2

PROVISION FOR LIABILITY FOR TAXATION*

1. The Statement summarises the Council's view on the responsibility of the auditor relating to the provision for liability for taxation and replaces all earlier statements on this subject.

2. The liability for taxation arises not later than the last day of the accounting period for which the accounts are prepared. Therefore, provision for the anticipated tax liability in respect of the profit for such period has to be made irrespective of the fact that the Finance Act for the succeeding assessment year may not have been enacted. This provision has to be made on the basis of the law and rates as known at the time when the accounts are finalised and may be adjusted if any subsequent change takes place in the law or in the rates.

3. The attention of the Council has been drawn to the fact that there is a practice prevalent whereby companies do not make provision for taxation even when such a liability is anticipated. This practice is based on a view that, if a company does not debit to its Profit and Loss Account the amount of provision for taxation and conveys the information through a Note, it would be adequate compliance with the provisions of the Companies Act. The Council, however, believes that, on an overall consideration of the relevant provision of law, non-provision for taxation would amount to contravention of the provisions of Sections 209 and 211 of the Companies Act. Accordingly, it is necessary for the auditor to qualify his report, and such qualification should bring out in what manner the accounts do not disclose a "true and fair" view of the state of affairs of the company and the profit or loss of the company. An example of the manner in which the statement in the report that

---

* Published in CICA Newsletter, November, 1975, p.75-76.

the Balance Sheet and Profit and Loss Account disclose a true and fair view may be qualified, is given below:

> "The Company has not provided for taxation in respect of its profits, and the estimated aggregate amount of taxation not so provided for is Rs.......including Rs.......for the year ended on.......To the extent of such non-provision for the year, the profits of the Company for the financial year under report have been over-stated, and to the extent, of such aggregate non-provision, the Reserves of the company appearing in the Balance Sheet have been over-stated and the Current Liabilities and Provisions appearing in the said Balance Sheet have been under-stated."

4. It may happen that the Balance Sheet and Profit and Loss Account prepared by the Board of Directors of the company includes a Note stating the fact of non-provision for taxation. If the Note is substantially on the lines similar to the illustration indicated above and if the auditor is satisfied that it adequately brings out the qualification in respect of the "true and fair" view, he may instead of repeating the qualification in its entirely in his report, invite a reference to the note and make his report subject to the note. An example of the manner in which this may be done is given below:—

> "Subject to Note(s).........regarding the non-provision for taxation, the Balance Sheet........"

5. The examples in para 3 and 4 are restricted to the question of non-provision for taxation. If there are other items for which provision is necessary but has not been made, the qualification may be suitably amended in the light of the method of accounting adopted and other circumstances of each case.

6. The attention of the Council has also been drawn to the fact that there are cases of Companies where the Profit & Loss Account shows a balance of profit but there is either no provision for taxation or the provision is of a figure which is materially lower than the amount which should be arrived at by applying the applicable rate of tax to such profits. In many cases, there is no note on the accounts explaining the reasons as to why provision for taxation has not been made or has been made for a smaller amount.

It is possible that such a situation may arise, *inter alia,* due to the fact that in computing the liability for taxation, credit has been taken for past unabsorbed depreciation or losses or for reliefs under the Income-tax Act such as development rebate and deductions under Chapter VIA of the Income-tax Act, 1961 or because of a difference between depreciation charged in the accounts and the depreciation allowable for tax purposes. While in such cases the non-provision for taxation or the provision of a smaller amount might be justified, the Council feels that in the interest of a better presentation of accounts and the disclosure of pertinent information to the users of such accounts, it would be desirable if the accounts contain a note explaining the reasons why the provision for taxation has not been made or has been made for a smaller amount.

Examples of such a note would be as under:

(i) No provision for taxation has been considered necessary in view of the unabsorbed depreciation and/or unabsorbed development rebate and/or deficiency under Section 80J and/or losses brought forward from previous years.

(ii) Provision for taxation has been made after taking into account unabsorbed depreciation and/or unabsorbed development rebate and/or deficiency under Section 80J/or losses brought forward from previous years.

(iii) No provision for taxation has been considered necessary in view of the allowance of development rebate and/or deductions allowable under Chapter VIA of the Income-tax Act, 1961.