

## INCOME TAXES (IAS 12).

- **Income tax** –This include all domestic and foreign taxes which are based on taxable profit.
- **Deferred Tax**-This is the tax payable in the future which arises as a result of taxable temporary differences.
- **Temporary Difference**-Is the difference between the carrying amount and the tax base of an asset or liability.
- **Tax Base**-Is the amount attributable to an asset or liability for the tax purposes.
- **Taxable temporary Differences**-This are temporary differences that will result in deferred tax liability.
- **Deductible temporary Differences**-This are temporary differences that will result in deferred tax asset.
- **Deferred tax liability**-these are amount of income taxes payable in future period in respect of taxable temporary difference.
- **Deferred tax asset**-these are amount of income taxes recoverable in future period in respect of deductible temporary difference.

### Basis of measuring for current tax and deferred tax.

- Tax expense for the period is made up of two elements:
  - Current tax
  - Deferred tax.
- Current tax is the tax for the period based on the taxable profit for the year ie (gross income-allowable expenses).
- Deferred tax on the other hand arises as a result of temporary differences. Increase in deferred tax is an expense which increases the tax liability for the year while a decrease in deferred tax is an income hence reducing the tax liability for the period.

# ACCOUNTING FOR ASSETS & LIABILITIES

## Illustration 1

DEC 2012 Q2

- (a) Differentiate between "taxable temporary differences" and "deductible temporary differences" (4 mks)
- (b) Equip Agencies Ltd purchased an equipment for sh 4000,000 on 1 July 2008. Depreciation is provided on straight line basis at the rate of 25% per annum. During the four year from 1 July 2008 to June 2012 the profit before tax and allowed wear and tear charges for tax purposes were as follows:

<u>Period ending</u>	<u>Profit before tax (sh)</u>	<u>Allowable wear &amp; Tear charges</u>
2009	800,000	40% on cost
2010	900,000	30% on cost
2011	950,000	20% on cost
2012	850,000	10% on cost

Corporation tax rate is 30%

Required

- (i) Taxable profit
- (ii) Temporary differences
- (iii) Deferred tax account

solution

<u>(i) Taxable profit</u>	<u>sh'000</u>			
	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Profit before tax	800	900	950	850
Add: Depreciation <small>(4000 ÷ 4)</small>	1000	1000	1000	1000
Less: Wear and tear	(1600)	(1200)	(800)	(400)
Taxable profit	200	700	1150	1450
Current tax 30%	60	210	345	435



(ii) Temporary differences

Period	Carrying Amount	Tax Base	T.D	Deferred tax
2009	$4000 - 1000 = 3000$	$4000 - 1600 = 2400$	600	$30\% \times 600 = 180$
2010	$3000 - 1000 = 2000$	$2400 - 1200 = 1200$	800	240
2011	$2000 - 1000 = 1000$	$1200 - 800 = 400$	600	180
2012	$1000 - 1000 = 0$	$400 - 400 = 0$	0	0

OR

Period	Wear & Tear	Depreciation	Temporary Difference	Deferred Tax
2009	1600	1000	600	$30\% \times 600 = 180$
2010	1200	1000	200	60
2011	800	1000	(200)	(60)
2012	400	1000	(600)	180

(iii) Deferred Tax Account

Deferred Tax Account

2009		Ball bcd	0	
	Balance ad	<u>180</u>	<u>180</u>	
2010		Balance bcd	180	
	Balance ccd	<u>240</u>	<u>60</u>	
		<u>240</u>	<u>240</u>	
2011	Fls	60	Balance bcd	240
	Balance ccd	<u>180</u>		
		<u>240</u>		<u>240</u>
2012	Fls	180	Balance bcd	180
	Balance ccd	<u>0</u>		
		<u>180</u>		<u>180</u>

APRIL 2022 Q 5b

(b) (i) Temporary difference

Details	Carrying Amount	Tax Base	Temporary Difference
Inventory	1130	1250	(120)
Trade Receivable	450	480	(30)
PPE	3050	2750	300
Development Expenditure	460	0	460
Trade & other payable	(600)	(500)	<u>(100)</u>
			510

(ii) Deferred tax bal c/d  $30\% \times 510 = 153$

Deferred tax Account			
profit & loss A/c	164	Balance b/d.	272
		Revaluation gain PPE $(30\% \times 150)$	45
Balance c/d	<u>153</u>		
	<u>317</u>		<u>317</u>



## Borrowing cost

Illustration: Dec 2012 Q5d.

Assure Ltd borrowed sh 30 million to finance two Capital projects "A" and "B" on 1 July 2010. The money was utilised on the two projects as follows:

	<u>Project A</u>	<u>Project B</u>
	<u>sh</u>	<u>sh</u>
1 July 2011	5,000,000	10,000,000
1 January 2012	5,000,000	10,000,000

Unutilised funds on 1 July 2011 were invested temporarily at the rate of 7% per annum. The rate of interest on the loan was 9%.

Required:

- (i) Borrowing cost to be capitalised for each of the projects as at 30 June 2012 (4 mks)
- (ii) The value of the asset in the books of Assure Ltd on 30 June 2012 (4 mks)

Solution:

	<u>Project A</u>	<u>Project B</u>
(i) Interest expense $9\% \times 10m$	900,000	$9\% \times 20m$ 1,800,000
Interest income $7\% \times 5m \times \frac{6}{12}$	(175,000)	$7\% \times 10m \times \frac{6}{12}$ (350,000)
Borrowing	<u>725,000</u>	<u>1,450,000</u>

(ii) Value of the Asset

	<u>Project A</u>	<u>Project B</u>
Amount borrowed	10,000,000	20,000,000
Borrowing cost	<u>725,000</u>	<u>1,450,000</u>
	<u>10,725,000</u>	<u>21,450,000</u>

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(i)  $\text{Cap rate} = \frac{\text{Aggregate interest payable}}{\text{Aggregate debt outstanding}}$

$$= \frac{10\% \times 300,000 + 12\% \times 200,000}{300,000 + 200,000} = 10.8\%$$

Computation of borrowing cost

To 30 June 2020

Power plant sh'000'

$$100,000 \times 10.8\% \times \frac{6}{12} = 5400$$

To 31 Dec 2020

Storage facility sh'000'

$$60,000 \times 6\% \times \frac{9}{12} = 2700$$

To Dec 2020

$$175,000 \times 10.8\% \times \frac{6}{12} = 9450$$

Borrowing cost to capitalise 14850

2700

(ii) Value of the Asset

Cost of construction

Power plant

175,000

Storage facility

60,000

Borrowing cost

14850

2700

189850

62700