

DEFERRED TAX LAW IN INDIA

Complete Guide with Journal Entries & Examples

Practical Application for Finance Professionals

A Comprehensive Resource for Teaching & Learning

May 2026

1. Core Concept: Understanding Deferred Tax

Deferred tax exists because accounting profit and taxable profit are often different. The same transaction might be treated one way for financial reporting (accounting) and another way for income tax purposes. This creates temporary differences that reverse over time.

In simple terms: Deferred tax is essentially an interest-free loan from/to the tax authority that reverses when temporary differences reverse. It's a balancing act between when you recognize profits and when you pay taxes on them.

1.1 Simple Illustration

Suppose you own an investment stock worth ₹10,000:

Treatment	Accounting	Income Tax
Gain Recognition	Mark to market: ₹2,000 gain	Gain on sale only: ₹0

Result: You show ₹2,000 profit in financial statements but pay no tax on it this year. The tax on that ₹2,000 is 'deferred' to when you actually sell the stock.

2. Two Main Types of Temporary Differences

2.1 Taxable Temporary Differences → Deferred Tax Liability (DTL)

Future tax payments will be HIGHER than current financial statement expense.

Example: Depreciation Mismatch

Company buys machinery for ₹10 lakhs:

Year	Accounting Depr.	Tax Depreciation
Year 1	₹1,00,000	₹4,00,000 (40%)
Temp. Difference		₹3,00,000

Impact: Tax deduction is higher now (₹4,00,000), so you pay less tax NOW. But in future years, depreciation will be lower, so you'll pay MORE tax then. This creates a DTL.

2.2 Deductible Temporary Differences → Deferred Tax Asset (DTA)

Future tax payments will be LOWER than current financial statement expense.

Example: Provision for Doubtful Debts

Company has receivables of ₹10 lakhs:

Treatment	Accounting	Income Tax
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Doubtful Debt	₹5,00,000 (provision)	₹0 (on actual loss)
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Impact: You claim ₹5,00,000 expense in accounts (lower profit, higher tax NOW). But tax doesn't allow it until actually written off. So you pay more tax NOW, then less tax later. This creates a DTA.

3. Real-World Scenario: TechCorp Ltd.

Year 1 (April 2025 – March 2026) – Complete Case Study

Item	Accounting	Tax Law
Asset Cost	₹10,00,000	₹10,00,000
Depreciation	10 years: ₹1,00,000 p.a.	40% Y1: ₹4,00,000
Doubtful Debt	₹50,000	₹0
Fair Value Gain	₹2,00,000	₹0
Tax Rate	27.82%	27.82%

4. Step-by-Step Calculation

Step 1: Calculate Accounting Profit Before Tax

Revenue	₹50,00,000
Less: Depreciation (₹1,00,000)	(1,00,000)
Less: Doubtful Debt Provision	(50,000)
Less: Other expenses	(25,00,000)
Profit Before Tax	₹23,50,000

Step 2: Calculate Taxable Income

Accounting Profit Before Tax	₹23,50,000
Add: Doubtful Debt (not deductible)	50,000
Less: Extra depreciation (₹4,00,000 - ₹1,00,000)	(3,00,000)
Add: Fair Value Gain (not deductible)	2,00,000
Taxable Income	₹23,00,000

Step 3: Identify Temporary Differences

Item	Taxable Temp. Diff.	Deductible Temp. Diff.
Depreciation	₹3,00,000	—
Doubtful Debt	—	₹50,000
Fair Value Gain	—	₹2,00,000
Total	₹3,00,000	₹2,50,000

Step 4: Calculate Deferred Tax

Component	Deferred Tax
DTL: ₹3,00,000 × 27.82%	₹83,460
DTA: ₹2,50,000 × 27.82%	₹69,550
Net DTL (Liability)	₹13,910

Step 5: Calculate Current Income Tax

Taxable Income	₹23,00,000
× Effective Tax Rate	27.82%
Current Income Tax	₹6,39,860

5. Journal Entries – How to Record in Books

Three journal entries are passed to record deferred tax in the books:

Entry 1: Record Current Year Income Tax Expense

Dr. Income Tax Expense (P&L)	₹6,39,860
Cr. Income Tax Payable	₹6,39,860

[This is the actual tax payable to government based on taxable income]

Entry 2: Record Deferred Tax Liability (from Depreciation)

Dr. Deferred Tax Expense (P&L)	₹83,460
Cr. Deferred Tax Liability (Balance Sheet)	₹83,460

[Tax will be paid in future when depreciation reverses; shown as non-current liability on balance sheet]

Entry 3: Record Deferred Tax Asset (from Provisions & Fair Value Gains)

Dr. Deferred Tax Asset (Balance Sheet)	₹69,550
Cr. Tax Benefit/Income (P&L)	₹69,550

[Future tax savings from deductible differences; shown as non-current asset on balance sheet]

6. P&L Statement – How Deferred Tax Impacts Profit

PROFIT BEFORE TAX	₹23,50,000
Less: TAX EXPENSE	
Current Income Tax	(6,39,860)
Deferred Tax Expense (DTL)	(83,460)
Tax Benefit (DTA)	69,550
Net Tax Expense	(6,53,770)
PROFIT AFTER TAX	₹16,96,230

7. Balance Sheet – DTL & DTA Presentation

Non-Current Liabilities Section:

Particulars	Amount
Non-Current Liabilities:	
Deferred Tax Liability	₹83,460
Non-Current Assets:	
Deferred Tax Asset	₹69,550

Or Netted Off (if company policy):

Net Deferred Tax Liability	₹13,910
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8. Summary Table – Quick Reference

Concept	Impact on Taxes	TechCorp Example
DTL	Future tax outflow	Depreciation: ₹83,460
DTA	Future tax inflow	Provisions & Gains: ₹69,550
P&L Impact	Both current & deferred	Net tax: ₹6,53,770
Balance Sheet	Tracks timing gaps	Net: ₹13,910 liability

9. Key Teaching Points for Your Students

1. Timing Differences are Temporary

Deferred tax arises because of temporary timing differences between accounting and tax treatment. These ALWAYS reverse in future periods. Don't confuse with permanent differences (e.g., donations, penalties) which don't create deferred taxes.

2. DTL = You Owe Tax in Future

When accelerated depreciation or other taxable differences exist, you pay less tax NOW but more tax in the FUTURE. This is recorded as a liability.

3. DTA = You Get Tax Relief in Future

When provisions or fair value losses exist, you pay more tax NOW but less tax in the FUTURE. This is recorded as an asset.

4. Three Separate Tax Components

Indian tax isn't just 25%. It's: Corporate Tax (25%) + Surcharge (7% on tax) + H&E Cess (4% on tax+surcharge) = 27.82% effective rate. Students often forget surcharge and cess!

5. P&L Shows Both Current AND Deferred

Total tax expense in P&L includes both the actual tax payable AND the movement in deferred tax positions. This ensures profit isn't misstated due to timing differences.

6. Balance Sheet Shows the Liability/Asset

DTL is a non-current liability (balance sheet), DTA is a non-current asset (balance sheet). They represent amounts you'll pay/receive when reversals happen.

10. Practical Application for Stock & Mutual Fund Valuation

When analyzing companies for investment decisions, pay attention to:

a) High DTA relative to earnings → Flag potential earnings volatility. When DTA reverses, tax will jump. b) Compare DTL across peers → Lower DTL means more tax-efficient. Better for free cash flow. c) Effective tax rate vs nominal rate → If effective rate is 35% but nominal is 25%, there are deferred tax implications. Investigate why. d) Trend analysis → Is DTA growing (good - more future tax relief) or DTL growing (bad - more future tax outflow)? e) Equity research reports → Always adjust reported earnings for deferred tax movements to understand operating performance.