

Query No. 4

Subject: *Recognition of deferred tax asset/liability in respect of depreciation on Held-To-Maturity (HTM) category investments as per Accounting Standard 22, 'Accounting for Taxes on Income'.¹*

A. Facts of the Case

1. The querist has stated that a bank follows the guidelines of the Reserve Bank of India for making provision for investments in books of account. As per the guidelines of the Reserve Bank of India, investments held under held-to-maturity (HTM) need not be marked to market and will be carried at acquisition cost, unless it is more than the face value, in which case the premium is to be amortised over the period remaining to maturity.

2. However, for the purpose of income tax, bank treats all the securities/investments including HTM category securities as stock-in-trade. In other words, bank has been claiming depreciation on such investments for income tax purpose.

3. The querist has further stated that on account of the above-mentioned accounting treatment, the following questions are being raised:

- (i) Whether there is a timing difference arising out of depreciation on investment held under HTM category and;
- (ii) Whether bank is required to create deferred tax liability (DTL) for the same;

The statutory central auditors of the bank are of the view for creating DTL on such depreciation on HTM securities as per Accounting Standard (AS) 22, 'Accounting for Taxes on Income' and the auditors are insisting for creating DTL.

¹ Opinion finalised by the Committee on 2.9.2016.

Views of the querist:

4. According to the querist, Accounting Standard (AS) 22, 'Accounting for Taxes on Income' envisages recognition of deferred tax assets/deferred tax liabilities for the timing differences. As per the Standard,

“Timing differences are 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.”

“Permanent differences are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently.”

From the above, it is clear that two conditions need to be fulfilled for timing difference:

- (i) There should be difference between accounting income and taxable income as accepted by income tax department; and
- (ii) Reversal of the difference so originated should occur in subsequent periods.

Further, paragraph 7 of AS 22, inter alia, reads as *“Timing differences arise because the period in which some items of revenue and expenses are included in taxable income do not coincide with the period in which such items of revenue and expenses are included or considered in arriving at accounting income”*(emphasis supplied by the querist). That means only when an item of expense/income is given same treatment both under taxable income and accounting income, it will fall within the definition of timing difference. For example, if an item of expenditure is claimed as expenses in one period and allowed as deduction while computing taxable income in another period, then it will result in timing difference. However, if an item is given totally two different treatments under accounting income and taxable income, the same has to be treated as permanent difference. In the case of depreciation on investment, the treatment in the books of account and for the purpose of income tax is totally different. Hence, according to the querist, that cannot be considered as timing difference.

B. Query

5. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

- (i) Whether there is a timing difference arising out of depreciation on investment held under HTM category; and
- (ii) Whether bank is required to create deferred tax liability (DTL) for the same.

C. Points considered by the Committee

6. The Committee notes that the basic issue raised by the querist relates to deferred tax implications of depreciation on HTM investments for income tax purposes leading to difference in value of HTM investments for accounting and tax purposes in the situation as specified in the facts of the case. Therefore, the Committee has examined only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, appropriateness of treatment of HTM investments as stock-in-trade for tax purposes. Further, the Committee refrains from expressing any view on the correctness of interpretation of tax treatment by the querist.

7. The Committee notes that as per the querist, for income tax purposes, the HTM investments are treated as stock-in-trade, viz., investments are carried at lower of cost and market price and the difference is charged as depreciation for income tax purposes, however for accounting purposes, no such depreciation is charged. Thus, it leads to difference in valuation of HTM investments for tax purposes and accounting purposes. If such differential valuation is accepted by the Income-tax department, a question arises as to whether the difference is a timing difference or a permanent difference.

8. The Committee notes the following paragraphs from AS 22, issued by the Institute of Chartered Accountants of India:

***“4.6 Timing differences are 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.*”**

4.7 Permanent differences are the differences between taxable income and accounting income for a period that originate in one period and do not reverse subsequently.”

“5. Taxable income is calculated in accordance with tax laws. In some circumstances, the requirements of these laws to compute taxable income differ from the accounting policies applied to determine accounting income. The effect of this difference is that the taxable income and accounting income may not be same.

6. The differences between taxable income and accounting income can be classified into permanent differences and time differences. Permanent differences are those differences between taxable income and accounting income which originate in one period and do not reverse subsequently. For instance, if the purpose of computing taxable

income, the tax laws allow only a part of an item of expenditure, the disallowed amount would result in a permanent difference.

7. Timing differences are those 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. Timing differences arise because the period in which some items of revenue and expenses are included in taxable income do not coincide with the period in which such items of revenue and expenses are included or considered in arriving at accounting income. For example, machinery purchased for scientific research related to business is fully allowed as deduction in the first year for tax purposes whereas the same would be charged to the statement of profit and loss as depreciation over its useful life. The total depreciation charged on the machinery for accounting purposes and the amount allowed as deduction for tax purposes will ultimately be the same, but periods over which the depreciation is charged and the deduction is allowed will differ. Another example of timing difference is a situation where, for the purpose of computing taxable income, tax laws allow depreciation on the basis of the written down value method, whereas for accounting purposes, straight line method is used. Some other examples of timing differences arising under the Indian tax laws are given in Illustration 1.”

9. From the above, the Committee is of the view that there are two essentialities for timing differences to arise:

- (i) There should be difference between taxable income and accounting income originating in one period; and
- (ii) The difference so originated should be capable of reversal in one or more subsequent periods.

The Committee notes that as per the definitions quoted above, the reversal of the difference can take place at any time in future, i.e., without any time limit.

10. The Committee notes that in case HTM investments are treated as stock-in-trade for tax purposes and depreciation is charged, it would result in a difference between accounting income and taxable income in the period in which such depreciation is charged. Further, the Committee notes that though due to such depreciation charged, there would be difference in accounting income and taxable income at relevant dates, the cumulative effect on profit and loss account from the time of acquisition to the disposal of the investment is same both for accounting and tax purposes. Thus, the difference originating in one period is bound to reverse in one or more subsequent period(s), for example, on sale or maturity of investments. Therefore, the Committee

is of the view that the difference between taxable income and accounting income attributable to the difference in valuation of the HTM investments is a timing difference. Accordingly, the Committee is of the view that the said timing difference should be considered for creation of deferred tax asset/liability in accordance with the provisions of AS 22.

D. Opinion

11. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 5 above:

- (i) Yes, there is a timing difference arising out of depreciation for income tax purposes, on investment held under HTM category, as discussed in paragraph 10 above and;
- (ii) The bank is required to create deferred tax asset/liability for such a timing difference in accordance with the provisions of AS 22.