Accounting for Fixed Assets

ISSUE

1. Which machinery spares are covered under AS 2 and AS 10 and what should be the accounting for machinery spares under the respective standards.

CONSENSUS

2. Machinery spares which are not specific to a particular item of fixed asset but can be used generally for various items of fixed assets should be treated as inventories for the purpose of AS 2. Such machinery spares should be charged to the statement of profit and loss as and when issued for consumption in the ordinary course of operations.

3. Whether to capitalise a machinery spare under AS 10 or not will depend on the facts and circumstances of each case. However, the machinery spares of the following types should be capitalised being of the nature of capital spares/insurance spares –

   (i) Machinery spares which are specific to a particular item of fixed asset, i.e., they can be used only in connection with a particular item of the fixed asset, and

   (ii) their use is expected to be irregular.

4. Machinery spares of the nature of capital spares/insurance spares should be capitalised separately at the time of their purchase whether procured at the time of purchase of the fixed asset concerned or subsequently. The total cost of such capital spares/insurance spares should be allocated on a systematic basis over a period not exceeding the useful life of the principal item, i.e., the fixed asset to which they relate.

5. When the related fixed asset is either discarded or sold, the written down value less disposal value, if any, of the capital spares/insurance spares should be written off.

6. The stand-by equipment is a separate fixed asset in its own right and should be depreciated like any other fixed asset.

BASIS FOR CONCLUSIONS

7. Paragraphs 8.2 and 25 of AS 10, 'Accounting for Fixed Assets', state as below:

   "8.2 Stand-by equipment and servicing equipment are normally capitalised. Machinery spares are usually charged to the profit and loss statement as and when consumed. However, if such spares can be used only in connection with an item of fixed asset and their use is expected to be irregular, it may be appropriate to allocate the total cost on a systematic basis over a period not exceeding the useful life of the principal item."

   "***25. Fixed asset should be eliminated from the financial statements on disposal or when no further benefit is expected from its use and disposal."***

8. Paragraph 4 of AS 2, 'Valuation of Inventories', states as below:

   "4. Inventories encompass goods purchased and held for resale, for example, merchandise purchased by a retailer and held for resale, computer software held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, consumables and loose tools awaiting use in the production process. Inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular; such machinery spares are accounted for in accordance with Accounting Standard (AS) 10, Accounting for Fixed Assets."

[1] The authority of this ASI is the same as that of the Accounting Standards to which it relates. The contents of this ASI are intended for the limited purpose of the Accounting Standards to which it relates. ASI is intended to apply only to material items.

9. Machinery spares of the nature of capital spares/insurance spares are capitalised. Capital spares/insurance spares are meant for occasional use. Since they can be used only in relation to a specific item of fixed asset, they are to be discarded in case that specific fixed asset is disposed of. In other words, such spares are integral parts of the fixed asset.

10. A stand-by equipment is not of the nature of a spare but is of the nature of another piece of equipment which is being used in the manufacturing process. For example, a generator set kept in store as a stand-by to the generator set which is being used in the manufacturing process. Therefore, the stand-by equipment is a separate fixed asset in its own right and is depreciated like any other fixed asset.

Accounting Standards Interpretation (ASI) 3[1]

Accounting for Taxes on Income in the situations of Tax Holiday under Sections 80-IA and 80-IB of the Income-tax Act, 1961

Accounting Standard (AS) 22, Accounting for Taxes on Income

ISSUE

1. Sections 80-IA and 80-IB of the Income-tax Act, 1961 (hereinafter referred to as the 'Act') provide certain deductions, for certain years, in determining the taxable income of an enterprise. These deductions are commonly described as 'tax holiday' and the period during which these deductions are available is commonly described as 'tax holiday period'.

2. The issue is how AS 22 should be applied in the situations of tax-holiday under sections 80-IA and 80-IB of the Act.

CONSENSUS

3. The deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent the enterprise's gross total income is subject to the deduction during the tax holiday period as per the requirements of the Act.

4. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence as laid down in paragraphs 15 to 18 of AS 22.

5. For the above purposes, the timing differences which originate first should be considered to reverse first.

The Appendix to this Interpretation illustrates the application of the above requirements.

BASIS FOR CONCLUSIONS

6. Section 80A (1) of the Act, provides that in computing the total income of an assessee, there shall be allowed from his gross total income, in accordance with and subject to the provisions of this Chapter, the deductions specified in sections 80C to 80U. Therefore, the deductions under sections 80-IA and 80-IB are the deductions from the gross total income of an assessee determined in accordance with the provisions of the Act. For example, depreciation under section 32 of the Act is provided for arriving at the amount of gross total income even if it is not claimed in view of Explanation 5 to clause (ii) of sub-section (1) of section 32 of the Act.

[1] The authority of this ASI is the same as that of the Accounting Standard to which it relates. The contents of this ASI are intended for the limited purpose of the Accounting Standard to which it relates. ASI is intended to apply only to material items.

7. In view of the above, the amount of the deduction under sections 80-IA and 80-IB of the Act, is based on the gross total income which is determined in accordance with the provisions of the Act. In respect of the situations covered under sections 80-IA and 80-IB, the difference in the relevant accounting income and taxable income (relevant gross total income minus deduction allowed under sections 80-IA and 80-IB) of an enterprise during a tax holiday period is classified into permanent differences and timing differences. The amount of deduction in respect of sections 80-IA and 80-IB is a permanent difference whereas the differences which arise because of different treatment of items of income and expenses for determination of relevant accounting income and relevant gross total income such as depreciation are timing differences.

8. The Framework for the Preparation and Presentation of Financial Statements provides that "An asset is recognised in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably". The Framework also provides that "A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably". In the situation of tax holiday under Sections 80-IA and 80-IB of the Act, it is probable that deferred tax assets and liabilities in respect of timing differences which originate and reverse during the tax holiday period will not be realised or settled. Accordingly, a deferred tax asset or a liability for timing differences which reverse during the tax holiday period does not meet the above criteria for recognition of asset or liability, as the case may be, and therefore is not recognised to the extent the gross total income of the enterprise is subject to the deduction during the tax holiday period.

9. Deferred tax assets/liabilities for timing differences which reverse after the tax holiday period are recognised in the period in which these differences originate because these can be realised/paid after the expiry of the tax holiday period by payment of lesser or higher amount of tax after the tax holiday period because of reversal of timing differences.

10. According to one view, during the tax holiday period, no deferred tax should be recognised even for the timing differences which reverse after the tax holiday period, because timing differences do not originate, for example, in the situation of a 100 percent tax holiday period the taxable income is nil. This view was not accepted because in the aforesaid situation, although the current tax is nil but deferred tax, on account of the timing differences which will reverse after the tax holiday period, exists. Further, even in case of carry forward of losses which can be set-off against future taxable income, deferred tax may be recognised, as per AS 22, in respect of all timing differences irrespective of the fact that the taxable income of the enterprise is nil in the period in which the timing differences originate.

11. According to another view, the timing differences which will reverse after the tax holiday period should be recognised at the beginning of the first year after the expiry of the tax holiday period and not in the year in which the timing differences originate. Accordingly, as per this view, during the tax holiday period, deferred tax should not be recognised. This view was also not accepted because as per AS 22 deferred tax should be recognised in the period in which the relevant timing differences originate.

Appendix

Note: This appendix is illustrative only and does not form part of the Accounting Standards Interpretation. The purpose of this appendix is to illustrate the application of the Interpretation to assist in clarifying its meaning.

Facts:

1. The income before depreciation and tax of an enterprise for 15 years is Rs. 1000 lakhs per year, both as per the books of account and for income-tax purposes.
2. The enterprise 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 enterprise has purchased one machine for Rs. 1500 lakhs. Residual value is assumed to be nil.
4. For accounting purposes, the enterprise 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 will be 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.

Table 2
Computation of Timing differences

(Amounts in Rs. lakhs)

1	2	3	4	5	6	7	8	9
Year	Income before deprecation and tax (both for accounting purposes and tax purposes)	Accounting Income after deprec-iation	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 depre-ciation for accounting purposes and tax purposes) (O=Originating 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)

Notes:

1. Timing differences originating during the tax holiday period are Rs. 644 lakhs, out of which Rs. 228 lakhs are revers-

ing 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 Interpretation, deferred tax on timing differences which originate during the tax holiday period and 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	47x30%=14 (see note 2 above)	14 (L)	14
2	Nil	181x30%=54	68 (L)	54
3	Nil	111x30%=33	101 (L)	33
4	Nil	58x30%=17	118 (L)	17
5	Nil	19x30%=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	-79x30%=-24	100 (L)	270
12	295	-84x30%=-25	75 (L)	270
13	296	-88x30%=-26	49 (L)	270
14	297	-91x30%=-27	22 (L)	270
15	298	-74x30%=-22 -19x30%=-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 consideration of prudence as per AS 22. 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.

Accounting Standards Interpretation (ASI) 4[1]

Losses under the head Capital Gains

Accounting Standard (AS) 22, Accounting for Taxes on Income

ISSUE

1. The issue is how AS 22 should be applied in respect of 'loss' arising under the head 'Capital gains' of the Income-tax Act, 1961 (hereinafter referred to as the 'Act'), which can be carried forward and set-off in future years, only against the income arising under that head as per the requirements of the Act.

CONSENSUS

2. Where an enterprise'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 Act, 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 Act. In respect of such 'loss', deferred tax asset should be recognised and carried forward subject to the consideration of prudence. Accordingly, in respect of such 'loss', deferred tax asset should be recognised and carried forward only to the extent that there is a reasonable certainty 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 Act. However, where an enterprise has unabsorbed depreciation or carry forward of business losses under the tax laws, the deferred tax asset in respect of 'loss' under the head 'Capital gains' should be recognised and carried forward only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available under the head 'Capital gains' against which such loss can be set-off as per the provisions of the Act.

3. 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 Act in respect of long-term capital assets, the deferred tax asset should be recognised and carried forward (subject to the consideration of prudence) on the amount which can be carried forward and set-off in future years as per the provisions of the Act.

BASIS FOR CONCLUSIONS

4. Section 71 (3) of the Act provides that "Where in respect of any assessment year, the net result of the computation under the head "Capital gains" is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to have such loss set off against income under the other head".

5. Section 74 (1) of the Act provides that "Where in respect of any assessment year, the net result of the computation under the head "Capital gains" is a loss to the assessee, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and—
   (a) in so far as such loss relates to a short-term capital asset, it shall be set off against income, if any, under the head "Capital gains" assessable for that assessment year in respect of any other capital asset;
   (b) in so far as such loss relates to a long-term capital asset, it shall be set off against income, if any, under the head "Capital gains" assessable for that assessment year in respect of any other capital asset not being a short-term capital asset;
   (c) if the loss cannot be wholly so set-off, the amount of loss not so set off shall be carried forward to the following assessment year and so on."

   Section 74 (2) of the Act provides that "No loss shall be carried forward under this section for more than eight assessment years immediately succeeding the assessment year for which the loss was first com-

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puted".

6. AS 22 defines 'timing differences' as "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".

7. Where an enterprise's statement of profit and loss includes an item of loss, which is considered a 'loss' under the head 'Capital gains' as per the provisions of the Act, the loss is a timing difference, to the extent the same is not set-off in the current year, because this loss can be allowed to be set-off against income arising under the head 'Capital gains' in future, subject to the provisions of the Act, and to that extent the amount of income under that head will not be taxable in the future year even though the said income would be included in the determination of the accounting income of that year.

8. AS 22 provides that "***Deferred tax should be recognised for all the timing differences, subject to the consideration of prudence in respect of deferred tax assets as set out in paragraphs 15-18***". Paragraph 15 of AS 22 provides that "***Except in the situations stated in paragraph 17, deferred tax assets should be 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***."

Paragraphs 17 and 18 of AS 22 provide as follows:

> "***17. Where an enterprise has unabsorbed depreciation or carry forward of losses under tax laws, deferred tax assets should be recognised only to the extent that there is virtual certainty supported by convincing evidence that sufficient future taxable income will be available against which such deferred tax assets can be realised.***
>
> 18. 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 enterprise has a history of recent losses, the enterprise recognises deferred tax assets 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. In such circumstances, the nature of the evidence supporting its recognition is disclosed."

It may be noted from the above that paragraph 18 explains that the existence of unabsorbed depreciation or carry forward of losses under tax laws is strong evidence that future taxable income may not be available. However, when in respect of a particular year, an enterprise has 'loss' under the head 'Capital gains', but has taxable income for that year, it can not be considered a strong evidence that future taxable income under the head 'Capital gains' may not be available. Accordingly, application of paragraphs 17 and 18 of AS 22 for recognition of deferred tax asset in respect of 'loss' under the head 'Capital gains', is not appropriate in case of an enterprise which has a history of business profits.

In view of the above, paragraph 17 read with explanatory paragraph 18 of AS 22 is in the context of business losses under the tax laws and not the 'loss' under the head 'Capital gains'. Therefore, 'loss' under the head 'Capital gains', when an enterprise does not have unabsorbed depreciation or carry forward of business losses, is not covered by paragraph 17 but is covered by paragraph 15 and accordingly, paragraph 15 is applied. However, the situation where an enterprise has unabsorbed depreciation or carry forward of business losses under the tax laws falls within paragraph 17. Accordingly, in such a situation, for recognition of deferred tax assets including those arising in respect of the 'loss' under the head 'Capital gains', paragraph 17 is applied.

In this regard, reasonable certainty or virtual certainty, as the case may be, of the availability of sufficient future taxable income against which deferred tax assets can be realised, will be construed to mean reasonable certainty or virtual certainty, as the case may be, of the availability of taxable income under the head "Capital gains" in future in accordance with the provisions of the Act.

9. 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 Act in respect of long-term capital assets, deferred tax asset is recognised and carried forward (subject to the consideration of prudence) on the amount which can be carried forward and set-off in future years as per the provisions of the Act since that is the amount which will be available for set-off in future years as per the provisions of the Act.

Accounting Standards Interpretation (ASI) 5[1]

Accounting for Taxes on Income in the situations of Tax Holiday under Section 10A and 10B of the Income-tax Act, 1961

Accounting Standard (AS) 22, Accounting for Taxes on Income

ISSUE

1. Chapter III of the Income-tax Act, 1961 (hereinafter referred to as the 'Act') deals with incomes which do not form part of total income. Sections 10A and 10B of the Act are covered under Chapter III. These sections allow certain deductions, for certain years, from the total income of an assessee. These deductions are commonly described as 'tax holiday' and the period during which these deductions are available is commonly described as 'tax holiday period'.

2. The issue is how AS 22 should be applied in the situations of tax-holiday under sections 10A and 10B of the Act.

CONSENSUS

3. The deferred tax in respect of timing differences which originate during the tax holiday period and reverse during the tax holiday period, should not be recognised to the extent deduction from the total income of an enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Act.

4. Deferred tax in respect of timing differences which originate during the tax holiday period but reverse after the tax holiday period should be recognised in the year in which the timing differences originate. However, recognition of deferred tax assets should be subject to the consideration of prudence as laid down in paragraphs 15 to 18 of AS 22.

5. For the above purposes, the timing differences which originate first should be considered to reverse first.

BASIS FOR CONCLUSIONS

6. Sections 10A and 10B are covered under Chapter III of the Act. These sections allow certain deductions, for certain years, from the total income of the assessee.

7. The Framework for the Preparation and Presentation of Financial Statements provides that "An asset is recognised in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably". The Framework also provides that "A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably". In the situation of tax holiday under sections 10A and 10B of the Act, it is probable that deferred tax assets and liabilities in respect of timing differences which originate and reverse during the tax holiday period will not be realised or settled. Accordingly, a deferred tax asset or a liability for timing differences which reverse during the tax holiday period does not meet the above criteria for recognition of asset or liability, as the case may be, and therefore is not recognised to the extent deduction from the total income of the enterprise is allowed during the tax holiday period as per the provisions of sections 10A and 10B of the Act.

8. Deferred tax assets/liabilities for timing differences which reverse after the tax holiday period are recognised in the period in which these differences originate because these can be realised/paid after the expiry of the tax holiday period by payment of

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lesser or higher amount of tax after the tax holiday period because of reversal of timing differences.

9. This Interpretation prescribes the same accounting treatment for situations of tax holiday under sections 10A and 10B of the Act as prescribed for situations of tax holiday under sections 80-IA and 80-IB of the Act (see ASI 3).

According to one view situation of tax holiday under sections 10A and 10B should be treated differently as compared to situations of tax holiday under sections 80-IA and 80-IB of the Act since sections 10A and 10B are covered under Chapter III of the Act which deals with incomes which do not form part of total income whereas sections 80-IA and 80-IB are covered under Chapter VI-A which deals with deductions to be made in computing total income.

This view was not accepted because irrespective of the fact that sections 10A and 10B are covered under Chapter III and sections 80-IA and 80-IB are covered under Chapter VI-A, the substance of the reliefs, in terms of economic reality is the same. Keeping in view the 'substance over form' principle of accounting as laid down in AS 1, 'Disclosure of Accounting Policies', there should not be any difference between the treatment in respect of tax holiday under sections 80-IA, 80-IB and 10A, 10B.

Accounting Standards Interpretation (ASI) 6[1]

Accounting for Taxes on Income in the context of Section 115JB of the Income-tax Act, 1961

Accounting Standard (AS) 22, Accounting for Taxes on Income

ISSUES

1. The issue is how AS 22 is applied in a situation where a company pays tax under section 115JB (commonly referred to as Minimum Alternative Tax) of the Income-tax Act, 1961 (hereinafter referred to as the 'Act').
2. Another issue is how deferred tax is measured on the timing differences originating during the current year if the enterprise expects that these differences would reverse in a period in which it may pay tax under section 115JB of the Act.

CONSENSUS

3. The payment of tax under section 115JB of the Act is a current tax for the period.
4. In a period in which a company pays tax under section 115JB of the Act, 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 AS 22, should be measured using the regular tax rates and not the tax rate under section 115JB of the Act.
5. In case an enterprise 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 Act, 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 22, should be measured using the regular tax rates and not the tax rate under section 115JB of the Act.

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BASIS FOR CONCLUSIONS

6. Sub-section (1) of Section 115JB of the Act provides that "Notwithstanding anything contained in any other provision of this Act, where in the case of an assessee, being a company, the income-tax, payable on the total income as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 2001, is less than seven and one-half per cent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of seven and one-half per cent." Tax paid/payable under section 115JB is the current tax and does not, in itself, give rise to any deferred tax since this payment of tax is pursuant to the special provision of the Act. This section only prescribes the mode of computation of tax payable for the current year.

7. Paragraph 20 of AS 22 requires that current tax should be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the applicable tax rates and tax laws. Paragraph 21 of AS 22 provides that deferred tax assets and liabilities should be measured using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. In a period in which an enterprise pays tax under section 115JB of the Act, the rate of seven and one-half percent is relevant for the purpose of measurement of current tax and not for the purpose of measurement of deferred tax.

8. There are two methods for recognition and measurement of tax effects of timing differences, viz., the "full provision method" and "partial provision method". Under the "full provision method", the deferred tax is recognised and measured in respect of all timing differences (subject to consideration of prudence in case of deferred tax assets) without considering assumptions regarding future profitability, future capital expenditure etc. On the other hand, the 'partial provision method' excludes the tax effects of certain timing differences which will not reverse for some considerable period ahead. Thus, this method is based on many subjective judgements involving assumptions regarding future profitability, future capital expenditure etc. In other words, partial provision method is based on an assessment of what would be the position in future. Keeping in view the elements of subjectivity, the 'partial provision method' under which deferred tax is recognised on the basis of assessment as to what would be the expected position, has generally been discarded the world-over. AS 22 also does not consider the above assumptions and, therefore, is based on 'full provision method'.

The expectation that the timing differences arising in the current period would reverse in a period in which the enterprise may pay tax under section 115JB of the Act, also involves assessment of the future taxable income and accounting income and therefore, is considerably subjective. It can not be known beforehand, with a reasonable degree of certainty, whether in future an enterprise would pay tax under section 115JB of the Act because that determination can only be made after the fact.

Recognition and measurement of deferred tax using the rate under section 115JB of the Act, i.e., seven and one-half percent, on the basis of an assessment that the timing differences would reverse in a period in which the enterprise may pay tax under section 115JB of the Act, would be a situation analogous to the adoption of the 'partial provision method' which has already been rejected.

In view of the above, this Interpretation requires that even if an enterprise 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 Act, 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 22, should be measured using the regular tax rates and not the tax rate under section 115JB of the Act.

A new idea is delicate. It can be killed by a sneer or a yawn; it can be stabbed to death by a joke or worried to death by a frown on the right person's brow.

—Charles Brower