Accounting Standards Interpretation (ASI) 9

Virtual certainty supported by convincing evidence

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

ISSUE

1. Paragraph 17 of AS 22 requires that “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”.

2. The issue is what amounts to ‘virtual certainty supported by convincing evidence’ for the purpose of paragraph 17 of AS 22.

CONSENSUS

3. Determination of virtual certainty that sufficient future taxable income will be available is a matter of judgement and will have to be evaluated on a case to case basis. Virtual certainty refers to the extent of certainty, which, for all practical purposes, can be considered certain. Virtual certainty cannot be based merely on forecasts of performance such as business plans.

4. Virtual certainty is not a matter of perception and it should be supported by convincing evidence. Evidence is a matter of fact. To be convincing, the evidence should be available at the reporting date in a concrete form, for example, a profitable binding export order, cancellation of which will result in payment of heavy damages by the defaulting party. On the other hand, a projection of the future profits made by an enterprise based on the future

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1 Published in ‘The Chartered Accountant’, November 2003, pp. 491-492. 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.
capital expenditures or future restructuring etc., submitted even to an outside agency, e.g., to a credit agency for obtaining loans and accepted by that agency cannot, in isolation, be considered as convincing evidence.

**BASIS FOR CONCLUSIONS**

5. In a situation where an enterprise does not have unabsorbed depreciation or carry forward of losses, the degree of certainty required under AS 22 for recognition of deferred tax asset is ‘reasonable certainty’. In contrast, as a measure of greater prudence, AS 22 prescribes a much higher level of certainty, i.e., virtual certainty, for recognition of deferred tax asset in a situation where an enterprise has unabsorbed depreciation or carry forward of losses. Therefore, the level of certainty required for recognition of deferred tax asset in a situation where an enterprise has unabsorbed depreciation or carry forward of losses is much more than the situation where the enterprise does not have the same.

6. Projections on the basis of future actions of an enterprise cannot be considered as convincing evidence since the enterprise may change its plans on the basis of subsequent developments.