

**Accounting Standards Interpretation (ASI) 3¹
(Revised)**

**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 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 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.

¹ Published in 'The Chartered Accountant' August 2005, pp. 325-328. 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.

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.

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 reverse during the tax holiday period, whether originated in the tax holiday period or before that (refer provisions of section 80-IA(2) of the Act), 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, whether originated in the tax holiday period or before that, 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)

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	2	3	4	5	6	7	8	9
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 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 Interpretation, 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	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	Nil	270
		-19x30%=-6	6 (A) ²	

- 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.