Corporate Reporting

Lecture 4 and 5
Accounting for Income Taxes

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Objectives

1. Understand the difference between an organisation's income for accounting purposes, and its income for taxation purposes;
2. Be able to identify some of the factors that will cause a difference between income for accounting purposes and income for taxation purposes;
3. Understand how deferred tax assets and deferred tax liabilities arise;

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Objectives (cont.)

4. Be able to account for the consequences of changes of tax rates on deferred tax assets and deferred tax liability.
5. Understand how to account for taxation losses incurred by companies and understand how, in certain circumstances, taxation losses can lead to the recognition of assets in the form of deferred tax assets
6. Understand how to account for temporary differences created by revaluations of non-current assets

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Lecture References

- Text - Chapter 17
- AASB - 112

2009-7-16

Accounting Versus Taxable Income (Objective 1)

- Accounting income is determined by GAAP;
- Income for taxation purposes is known as taxable income;
- Determined in accordance with Australian income tax legislation, not according to general accounting rules;
- Differences b/w Accounting and taxation income is due to
- Some revenue and expense items are calculated differently.

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Accounting Versus Taxable Income

Tax payable		Tax expense
taxable Income		Accounting Revenue
less		*less*
Allowable Deductions		Expenses
equals		*equals*
Taxable Income		NP before Tax
times		*times*
Tax Rate		Tax Rate

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Taxation vs Accounting Treatments

- **Assessable income ≠ Accounting revenue**
  - **Revenue not yet received is not assessable**
  - **Some revenue is exempt from tax, e.g. Government grants**
- **Allowable deductions ≠ Accounting expenses**
  - **Accounting and taxation depreciation rates may differ**
  - **Some expenses are not deductible, e.g. entertainment**
  - **Some expenses are not deductible until a future period, e.g. doubtful debts expense not deductible until debts go bad**

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GAAP -> Accounting Profit

Income Tax Expense

≠

Tax Laws -> Taxable Income

Income Tax Payable

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Example 1:

ABC Ltd's operating profit for years from 1990 to 1993 were $10,000, $15,000, $20,000 and $25,000 respectively. At beginning of the year 1990, ABC Ltd bought a super computer for $10,000, the useful life was 4 years. However, it could be deductible for 50% per year for the tax purpose, what were the accounting income and taxable income for each year?

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	1990	1991	1992	1993	Total
Operating profits	10,000	15,000	20,000	25,000	70,000
Tax expense (30%)	3,000	4,500	6,000	7,500	21,000
+ Depreciation for accounting purpose	2,500	2,500	2,500	2,500	10,000
- Depreciation for tax purpose	5,000	5,000			10,000
Taxable income	7,500	12,500	22,500	27,500	70,000
Tax paid (30%)	2,250	3,750	6,750	8,250	21,000

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Tax expense versus Tax payable

Tax Expense = Tax payable ± ?

1990

Income tax expense		Current Income Tax expense		Deferred Income Tax expense
3,000	=	2,250	+	750
		Tax payable		Deferred tax liability

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Example 2:

XYZ Ltd's operation profits for year 2000 and 2001 are $10,000 and $15,000 respectively. In year 2000, XYZ Ltd made a provision for warranty expenses $5,000, and this amount was spent in 2001 for repairing company's products. What are the accounting income and taxable income for each year?

Accounting rule: As an expense when accrued

Tax rule: deductible when actually spent

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	2000	2001	Total
Operating profits	10,000	15,000	25,000
Tax expense (30%)	3,000	4,500	7,500
+ Provision for warranty expenses	5,000		5,000
- Warranty expenses		5,000	5,000
Taxable income	15,000	10,000	25,000
Tax paid (30%)	4,500	3,000	7,500

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Tax expense versus Tax payable

Tax Expense = Tax payable ± ?

2000

Income tax expense		Current Income Tax expense		Deferred Income Tax expense
3,000	=	4,500	-	1,500
		Tax payable		Deferred tax assets

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Factors that Cause the Difference Between Taxable Income and Accounting Profit (Objective 2)

Common difference occurring when preparing annual corporate tax return.

	Accounting Treatment	Income Tax Treatment
1. Depreciation	Expense as per AASB 116, usually straight line	Accelerated rates or higher/ lower straight line rates
2. Bad/Doubtful Debt	Recognised as an expense when regarded as doubtful Dr. Doubtful Debts expense Cr. Provision for Doubtful Debts	Deduction given when actually bad
3. Employee Benefit - Long Services Leave etc	AASB 119 requires these to be accrued and written off as an expense	Deduction when paid

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	Accounting Treatment	Income Tax Treatment
4. Rental Revenues	Regarded as liability if received in advance	taxable for tax when received in cash
5. Fines – Penalties	Recognised when payable	Non-allowable
6. Entertainment Expense	Treated as an expense	Non-allowable
7. Research and Development Costs	Recognised as an asset, and amortised as per AASB 138	Deducted when paid
8. Revaluation of Non-Current Assets	Treatment as per AASB 116 – depreciation based on revalued amount	Depreciation based on assets "original cost"
9. Goodwill	Purchased Goodwill is subject to impairment test, as per AASB 138	Non-allowable

(Cont'd)

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	Accounting Treatment	Income Tax Treatment
10. Tax Losses	Not recognised	Offset against future taxable income
11. Purchase of supplies	Recognised as an asset, and charged as expense when used	Deduction when paid
12. Production Warranties	Recognised as an expense when accrued	Deduction when warranty costs are actually paid

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Profit & Loss Statement Approach

- Focus on differences between tax expense & tax paid:
  - Tax Paid > Tax Expense
    - *Asset* - DTA
  - Tax Paid < Tax Expense =
    - *Liability* - DTL
- Conceptually weak: the recognition of assets (liabilities) is not according to the definitions
- Replaced by the Balance Sheet Approach

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Balance Sheet Approach (Objective 3)

- **Current Accounting Standard**
  AASB 112 Income Tax
- **Focuses on comparing the carrying value of an entity's assets and liabilities (determined by accounting rules) with the tax base for those assets and liabilities**
  - comparing the actual balance sheet derived by using accounting rules with a **notional** balance sheet derived from taxation rules

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Carrying Amount Vs Tax Base of Asset or Liability

- **Carrying amount is the amount the asset or liability is recorded at in the accounting records**
- **Tax base is defined as the amount that is attributed to an asset or liability for tax purposes**
- **Where different from the carrying amount a 'temporary difference' can arise**

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Temporary Differences

- **An taxable temporary difference (TTD):**
  - will result in an increase in taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled
    - creates a liability - deferred tax liability
- **A deductible temporary difference (DTD)**:
  - will result in a decrease of taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled
    - creates an asset - deferred tax asset

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Redo Example 1: Using Balance Sheet Approach

1990
Non-current Asset- equipment

	Carrying amount	Tax base
Cost	$10 000	$10 000
Less Accumulated depreciation	$2 500	$5 000
	$7 500	$5 000

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In this example (Asset) Carrying Amount > Tax base which means there is an taxable (taxable) temporary difference of $2,500.This leads to a DTL.

Dr. Income tax expense
Cr. DTL

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Redo Example 2: Using Balance Sheet Approach

2000
Provision for Warranty Expenses

	Carrying amount	Tax base
Provision for Warranty expenses	$5,000	$0

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In this example (Liability) Carrying amount > Tax base which means there is a deductible temporary difference of $5,000.This leads to a DTA.

Dr. DTA

Cr. Income tax expense

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Excluded taxable temporary differences

Certain taxable temporary differences are excluded under the standard from being recognised as deferred tax liabilities (AASB 112). They are:

- ⇨ goodwill, the amortisation of which is not allowed as a tax deduction;
- ⇨ investments in subsidiaries etc;
- ⇨ initial recognition of an identifiable asset or liability or group of identifiable assets.

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How to Establish Tax Base

- The notion of a tax base can be likened to the amount that would appear in a balance sheet, derived from financial statements prepared for tax purposes.
- The tax base can be calculated using the following formula.

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ASSET

ASSET CARRYING AMOUNT	-	ANY FUTURE TAXABLE AMOUNT	+	ANY FUTURE DEDUCTIBLE AMOUNT	=	TAX BASE

LIABILITY

LIABILITY CARRYING AMOUNT	-	ANY FUTURE DEDUCTIBLE AMOUNT	+	ANY FUTURE TAXABLE AMOUNT	=	TAX BASE

The formula effectively calculates the amount at which an asset or liability would generally be recorded in a tax based balance sheet, however there is an exception in the case of a liability for revenue received in advance.

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Liability (Exception)

There is an exception for a liability relating to Revenue received in advance

LIABILITY CARRYING AMOUNT	-	REVENUE RECEIVED IN ADVANCE WHICH HAS BEEN INCLUDED IN TAXABLE AMOUNTS IN CURRENT PERIOD	=	TAX BASE FOR A LIABILITY FOR REVENUE RECEIVED IN ADVANCE

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Determining Deferred Tax Assets and Liabilities

	Deferred Tax Liability (DTL)	**Deferred Tax Asset (DTA)**
ASSETS	Carrying Amount ➢ Tax Base	Carrying Amount ≺ Tax Base
LIABILITIES	Carrying Amount ≺ Tax Base	Carrying Amount ➢ Tax Base

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Calculation of Deferred Tax Assets and Liabilities

Carrying Amount of Assets and Liabilities - Tax Bases of Assets or Liabilities = Taxable or Deductible Temporary Differences

Taxable or Deductible Differences X Tax Rate = Deferred Tax Liability (DTL) Deferred Tax Assets (DTA)

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Example 3:

An asset cost $200,000, and has accumulated accounting depreciation to date of $80,000, yielding a carrying amount of $120,000. Assume $110,000 had been claimed as depreciation for tax purposes, then $90,000 can be claimed in future periods.

Therefore, $90,000 is the deductible amount.

Recovery of the carrying amount either by use or sale, will lead to expected taxable amount of $120,000.

The tax base is determined as:

ASSET CARRYING AMOUNT = $120,000	-	TAXABLE AMOUNT = $120,000	+	DEDUCTIBLE AMOUNT $90,000	=	TAX BASE $90,000

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Calculation of Deferred Tax Liability/ Tax Asset from previous examples

Example 3

CARRYING AMOUNT OF ASSETS = $120,000	-	TAX BASE $90,000	=	TAXABLE TEMPORARY DIFFERENCES $30,000
TAXABLE DIFFERENCE $30,000	x	TAX RATE 0.3	=	DEFERRED TAX LIABILITY $9,000

Journal Entry

	DR	CR

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Example 4:

An asset cost $200,000, and has accumulated accounting depreciation to date of $80,000, yielding a carrying amount of $120,000. Assume $40,000 had been claimed as depreciation for tax purposes, then $160,000 can be claimed in future periods.

Therefore, $160,000 is the deductible amount.

Recovery of the carrying amount either by use or sale, will lead to expected taxable amount of $120,000.

The tax base is determined as:

ASSET CARRYING AMOUNT $120,000	-	TAXABLE AMOUNT $120,000	+	DEDUCTIBLE AMOUNT $160,000	=	TAX BASE $160,000

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Example 4

CARRYING AMOUNT OF ASSETS = $120,000	-	TAX BASE $160,000	=	DEDUCTIBLE DIFFERENCES $40,000
DEDUCTIBLE DIFFERENCE $40,000	x	TAX RATE 0.3	=	DEFERRED TAX ASSET $12,000

Journal Entry

	DR	CR

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Example 5:

Receivables have a net carrying amount of $10,000, after the recognition of doubtful debts of $300. The balance will be recovered through payments from debtors. The initial amount of revenue of $10,300 has already been taxed as a part of the taxable amount when recognising revenue that this represents (i.e. sales made in past periods). Hence there will no taxable amount when the earnings amount is realised. The $300 will give rise to future deductible amounts in the form of bad debts.

CARRYING AMOUNT $10,000	-	TAXABLE AMOUNT Nil	+	DEDUCTIBLE AMOUNT $300	=	TAX BASE $10,300

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Example 5

CARRYING AMOUNT OF ASSETS = $10,000	-	TAX BASE $10,300	=	DEDUCTIBLE TEMPORARY DIFFERENCE ($300)
DEDUCTIBLE DIFFERENCE $300	x	TAX RATE 0.3	=	DEFERRED TAX ASSET $90

Journal Entry

	DR	CR

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Example 6:

An entity acquires a piece of land for $200,000, and has subsequently written it down to a recoverable amount of $150,000. The tax base is:

CARRYING AMOUNT $150,000	-	TAXABLE AMOUNT $150,000	+	FUTURE DEDUCTIBLE AMOUNT $200,000	=	TAX BASE $200,000

In the event of a disposal of land, the difference between the carrying amount and the tax base would become a capital loss.

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Example 6

CARRYING AMOUNT OF ASSETS = $150,000	-	TAX BASE $200,000	=	DEDUCTIBLE TEMPORARY DIFFERENCES ($50,000)
DEDUCTIBLE DIFFERENCE $50,000	x	TAX RATE 0.3	=	DEFERRED TAX ASSET $15,000

Journal Entry

	DR	CR

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Example 7:

An entity has a loan payable of $60,000 (which will give rise to no future tax deductions or taxable income).

CARRYING AMOUNT $60,000	-	FUTURE DEDUCTIBLE AMOUNT Nil	+	FUTURE TAXABLE AMOUNT Nil	=	TAX BASE $60,000

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Example 7

CARRYING AMOUNT OF LIABILITY = $60,000	-	TAX BASE $60,000	=	DEDUCTIBLE TEMPORARY DIFFERENCES Nil

No entry

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Example 8:

An entity has received $100,000 of rent received in advance. The ATO taxes the revenue on receipt by the entity, hence for tax purposes there is no tax liability as the amount of rent received is included in the current year's taxable income in which the cash flow occurs i.e. the entity pays tax on the rent in the current year, despite the fact that for accounts purposes, the rent will be recognised as revenue in the subsequent year.

The tax base is determined as:

CARRYING AMOUNT OF THE LIABILITY $100,000	-	AMOUNT OF REVENUE RECEIVED IN ADVANCE THAT WILL NOT BE SUBJECT TO TAX IN THE FUTURE $100,000	=	TAX BASE = $0

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Example 8

LIABILITY CARRYING AMOUNT $100,000	-	TAX BASE $0	=	DEDUCTIBLE TEMPORARY DIFFERENCES $100,000
DEDUCTIBLE DIFFERENCE $100,000	x	TAX BASE 0.3	=	DEFERRED TAX ASSET $30,000

Journal Entry

	DR	CR

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Reversal of Temporary Differences

As the differences have a "temporary" tag, it is expected that over time, temporary differences originate in one or more earlier periods and should reverse in one or more later periods.

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Two issues in tax effect accounting

Initial recognition: Whether a Deferred Tax Liability (DTL) or a Deferred Tax Assets (DTA) should be recognized?

Subsequent reversal: When should previous recognized DTL or DTA be reversed?

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Reversal of DTL/ DTA

- The total deduction (inclusion) of an item for both accounting purpose and tax purpose **is the same over time**.
- A DTL / DTA Created in initial period (periods) Cr. DTL (Dr. DTA) **must be reversed** in the subsequent period (periods) Dr. DTL (Cr. DTA).
- An item is allowed to be deducted less (or assessed more) for the tax purpose in the earlier period (periods) must be deducted more (or assessed less) in later period (periods)

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	1990	1991	1992	1993	Total
Operating profits	10,000	15,000	20,000	25,000	70,000
Tax expense (30%)	3,000	4,500	6,000	7,500	21,000
+ Depreciation for accounting purpose	2,500	2,500	2,500	2,500	10,000
- Depreciation for tax purpose	5,000	5,000			10,000
Taxable income	7,500	12,500	22,500	27,500	70,000
Tax paid (30%)	2,250	3,750	6,750	8,250	21,000

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Example 1:

Income tax expense = Tax payable + DTL

1990:	3,000=	2,250	+	750
1991:	4,500=	3,750	+	750
1992:	6,000 =	6,750	-	750
1993:	7,500 =	8,250	-	750

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Example 1:

1990
Dr. Income tax expense 750
Cr. Deferred tax liability (DTL) 750
1991
Dr. Income tax expense 750
Cr. Deferred tax liability (DTL) 750
1992 ***(Start to reverse DTL)***
Dr. Deferred tax liability (DTL) 750
Cr. Income tax expense 750
1993
Dr. Deferred tax liability (DTL) 750
Cr. Income tax expense 750

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	2000	2001	Total
Operating profits	10,000	15,000	25,000
Tax expense (30%)	3,000	4,500	7,500
+ Provision for warranty expenses	5,000		5,000
- Warranty expenses		5,000	5,000
Taxable income	15,000	10,000	25,000
Tax paid (30%)	4,500	3,000	7,500

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Example 2:

Income tax expense = Tax payable + DTA

2000: 3,000= 4,500 - 1,500
2001: 4,500= 3,000 + 1,500

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Example 2:

2000

Dr. Deferred Tax Asset(DTA) 1,500
Cr. Income Tax Expense 1,500

2001 ***(Start to reverse DTA)***

Dr. Income Tax Expense 1,500
Cr. Deferred Tax Asset (DTA) 1,500

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How to find out the indicators for Initial recognitions or reversals

- *Step 1:* Determine the Tax Base at the beginning and at the end of the year;
- *Step 2:* Compare the carrying amount with tax base and determine whether there is an taxable or deductible temporary difference;

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- *Step 3:* if the taxable or deductible temporary difference **increases** over the year (Positive movement), then it creates a deferred tax liability (DTL) or deferred tax asset (DTA)
- *Step 4:* if the taxable or deductible temporary difference **decreases** over the year (Negative movement), then it indicates we should **reverse** previously recognized deferred tax liability (DTL) or deferred tax asset (DTA)

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- Redo Example 1 and 2 by using balance sheet approach

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Example 1: Assets – Super Computer

Time	Carrying amount	Tax base	taxable temporary difference	Change (+/-)	DTL (30%)	Deferred tax expense
1/1/90	10,000	10,000	0			
31/12/90	7,500	5,000	2,500	+2,500		
31/12/91	5,000	0	5,000	+2,500		
31/12/92	2,500	0	2,500	**-2,500**		
31/12/93	0	0	0	**-2,500**		

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Example 2: Provision for Warranty Expenses

Time	Carrying amount	Tax base	Deductible temporary difference	Change (+/-)	DTA (30%)	Deferred tax expense (Revenue)
1/1/00	0	0	0			
31/12/00	5,000	0	5,000	+5,000		
31/12/01	0	0	0	**-5,000**		

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Change in Rate of Income Tax (Objective 4)

- Where tax rate changes & DTL / DTA accounts exist
- must adjust to reflect new rate

$$Ajustment = (\frac{ExistingBalance}{OldTaxRate} \times NewRate) - ExistingBalance$$

- Adjustment is made to income tax expense

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Example 9: Tax rate change

- La Trobe Ltd has the following account balance as at 30 June 20x3
- Deferred tax assets $13,800
- Deferred tax liability $11,500
- The government announced that it would change the company tax rate from 33 per cent to 36%, effective immediately.
- Prepare journal entries to effect this change.

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Example 10:

DTA Adj = $(\frac{13{,}800}{0.33} \times 0.36) - 13{,}800$

= 15,054 -13,800
= 1,254

DTL = $(\frac{11{,}500}{0.33} \times 0.36) - 11{,}500$

= 12,545 -11,500
= 1,045

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Tax Losses (Objective 5)

When a company incurs a tax loss under Division 36 of the Income Assessment Act 1997, that loss is carried forward as a deduction from taxable income in future periods. The loss to be carried forward must be reduced by any exempt income.

As the loss carried forward provides future deductions, a deferred tax asset may be raised, provided the recognition criteria are satisfied (see para. 34 AASB 112).

…it is probably that future taxable profits will be available against which the unused tax losses and unused tax credits can be utilised.

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Example 11

Singleton Ltd commenced operation in 2000, and incurred a loss of $1 million after deducting exempt income of $180,000. It is anticipated that the company will return to profits as there had been a solid business history of profitability. This expectation was realised and the reported taxable income was:

Year	Taxable Income
2001	$300,000
2002	$400,000
2003	$600,000

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Required:

Prepare journal entries to show the recognition of the asset associated with the tax loss as well as the journal entries to recognise the utilisation of the loss. The tax rate is 30 percent.

Solution:

Accepting the probability of the ability of the firm to recoup the benefits associated with the tax loss, the entry is: (2000)

	DR	CR
Deferred Tax Asset		
Income Tax Expense		

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In 2001, the entity has a taxable income of $300,000. If there was no tax loss, the tax payable would be $90,000. Instead of paying tax, the loss is called upon and the following entry is made:

		DR	CR
2001	Income Tax Expense		
	Deferred Tax Asset		
	Recoupment of Tax Loss		
2002	Income Tax Expense		
	Deferred Tax Asset		
	Recoupment of Tax Loss		

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2003 The remaining balance of the tax loss is utilised to cushion the tax that would normally be assessed on a taxable income of $600,000 viz $180,000.

	DR	CR
Income Tax Expense		
Deferred Tax Asset		
Income Tax Payable		
Tax applicable to taxable income, after allowing for loss brought forward		

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Revaluation of Non-current Assets (Objective 6)

- According to AASB 112 (par. 20) revaluations of non-current assets can create temporary differences;
- When non-current assets are revalued, the revaluation increment is not deductible for tax purposes, even though depreciation for accounting purposes will be based on the revalued amount;
- The tax base is not affected by the revaluation because depreciation for tax purposes will be based on the original cost of the asset.

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Revaluation of Non-current Assets (cont.)

- However, any increase in the carrying value of a non-current asset through a revaluation undertaken to recognise an increase in fair value implies an expected increase in the future flow of economic benefits;
- This increase can be taxable and can lead to a deferred tax liability if the carrying amount is greater than the tax base (refer to AASB 112, par. 20).

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Revaluation of Non-current Assets (cont.)

- Unlike previous examples where the temporary difference is adjusted against income tax expense, the deferred tax asset or liability associated with asset revaluations must also be adjusted against the equity account.

Dr Revaluation reserve
Cr Deferred tax liability

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Example 12

An entity acquired land at a cost of $950,000. It was revalued by an independent valuer in the current operating period at $1,350,000. (The tax base is therefore $950,000 and its carrying value $1,350,000, resulting in an taxable temporary difference of $400,000 = Deferred Tax Liability = 400 x 0.3 = $120,000.

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	DR	CR
Land Revaluation Reserve		
Revaluation Reserve Deferred Tax Liability (400,000 x 0.3)		

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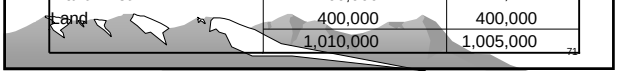
Comprehensive Example 1

La Trobe Ltd commences operations on 1 July 20A2. One year later, on 30 June 20A3, the entity prepares the following information, showing both the *carrying amounts* for accounting purposes, and *tax bases* of the respective assets and liabilities.

	Extract from Statement of Financial Position $	Tax Bases $
Assets		
Cash	150,000	150,000
Receivables (net)	135,000	140,000
Inventory	165,000	165,000
Plant – net	160,000	150,000
Land	400,000	400,000
	1,010,000	1,005,000



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Comprehensive Example 1 (Cont'd)

	Extract from Statement of Financial Position $	Tax Bases $
Liabilities		
Payables	40,000	40,000
Provision for Long Service Leave	60,000	
Provision for Warranty	70,000	
Loan payable	350,000	350,000
	520,000	390,000
Net Assets	$490,000	$615,000

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Other Information:

- The accounting profit before tax for the year was $285,000.
- There is a doubtful debt provision of $5,000.
- An item of plant is purchased at a cost of $200,000 on 1 July 20A2. For accounting purposes it is expected to have a life of 5 years; however, for taxation purposes it can be depreciated over 4 years. It is not expected to have any residual value.
- The amount accrued in respect of warranty expenses was paid on 31 July 20A3. Long service leave has not been paid.
- Assume that the taxable income for the year ended 30 June 20A4 was $500,000
- The tax rate is 30 percent.

Required:

Prepare the tax reconciliation for the year ended 30 June 20A3 (only), and the worksheet for the two years to 30 June 20A4.

Show journal entries for both periods to record the deferred tax assets and liabilities, tax expense and tax payable.

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Solution

1. Tax Reconciliation for year ended 30 June 20A3

	Accounting profit before tax		$285,000
add	Doubtful Debt Provision not allowable for tax purposes		5,000
	Depreciation of Plant - Accounting (add back)	$40,000	
	- Taxation (deduct)	(50,000)	(10,000)
	Provision for Warranties (not allowable)		70,000
	Provision for Long Service Leave (not allowable)		60,000
	Taxable Income		**$410,000**

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	Extract from accounting balance sheet $	Tax bases $	Deductible temporary differences $	taxable temporary differences $	Tax expense $	Income tax payable $
Assets						
Cash	150,000	150,000				
Receivables (net)	135,000	140,000	5,000		(5,000)	
Inventory	165,000	165,000				
Plant – net	160,000	150,000		10,000	10,000	
Land	400,000	400,000				
	1,010,000	1,005,000				
Liabilities						
Payables	40,000	40,000				
Provision for long service leave	60,000		60,000		(60,000)	
Provision for warranty	70,000		70,000		(70,000)	
Loan Payment	350,000	350,000				
	520,000	390,000				
Net assets	490,000	615,000				

(Cont'd)

	Extract from accounting balance sheet $	Tax bases $	Deductible temporary differences $	taxable temporary differences $	Tax expense $	Income tax payable $
Temporary differences at period end			135,000	10,000	(125,000)	
***Less:** prior period amounts*			-	-	-	
Movement for the period			135,000	10,000	(125,000)	
Tax effected at 30%			40,500	3,000	(37,500)	
Tax on taxable income, 30% x $400,000					123,000	123,000
Income tax adjustments			40,500	3,000	85,500	123,000

(Cont'd)

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The journal entry for the period of 30 June 20A3

	DR	CR
Tax Expense		
Deferred Tax Asset		
Deferred Tax Liability		
Tax Payable		

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In the second year of trading of La Trobe Ltd, ending 30 June 20A4, the taxable income has already been calculated to be $500,000.

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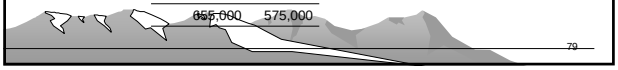
	Extract from accounting balance sheet $	Tax bases $	Deductible temporary differences $	taxable temporary differences $	Tax expense $	Income tax payable $
Assets						
Cash	180,000	180,000				
Receivables (net)	145,000	155,000	10,000		(10,000)	
Inventory	185,000	185,000				
Plant – net	120,000	100,000		20,000	20,000	
Land	400,000	400,000				
	1,030,000	1,020,000				
Liabilities						
Payables	40,000	40,000				
Provision for long service leave	80,000		80,000		(80,000)	
Provision for warranty						
Loan Payment	535,000	535,000				
	655,000	575,000				



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	Extract from accounting balance sheet $	Tax bases $	Deductible temporary differences $	taxable temporary differences $	Tax expense $	Income tax payable $
Net assets	375,000	445,000				
Temporary differences at period end			90,000	20,000	(70,000)	
Less: *prior period amounts*			135,000	10,000	(125,000)	
Movement for the period			(45,000)	10,000	55,000	
Tax effected at 30%			(13,500)	3,000	16,500	
Tax on taxable income, 30% x $500,000					150,000	150,000
Income tax adjustments			(13,500)	3,000	166,500	150,000
			CR	CR	DR	CR

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The tax journal entries for the year to 30 June 20A3 are as follows:

Dr Income tax expense
Cr Deferred tax asset
Cr Deferred tax liability
Cr Income tax payable

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Summary

- Main purpose of the lecture is to consider how to account for tax
- Taxable profit and accounting profit will often be different because expense and recognition rules used in accounting are often different from those applied for taxation purposes
- AASB 112 'Income Taxes' applies the balance sheet method in accounting for taxes—carrying values and tax bases are compared for assets and liabilities
- The difference between carrying values and tax bases leads to either deductible temporary differences or taxable (taxable) temporary differences—multiplying these differences by the tax rate gives rise to either a deferred tax asset or deferred tax liability

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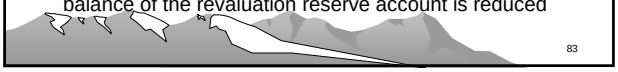
Summary (cont.)

- Generally speaking, if the carrying amount of an asset is greater than its tax base there will be a deferred tax liability and if the carrying amount of an asset is less than its tax base there will be a deferred tax asset
- If the carrying amount of a liability is greater than its tax base there will be a deferred tax asset and if the carrying amount is less than the tax base there will be a deferred tax liability
- For an entity to recognise deferred tax assets there is a requirement that the derived associated economic benefits be probable
- When a temporary difference associated with the revaluation of a non-current asset takes place the balance of the revaluation reserve account is reduced



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