

ACC2100 / ACF2100 Financial Accounting

Topic 3 Accounting for Income Tax: Current Tax Issues Lecture Examples

Example 1 (PQ6.2 Cases 1 & 4)

The chief financial officer of Lost Weekend Ltd has asked you to calculate the taxable income and prepare the journal entry for the current tax liability in each of the following cases. Assume a tax rate of 30%.

	Case 1	Case 4
Accounting profit (loss)	\$40,000	(\$10,000)
After debiting as expense:		
Goodwill impairment*	6,000	8,000
Entertainment costs*	—	—
Donation to political party*	1,000	—
Depreciation of new plant (10%)	4,000	2,000
Long service leave expenses	600	1,200
For tax purposes:		
Tax depreciation for plant	8,000	4,000
Long service leave paid	—	2,400
*these items are non-deductible for tax purposes		

Steps for calculating taxable profit...

1. Identify the accounting profit or loss
2. Adjust (remove) the effects of any accounting items that are not included in the tax calculation
 - a. Deduct any items of accounting income that are not taxable
 - b. Add back any items of expense that are not deductible
3. Adjust (include) any taxable items not already included
 - a. Add in any items of taxable income not already included
 - b. Deduct any deductible items not already included in the accounting figures
4. Calculate current tax liability based on taxable profit x tax rate

Example 1 Solution

Case 1

Current Tax Worksheet

Profit before income tax	\$	\$ 40 000
Add:		
Goodwill impairment loss		
Donation to political party		
Depreciation expense		
Long service leave expense		11 600
		51 600
Deduct:		
Long service leave paid		
Tax depreciation		
Taxable profit		
Current tax liability @ 30%		

The journal entry is:

Income Tax Expense	Dr
Current Tax Liability	Cr

Case 4

Current Tax Worksheet

Loss before income tax	\$	\$ (10 000)
Add:		
Goodwill impairment loss		
Depreciation expense		
Long service leave expense		11 200
		1 200
Deduct:		
Long service leave paid		
Tax depreciation		
Tax loss		
Current tax liability @ 30%		

Assuming that recognition criteria for a tax loss are satisfied, the journal entry is:

Deferred Tax Asset	Dr
Income Tax Income	Cr

Example 2

The financial statements of Waterfield Ltd for the year ended **30 June 2016** showed a profit before tax of \$10,500, including the following items of income and expense:

Government grant (exempt from tax)	2,500
Fines and penalties	1,200
Impairment of goodwill	3,600
Depreciation expense – plant	15,000
Bad debts expense	5,500
Annual leave expense	6,200
Warranty expense	3,200
Rent expense	6,000

Additional Information for 30 June 2016:

- The tax deduction for plant depreciation was \$25,000.
- The balance in the Allowance for Doubtful Debts account at 30 June 2015 was \$6,500, and at 30 June 2016 the balance in the account was \$1,800.
- Annual leave costs of \$13,100 had been paid during the current year.
- The balance of the Provision for Warranty account at 30 June 2015 was \$3,500, and at 30 June 2016 the balance in the account was \$2,700.
- The balance of the Prepaid Rent account at 30 June 2015 was \$20,000, and the balance in the account at 30 June 2016 was \$15,000.
- Waterfield Ltd has an expectation of profits in future years.

For the year ended **30 June 2017**, the financial statements of Waterfield Ltd showed a profit before tax of \$28,400, including the following items of income and expense:

Depreciation expense – plant	15,000
Bad debts expense	6,000
Annual leave expense	10,700
Rent expense	6,000

Additional Information for **30 June 2017**:

- (a) The tax deduction for plant depreciation was \$25,000.
- (b) There were no bad debts written off during the year.
- (c) Annual leave costs of \$10,000 had been paid during the year.
- (d) No warranty costs were paid during the year.
- (e) Rent paid for the year was \$2,000.

The corporate tax rate is 30%.

Required

- a) Prepare the complete current tax worksheet, and the applicable current tax journal entries required by Waterfield Ltd, for the year ended **30 June 2016**.
- b) Prepare the complete current tax worksheet, and the applicable current tax journal entries required by Waterfield Ltd, for the year ended **30 June 2017**.

Example 2 Solution

Calculations...

Allowance for doubtful debts					
	Bad debts w/o		1/07/15	Opening balance	
30/06/16	Closing balance			Expense	

Provision for Warranty					
	Warranty costs paid		1/07/15	Opening balance	
30/06/16	Closing balance			Warranty exp	

Prepaid Rent					
1/07/15	Opening balance			Rent expense	
	Rent paid		30/6/16	Closing balance	

Complete Current Tax Worksheet for the year ended 30 June 2016

Accounting profit before income tax		
<i>Add:</i>		
Entertainment expenses		
Impairment of goodwill		
Depreciation expense – plant		
Bad debts expense		
Annual leave expense		
Warranty expense		
Rent expense		
<i>Deduct:</i>		
Government grant (exempt from tax)		
Tax depreciation – plant		
Bad debts written off*		
Annual leave paid		
Warranty costs paid*		
Rent paid*		
Add back exempt income		
Taxable profit (loss)		
Current tax liability @ 30%		

Deferred Tax Asset		
Income Tax Expense		
(Recognition of deferred tax asset on tax loss incurred:		

Current Tax Worksheet for the year ended 30 June 2017

Accounting profit before income tax		
<i>Add:</i>		
Depreciation expense – plant		
Bad debts expense		
Annual leave expense		
Rent expense		
<i>Deduct:</i>		
Tax depreciation – plant		
Annual leave paid		
Rent paid		
Taxable profit (loss)		
Tax loss recovered		
Taxable profit (loss)		
Current tax liability @ 30%		

Income Tax Expense		
Deferred Tax Asset		
Current Tax Liability		
(Recognition of deferred tax asset on tax loss incurred)		