

ACC2100 / AFC2100 Financial Accounting

Topic 4 Accounting for Income Tax: Deferred Tax Issues Lecture Examples

Example 1 (PQ6.5 Parts 1 & 2)

Rattlesnakes Ltd is reviewing its deferred tax for the year. In each of the following situations prepare the end-of-period adjustment journal entries to account for income tax on the initial appearance or reversal of any temporary differences. Explain in each case why particular accounts are affected.

1. The company purchased a depreciable asset at the beginning of the year for \$100 000. For accounting purposes, an annual depreciation rate of 20% straight-line is used, whereas for taxation the rate is 30% straight-line.
2. The company's provision for long-service leave at the beginning and end of the year are \$160 000 and \$155 000 respectively. In the current year, \$20 000 in long-service leave was paid to a long-standing employee.

Example 1 Solution

1. Depreciable asset

- ❖ CA =
- ❖ TB = future deductible amount for the asset
- ❖ TB =

CA > TB ⇒ Taxable Temporary Difference of

⇒ Deferred Tax Liability =

Income Tax Expense	Dr
Deferred Tax Liability	Cr

The company has claimed a tax deduction for depreciation of \$30 000 in the current year but the depreciation expense is only \$20 000. As the deduction exceeds the expense, taxable profit in the current year is reduced and tax is deferred to a future period.

Tax depreciation is usually greater than depreciation expense in the early years of an asset's life because of accelerated depreciation rates for tax. However, after the asset is fully depreciated for tax purposes the depreciation expense will be greater than tax depreciation. This results in the reversal of the taxable temporary difference and deferred tax liability.

2. Provision for long service leave

Beginning of the year:

- ❖ CA =
- ❖ TB = CA – future deductible amount
- ❖ TB =

CA > TB ⇒ Deductible Temporary Difference of
⇒ Deferred Tax Asset =

End of the year:

- ❖ CA =
- ❖ TB = CA – future deductible amount
- ❖ TB =

CA > TB ⇒ Deductible Temporary Difference of
⇒ Deferred Tax Asset =

Over the year, the balance in the deferred tax asset has

Income Tax Expense	Dr
Deferred Tax Asset	Cr

The company has claimed a tax deduction for LSL paid of \$20 000 in the current year but the LSL expense is only \$15 000. As the deduction exceeds the expense, taxable profit of the current year is reduced and the deferred tax asset at the beginning of the year has been partially realised.

Example 2

The balance sheets of Silver Screen Ltd at 30 June 2017 and 2016 showed the net assets of the company as follows:

	2017	2016
Assets		
Cash	\$ 82,000	\$ 73,000
Inventory	158,000	127,000
Receivables	585,000	430,000
Allowance for doubtful debts	(40,000)	(20,000)
Plant	700,000	700,000
Accumulated depreciation - plant	(218,000)	(158,000)
Buildings	200,000	200,000
Accumulated depreciation - buildings	(35,000)	(25,000)
Goodwill (net)	50,000	63,000
Deferred tax asset	?	28,000
Liabilities		
Payables	265,000	247,000
Provision for long-service leave	50,000	30,000
Provision for warranty expenses	30,000	20,000
Deferred tax liability	?	8,000

Additional information

- (i) Accumulated depreciation on plant at 30 June 2016 for tax purposes was \$198,000. Tax depreciation on plant for the year ended 30 June 2017 was \$120,000.
- (ii) The income tax rates were 40% for the year ended 30 June 2016 and previous years, and 30% for the year ended 30 June 2017. No entry has been made in the current year to adjust for the change in tax rate.

Required

- (a) Prepare the journal entry to adjust for the change in income tax rates for the year ended 30 June 2017.
- (b) Complete a deferred tax worksheet and provide the journal entries to record the adjustment to the deferred tax asset and the deferred tax liability accounts for the year ended 30 June 2017. Do not offset the deferred tax accounts.

When determining tax bases, remember...

- Assets that generate future taxable economic benefits: $TB = FDA$
- Assets that do not generate future taxable economic benefits: $TB = CA$, for receivables $TB = \text{Gross Receivables}$
- Liabilities except unearned revenue: $TB = CA - FDA$
- Liability of unearned revenue: $TB = CA - \text{Untaxed future revenue}$

Example 2 Solution

a) DTA Adj =

=

DTL Adj =

=

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

b)

**Deferred Tax Worksheet
as at 30 June 2017**

	Carrying Amount	Deductible Amount	Tax Base	TTD	DTD
	\$	\$	\$	\$	\$
<u>Assets</u>					
Cash	82 000	0	82 000		
Inventory	158 000	158 000	158 000		
Acc Receivable	545 000	0	585 000		
Plant	482 000	382 000	382 000		
Buildings	165 000	0	0		
Goodwill	50 000	0	0		
<u>Liabilities</u>					
Acc payable	265 000	0	265 000		
Provision for LSL	50 000	50 000	0		
Provision for Warr.	30 000	30 000	0		
Total temporary differences					
Excluded diff: buildings & g/will					
Net temporary differences					
DTL (30% of TTD)					
DTA (30% of DTD)					
Beg Balances					
Adjustments					
Increase/Decrease for year					

Plant:

CA for acc = \$700 000 (cost) – \$218 000 (acc depn) = \$482 000

CA for tax = \$700 000 (cost) – (\$198 000 + 120 000) (tax depn) = \$382 000

The journal entry required to record movements in the deferred tax accounts for the year ended 30 June 2017 is as follows:

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