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ACC / ACF2100

Topic 4: Accounting for Income Tax:
Deferred Tax Issues

(Leo et al. Chapter 6)



Learning Objectives



1. Revise the general principles of current and deferred tax set out in AASB 112
2. Prepare a deferred tax worksheet to determine the differences between the accounting and tax values for assets and liabilities and use the worksheet to record the entries for deferred tax
3. Determine the tax bases of various assets and liabilities included in the statement of financial position
4. Calculate the taxable and deductible temporary differences of various assets and liabilities and identify items that are excluded from the calculation of deferred tax liabilities and assets
5. Describe the criteria for the recognition of deferred tax liabilities and assets and how these balances may reverse over time
6. Explain some of the additional issues that arise in accounting for income tax

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Differences between accounting and income tax treatments



ACCOUNTING	TAX
Accruals basis	Principally cash basis
Revenue – Expenses = Accounting profit	Taxable income (TI) – tax deductions (TD) = Taxable profit
AASBs and the Corporations Act determine the appropriate accounting treatment of transactions	The Income Tax Assessment Act determines the tax treatment of transactions

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Differences between accounting and income tax treatments



ITEM	ACCOUNTING	TAX
Employee benefits eg annual leave Provisions (e.g. for warranties) are treated in the same way as employee benefits	Liability recognised and expense accrued when debt owed to employees	Recognised as TD when leave is paid to employees
Prepaid expenses Insurance, rent, interest, royalties etc paid in advance	Recorded as an asset when pre-paid and expensed as incurred	Recognised as TD when paid
Cash received in advance of services	Liability recognised for unearned revenue and then allocated to revenue as services are performed	Recognised as TI when cash received
Bad/doubtful debts	Allowance is contra asset and expense recorded when debt is doubtful	Recognised as a TD when debts are written off as bad

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Differences between accounting and income tax treatments



ITEM	ACCOUNTING	TAX
Fines and penalties and entertainment costs	Recognised as an expense when payable	Not deductible
Depreciation of a depreciable asset Common for assets to be depreciated over a shorter life for tax purposes than for accounting purposes	Recognised as expense based on useful life of asset	Recognised as TD based on predetermined rates
R&D costs (expense)	Recognised as an expense based on the amount of the expenditure	Concessional deduction allowed equal to 125% of the expenditure
Development costs (intangible asset)	Capitalised (asset) and amortised	Recognised as TD when paid
Tax losses Subject to conditions e.g. reduced by exempt income	No recognition	Carried forward and offset against future TI

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Differences between accounting and income tax treatments



- All of these differences between accounting and income tax treatments can have...
 - Current tax consequences (last week)
 - Deferred (future) tax consequences (now)

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Deferred tax consequences



- Arise when the period in which revenue and expenses are **recognised for accounting** is different from the period in which items are **recognised for tax**
- Principally due to the accruals vs cash basis of recognising transactions
- These differences are called **Temporary Differences**

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Temporary differences



- AASB 112 defines temporary differences as:
the differences between the carrying amount of an asset or liability in the statement of financial position and its tax base.
- There are two types of temporary differences:
 - **Taxable temporary differences**
 - Which result in **taxable amounts in future periods** when the carrying amount of the asset or liability is recovered or settled
 - **Deductible temporary differences**
 - Which result in **amounts that are deductible in future periods** when the carrying amount of the asset or liability is recovered or settled

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Taxable temporary differences (TTD)



- Taxable amounts in future periods
- The company will pay **more tax in future periods**
- Recognised as deferred tax liabilities (DTL)
- **$TTD \times \text{tax rate} = DTL$**
- Can you think of any examples of taxable temporary differences?

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Deductible temporary differences (DTD)



- Deductible amounts in future periods
- The company will pay **less tax in future periods**
- Recognised as deferred tax assets (DTA)
- **$DTD \times \text{tax rate} = DTA$**
- Can you think of any examples of deductible temporary differences?

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Excluded temporary differences



- Certain temporary differences are **excluded** from being recognised
- AASB 112 prohibits temporary differences being recognised in relation to:
 - Goodwill
 - Buildings that are not deductible for tax

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Calculating temporary differences



- The carrying amounts of an entity's assets and liabilities are different from the amounts that would arise if a balance sheet was prepared for tax authorities
- **Carrying amount (CA)** = asset and liability balances (net of accum depn, allowances) based on accounting balance sheet
- **Tax base (TB)** = asset and liability balances that would appear in a "tax balance sheet"
- Temporary differences are calculated as...

$$CA - TB = TTD \text{ or } DTD$$

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Tax bases of assets and liabilities



Calculating the tax base of an asset:

Taxable economic benefits from recovery:

TB = deductible amount in future

No taxable economic benefits from recovery:

TB = CA

Calculating the tax base of a liability:

General rule:

TB = CA – deductible amount in future

Unearned revenue:

TB = CA – untaxed future revenue

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Summary of temporary differences



	Taxable temporary difference TTD x tax rate = DTL	Deductible temporary difference DTD x tax rate = DTA
Assets	CA > TB	CA < TB
Liabilities	CA < TB	CA > TB

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Class Interactions



Example 1

Number 1 – explanation through Document camera and pair discussions

Number 2 – explanation through Document camera and pair discussions

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Deferred tax worksheet



KERRY LTD Deferred Tax Worksheet as at 30 June 2017					
(1)	(2)	(3)	(4)	(5)	(6)
	Carrying amount	Future deductible amount*	Tax base	Taxable temporary differences	Deductible temporary differences
Assets					
Plant (net of accum depn)	\$ 75,000	\$ 50,000	\$ 50,000	\$ 25,000	\$ —
Land – revalued	500,000	220,000	220,000	280,000	—
Accounts receivable	40,000	—	40,000	—	—
Interest receivable	15,000	—	—	15,000	—
Prepaid insurance	9,000	—	—	9,000	—
Development asset	130,000	—	—	130,000	—
Research costs	—	120,000	120,000	—	120,000
Loan receivable	100,000	—	100,000	—	—
Inventory	80,000	80,000	80,000	—	—
Liabilities					
Accounts payable	75,000	—	75,000	—	—
Interest payable	3,000	3,000	—	—	3,000
Fines payable	20,000	—	20,000	—	—
Provision for employee benefits	16,000	16,000	—	—	16,000
Provision for warranty	8,000	8,000	—	—	8,000
Unearned revenue	25,000	25,000	—	—	25,000
Loan payable	170,000	—	170,000	—	—
Temporary differences					
Deferred tax liability (30%)				\$459,000	\$172,000
Deferred tax asset (30%)				\$137,700	\$ 51,600

*Untaxed future revenue rather than deductible amount for the liability of unearned revenue.

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Recognition of DTAs



- Deferred tax assets relating to temporary differences and tax losses are recognised only if:
 - there are sufficient taxable temporary differences for the entity to use against the deductible temporary differences; OR
 - if it is probable that the entity will have sufficient future taxable profit (against which the tax benefit can be offset)
- May reverse over time e.g. with a decrease in provision for employee benefits

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Recognition of DTLs



- Deferred tax liabilities must be recognised in full
- May reverse over time e.g. when plant becomes fully depreciated for tax purposes, but not accounting purposes

	30 June 2017		30 June 2018		30 June 2019		30 June 2020	
	Accounts	Tax	Accounts	Tax	Accounts	Tax	Accounts	Tax
Cost	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Accum depn	25,000	50,000	50,000	100,000	75,000	100,000	100,000	100,000
Carrying amount	75,000	—	50,000	—	25,000	—	—	—
Tax base	—	50,000	—	—	—	—	—	—
Taxable temporary difference	25,000	—	50,000	—	25,000	—	—	—
DTL (30%)	7,500	—	15,000	—	7,500	—	—	—

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Offsetting deferred tax accounts



- DTAs and DTLs can be offset against each other and the net amount recognised in the statement of financial position

- Deferred tax asset \$5,000
- Deferred tax liability \$7,000

- Journal entry shows net balance of \$2,000

Income tax expense	Dr	2,000	
Deferred tax liability	Cr		2,000

(Recognition of deferred tax)

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Change in tax rate



- When a new tax rate is enacted, the new rate is applied:
 - When calculating current tax liability
 - When calculating adjustments to deferred tax accounts
 - Opening balance x (1 – N / O)
 - To carried forward deferred tax balances from previous years

See lecture handout...

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Next week...
Property, Plant and Equipment
