

Solutions Manual

to accompany

Company Accounting 10e

prepared by

Ken Leo
John Hoggett
John Sweeting
Jeffrey Knapp
Sue McGowan

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Chapter 6: Accounting for company income tax

REVIEW QUESTIONS

1. A fellow student comments: “The taxes payable method makes sense because income tax expense is based on the income tax return. I don’t understand why we bother with deferred tax liabilities and deferred tax assets.” Present arguments to convince the student why accounting for income tax should consider both current tax and deferred tax.

The fellow student has a point because the current tax liability is an obligation to the Tax Office that is near-term and easily calculated. The Company has to pay tax based on its taxable profit for the year. The current tax liability meets the criteria of being probable and reliable. In contrast, deferred tax balances seem to require some imagination about the income taxes a company will have to pay well into the future.

Refer back to chapter 3 to the definitions of an asset and a liability in the *Conceptual Framework 2010*. An asset is defined as a “resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity”. A liability is defined as a “present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits”. Deferred tax liabilities and assets do not seem to satisfy the definitions of liabilities and assets. The key question regarding deferred tax liabilities is whether one believes that they are “present obligations”. They are not legal obligations (only current tax liabilities are legal), and it is arguable whether deferred tax liabilities are “constructive obligations”. Regarding assets, the key question is whether deferred tax assets are “resources controlled by the entity”. There is no doubt that future tax consequences of a positive nature do lead to future economic benefits in the form of tax savings. But are they “controlled by the entity”?

One strong argument for deferred tax is that the assets and liabilities shown in the statement of financial position may give rise to future tax consequences when the benefits of the assets are recovered or the liabilities are settled. If we ignore those future tax consequences, the financial statements include incomplete or limited information. Assume that land is sold in the future at its carrying amount of \$500 million and capital gains tax of \$140 million results. Surely, the future liability for capital gains tax is relevant information to the users of the financial report? If a deferred tax liability is not recognised in such a case, then it can be argued that the company’s liabilities are understated or unreported.

Another argument for deferred tax is that we consider future consequences beyond 12 months when estimating other liabilities such as provision for long service leave or provision for warranty. These provisions are measured as a “deferred liability” using best estimates including various assumptions about what will happen in the future. Why should income tax be any different?

2. Explain why income tax expense is usually not equal to accounting profit multiplied by the corporate tax rate. Your answer should refer to the main principles of accounting for income tax.

In accrual accounting, an expense that arises from the recognition of a liability must be measured by reference to what the expected cash flow will be on settlement of the liability. Rent expense that arises from rent payable is ultimately paid in cash. Similarly, income tax expense should reflect income taxes to be paid in cash whether for the current period or in a future period. Prima facie income tax calculated as accounting profit multiplied by the corporate tax rate does not connect with the income tax that a company expects to pay because income tax is levied on taxable profit not accounting profit.

The main principles of accounting for income tax are that a company should recognise both:

- the current tax consequences of the transactions and events of the period as reflected in the calculation of taxable profit
- the future or deferred tax consequences that will arise from the recovery of assets and settlement of liabilities

Accordingly, income tax expense includes a current tax component based on the transactions and events of the current period and deferred tax component that is attributable to changes in asset and liability balances during the current period. The required note disclosure for income tax expense makes this clear as shown in the textbook.

The components of income taxation expense are as follows:

Current tax expense	\$78 000
Deferred tax expense from origination and reversal of temporary differences	<u>54 000</u>
Total income tax expense	<u>\$ 132 000</u>

The main principles of accounting for income tax consider not only the current tax consequences, but place special emphasis on the future tax consequences arising as a result of differences between the carrying amounts of an entity's assets and liabilities determined under accounting standards and the tax bases of those assets and liabilities determined under income tax legislation.

3. Accounting profit is based on a full accrual model whereas taxable profit is based on a partial accrual model. Explain this comment by reference to the following items: long service leave, doubtful debts, prepayments, warranty costs, interest costs, development costs and rent received in advance.

In accordance with paragraph 27 of AASB 101 *Presentation of Financial Statements*, the financial statements other than the statement of cash flows must be prepared using the accrual basis of accounting. In contrast, taxable profit uses a partial accrual model because some items must be recognised on a cash basis.

Long service leave is accrued for accounting purposes resulting in the provision for employee benefits, however, for tax purposes it is only recognised as an allowable deduction when the leave is actually taken by an employee and paid in cash.

Doubtful debts are accrued as an accounting expense resulting in the contra-asset Allowance for Doubtful Debts. In contrast, the deduction is only allowed for tax purposes when the debt is written off accounts receivable as bad indicating that the cash from the customer is not going to be collected.

Prepaid insurance is recognised as an asset for accounting purposes and then charged to expense over time as the benefits of the asset are consumed. The tax treatment is to record the amount prepaid as an allowable deduction immediately (at the time of payment).

Warranty expenses are recognised on the sale of goods for accounting purposes resulting in the provision for warranty, whereas for tax purposes the deduction is not allowed until the goods are fixed under warranty and the entity has effectively paid for the warranty.

Interest expense is accrued for accounting purposes resulting in Interest Payable however, for tax purposes only interest paid is deductible.

Development costs may be recognised as an asset for accounting purposes and then expensed as the benefits are consumed. In contrast, development costs are allowed as a deduction for tax purposes when paid.

Rent received in advance is regarded as the liability Unearned Revenue for accounting purposes and then recorded as income (revenue) over time as the service is provided. The common tax treatment is to record the amount received in advance as taxable income immediately.

4. In contrast to accounting profit, taxable profit is based on rules that create economic incentives and disincentives. Explain this comment by reference to the following items: depreciation of non-current assets, exempt income, fines and penalties, and entertainment costs.

Depreciation expense recognised in accordance with AASB 116 *Property, plant and equipment* allocates the depreciable amount of the asset on a systematic basis over the asset's useful life. The tax treatment is based on a set of rates provided by the tax office. Tax depreciation is usually accelerated when compared to accounting depreciation because the government wants to encourage capital expenditures in the economy.

Exempt income may be recognised as revenue in accounting profit but does not enter the calculation of taxable profit. A good example is a government grant to a company for hiring apprentices. The government wants to encourage employers to give jobs to young people so they do not give money to a company and then take it away as a tax. The grant for apprentices is exempt from tax.

Fines and penalties are recognised as expenses in accounting profit but do not enter the calculation of taxable profit. The government does not want to encourage pollution, anti-competitive behaviour or traffic violations by giving those responsible a tax break for it.

Entertainment costs are recognised as expenses in accounting profit, but for tax purposes may not be allowed as deductions. The idea here is not to encourage hard drinking in the workplace by providing tax deductions for it.

- 5. In contrast to accounting profit, taxable profit does not include the effects of valuation adjustments. Explain this comment by reference to the following items: goodwill, revalued property or plant and inventory.**

Purchased goodwill is recognised as an asset for accounting purposes. Purchased goodwill is expensed based on annual impairment testing. An impairment loss is, in effect, a valuation adjustment that reflects a diminishment in recoverability of the asset. For tax purposes, write-downs of goodwill are not allowed as a deduction.

Revalued land that is sold will give rise to a gain or loss for accounting purposes that is calculated using the revalued amount of the land, that is, the carrying amount of the land at fair value. In contrast, the gain or loss included in taxable profit is based on the land's original cost.

Revalued plant is depreciated for accounting purposes based on revalued amount of plant rather than its original cost. In contrast, tax depreciation is based on the original cost of plant.

Inventory is valued at the lower of cost and net realisable value for accounting purposes. The valuation adjustment that arises from the use of net realisable value is recognised as an expense in accounting profit. For tax purposes, inventory is only deductible when sold based on its original cost.

- 6. Describe how to prepare a current tax worksheet to determine the current tax for the period. What items are typically added back to accounting profit and what items are deducted?**

The current tax worksheet uses an indirect approach to determine taxable profit. It begins with accounting profit, that is, profit before tax. Adjustments are then made to:

- remove items included in profit before tax that do not enter into the calculation of taxable profit
- add in other items that do enter into the calculation of taxable profit

Figure 6.8 in the textbook shows how the adjustments are made.

- (Revenues or gains that are not equal to assessable incomes in the period - subtract
Interest revenue
Dividend revenue
Gain on sale of plant for accounting purposes
Unearned revenue at the beginning of the year.
- Expenses or losses that are not equal to deductions in the period - add back
Non-deductible expenses, for example, entertainment
Impairment loss on goodwill or other assets
Warranty expense
Bad and doubtful debts expense,

Depreciation expense
Development expense.

- Assessable incomes that are not equal to revenues or gains in the period - add in
Interest received
Dividends received
Gain on sale of plant for tax purposes
Unearned revenue at the end of the year.
- Deductions that are not equal to expenses or losses in the period - subtract
Long service leave paid
Warranty paid
Bad debts written off
Tax depreciation
Development costs paid.

7. Explain why the current tax liability at the end of the reporting period may not equal the income tax expense for the period.

The current tax liability represents the amount of tax expected to be paid to the Australian Tax Office by the company on assessment for the current year using the current tax rates and tax law.

Current tax liability = tax on taxable income less any instalments of tax paid for the year

Tax on taxable income = taxable income x corporate tax rate

In contrast, income tax expense relates to income tax that is expected to be paid or refunded in the future because of current tax and deferred tax. Income tax expense includes a component for the current tax liability but also includes a component for any deferred tax liabilities and assets.

As shown in the textbook, the current tax included in profit or loss for the year is recognised as follows:

30.6.17	Income Tax Expense	D	78 000
	Current Tax Liability	r	78 000
	(Step 1: The journal entries to recognise the current tax	C	
	for the year based on taxable income)	r	

Income tax expense also includes the deferred tax that is included in the profit or loss for the year because of changes to assets and liabilities as follows:

30.6.1	Income Tax Expense	D	54 000
7	Deferred Tax Asset	r	6 000

Deferred Tax Liability	D	60 000
(Step 2: The journal entries to recognise the deferred tax in-	r	
cluded in the profit or loss for the year)	Cr	

Income tax expense does not include the deferred tax that is attributable to changes in assets and liabilities that are recognised in other comprehensive income as follows:

30.6.1	Tax on revaluation increase (OCI)	D	30 000
7	Deferred Tax Liability	r	30 000
(Step 3: The journal entries to recognise the deferred tax in-	Cr		
cluded in other comprehensive income for the year)	Cr		

8. Describe how to prepare a deferred tax worksheet to determine the deferred tax for the period.

(1) Asset/Liabil- ity	(2) Carrying Amount	(3) Deductible Amount	(4) Tax Base	(5) Taxable Temp Diff	(6) Deductible Temp Diff
				<u>Total</u>	<u>Total</u>
Deferred Tax Asset					Total x tax rate
Deferred Tax Liability				Total x tax rate	

The first column in the worksheet lists the names of each asset and liability of the company.

The second column of the worksheet sets out the carrying amount (book value) of each asset and liability.

The third column of the worksheet records the deductible amount for income tax purposes when an asset is recovered or liability settled.

The fourth column shows the tax base of an asset or liability. The tax base of an asset or liability is the amount implied by income tax legislation.

The fifth and sixth columns of the worksheet record the taxable and deductible temporary differences of the assets and liabilities respectively. If the carrying amount of an asset or liability is equal to its tax base, then there is no temporary difference to record.

The taxable temporary differences are totalled and multiplied by the corporate tax rate to determine the deferred tax liability balance at the end of the period.

The deductible differences are totalled and multiplied by the corporate tax rate to determine the deferred tax asset balance at the end of the period.

9. What is the tax base of an asset or liability and how is it determined? Are there any similarities in the approach to measuring the tax base of an asset compared to a liability?

AASB 112 defines the **tax base** as the amount that is attributed to an asset or a liability for tax purposes (para 5).

Tax base of an asset:

Taxable economic benefits expected from recovery of the asset

Tax base of asset = Deductible amount in future [1]
]

No taxable economic benefits expected from recovery of the asset

Tax base of asset = Carrying amount [2]
]

Tax base of a liability

General rule:

Tax base of liability = Carrying amount - Deductible amount in future [1]
Unearned revenue

Tax base of liability = Carrying amount – Untaxed future revenue [2]

As shown above, the definitions for the tax base of an asset or liability are similar to some extent because they depend on the “deductible amount in future” when the asset is recovered or the liability is settled.

10. Which items in the statement of financial position typically give rise to: (a) taxable temporary differences and deferred tax liabilities; and (b) deductible temporary differences and deferred tax assets?

As shown in Figure 6.14, differences between the carrying amount and tax base of an asset or liability are known as temporary differences. They are temporary because once the asset is realised/recovered or the liability is settled the difference will no longer exist. The recovery of the asset or settlement of the liability will have a future tax consequence as there will either be an increase or a decrease in the tax due in the future period. Taxable temporary differences give rise to an increase in future tax payments whereas deductible temporary differences give rise to a decrease in future tax payments.

For example, when interest is received for interest receivable in a future period there is an increase in taxable income and tax due in that future period.

For example, when long service leave is paid out of the provision for employee benefits in a future period, there is a decrease in taxable income and tax due in that future period.

Figure 6.14 of the text and section 6.6.3 highlight the following temporary differences:

(a) Deductible temporary differences

{Deductible temporary difference x tax rate = Deferred tax asset}

Asset carrying amount less than tax base

Accounts receivable

Depreciable plant (depreciation faster for accounting purposes)

Liability carrying amount greater than tax base

Provision for employee benefits (e.g. long service leave)

Provision for warranty

Interest payable

Unearned revenue

(b) Taxable temporary differences

{Taxable temporary difference x tax rate = Deferred tax asset}

Asset carrying amount greater than tax base

Depreciable plant (depreciation faster for tax purposes)

Revalued land

Dividend receivable

Interest receivable

Prepaid insurance

Development asset

It is apparent that the two main categories involve assets or liabilities with carrying amounts greater than tax bases.

11. According to AASB 112, certain temporary differences are to be excluded from the calculation of deferred tax liabilities and assets. Identify the items excluded and discuss reasons for their exclusion.

The temporary difference for goodwill is excluded from the calculation of deferred tax liabilities.

The exclusion of goodwill avoids the need to gross up goodwill to an amount greater than the amount at which it is initially recognised.

Using a simple example:

Cost of business acquired	100
Plant	50

Inventory	<u>20</u>
Goodwill	<u>30</u>

If taxable temporary difference on goodwill, deferred tax liability is $30 \times 30\% = 9$

Cost of business acquired	100
Plant	50
Inventory	20
Deferred tax liability	<u>(9)</u>
Goodwill	<u>39</u>

The temporary difference on initial recognition of an asset or liability that, at the time of the transaction, does not affect accounting or taxable profit is also excluded. Recall that the deferred tax balances relate to future tax consequences. A purchased building has no future tax consequences if depreciation is not deductible or capital gains tax is not payable. The recognition of a deferred tax liability in this case would be inconsistent with the main principles of AASB 112.

12. Discuss when a deferred tax asset or deferred tax liability must be recognised. Are there any similarities in the recognition approach?

The recognition of deferred tax liabilities is dissimilar to the recognition of deferred tax assets.

There are no recognition criteria for a deferred tax liability (DTL) because paras. 15 and 16 of AASB112, indicate that a DTL must be recognised for all taxable temporary differences. This is because it is always probable that future sacrifices of economic benefits will flow from the entity in the form of settling tax liabilities and the amount can be reliably measured.

In contrast, there are recognition criteria for a deferred tax asset (DTA). Para 24 of AASB 112 states that a deferred tax asset must be recognised for all deductible temporary differences. However, unlike the criteria for a DTL, the paragraph puts in the following proviso:

“to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised”

That is, economic benefits in the form of reductions in tax payments will only flow to a company if it is probable that it will have a taxable profit in future against which deductions can be offset.

13. Deferred tax liabilities and assets may reverse over time. Explain this comment by reference to depreciation of plant and provision for warranty.

Assume an item of plant is acquired at the beginning of Year 1 and depreciated using the rate of 25% for accounting purposes (\$2 500 by 4 years) but 50% for taxation purposes (\$5 000

by 2 years). The following table is in relation to the plant over the four years that it is depreciated for accounting purposes:

- the carrying amount
- tax base
- taxable temporary difference
- deferred tax liability

	Year 1		Year 2		Year 3		Year 4	
	Ac- count	Tax	Account	Tax	Ac- count	Tax	Account	Tax
Plant - cost	10 000	10 000	10 000	10 000	10 000	10 000	10 000	10 000
Accum Depn	2 500	5 000	5 000	10 000	7 500	10 000	10 000	10 000
Carrying amount	7 500	5 000	5 000	—	2 500	—	—	—
Tax base Temp Diff	2 500		5 000		2 500		—	
DTL (30%)	750		1 500		750		—	

The taxable temporary difference and deferred tax liability for the plant increase in Year 1 and Year 2 when tax depreciation (\$5 000) is greater than accounting depreciation (\$2, 500). The taxable temporary difference and deferred tax liability for the plant reverse (decrease) in Year 3 and Year 4 when accounting depreciation (\$2 500) is greater than tax depreciation (\$Nil).

Assume that warranty expense of \$5 000 is provided at the end of Year 1 and Year 2 and that warranty costs of \$2 500 are paid in Year 3 and Year 4. The provision for warranty at the end of each year is as follows:

	Year 1		Year 2		Year 3		Year 4	
	Ac- count	Tax	Account	Tax	Ac- count	Tax	Account	Tax
Provision for Warranty Temp Diff	5 000	0	10 000	0	7 500	0	5 000	0
	5 000		10 000		7 500		5 000	
DTA (30%)	1 500		3 000		2 250		1 500	

The deductible temporary difference and deferred tax asset for the provision increase in Year 1 and Year 2 when the amount of warranty expense (\$5 000) is greater than warranty paid (\$Nil). The deductible temporary difference and deferred tax asset for the provision reverse (decrease) in Year 3 and Year 4 when warranty paid (\$2 500) is greater than warranty expense (\$Nil).

14. According to AASB 112, a deferred tax asset may be offset against a deferred tax liability in certain circumstances. Identify those circumstances.

Para 74 of AASB 112 requires deferred tax assets and deferred tax liabilities to be offset against each other if:

- the entity has a legally enforceable right to set off current tax liabilities with current tax assets
- The deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority on:
 - o the same taxable entity
 - o different taxable entities that intend to settle current tax liabilities and assets on a net basis or realise assets and settle liabilities simultaneously in future periods

The taxation authority in Australia is the Australian Taxation Office (ATO). A company will ordinarily meet the requirements for offset in relation to Australian income tax and only show a net amount in the statement of financial position for either deferred tax asset or deferred tax liability.

In the text, offsetting is ignored to focus on how the balances of deferred tax assets and deferred tax liabilities are determined.

15. Why are tax adjustments for prior periods sometimes necessary? How are such adjustments brought to account?

Tax adjustments for prior periods arise because of an underprovision or overprovision of tax at the time the financial statements are completed. The current and deferred tax balances are determined for accounting purposes using the best information available at the time. However, these balances are subject to any further adjustments that may be made for the period when the income tax return is finally lodged with the ATO. The income tax return may be lodged some months after the financial statements are completed.

The tax adjustments for prior periods that relate to current and deferred tax recognised in the profit or loss are brought to account in the profit or loss of the current period.

16. Explain the significance of a change in the corporate tax rate when accounting for income tax.

Para 51 of AASB 112 states that the measurement of deferred tax liabilities and deferred tax assets must reflect the tax consequences that would flow from the manner in which the entity expects, at the end of the reporting period to recover or settle the carrying amounts of its assets and liabilities.

Para 52 indicates that the tax rate applicable that an entity expects when it recovers or settles the carrying amounts of its assets and liabilities is relevant to the measurement of deferred tax liabilities and deferred tax assets.

Accordingly, a change in the corporate tax rates necessitates the restatement of the balances of Deferred Tax Assets and Deferred Tax Liabilities that have been calculated using a previous tax rate. The beginning balances of DTA and DTL need to be adjusted to reflect the new tax rate that will be used in regard to the amount of tax now expected to be settled or recovered.

The change in the tax rate will also affect the current tax and deferred tax recognised in the current period, for example, the current tax liability will be determined using taxable income multiplied by the new tax rate.

17. Describe how income tax losses can provide a future tax benefit. What is criterion for the recognition of income tax losses as a deferred tax asset and in what circumstances is it likely to be satisfied? How does exempt income impact on tax losses?

Income tax losses can provide a future tax benefit because the losses can be carried forward and utilised to reduce the taxable income of a future period.

Paragraph 34 of AASB 112 sets out the recognition criteria in relation to raising a deferred tax asset from tax losses. A deferred tax asset is recognised for tax losses if it is probable that future taxable profit will be available against which the carried forward losses can be utilised. The recognition of tax losses as a deferred tax asset is consistent with the recognition of deductible temporary differences as deferred tax assets.

Paragraph 36 of AASB 112 requires close consideration of whether future taxable profits will be available for tax losses and points to the following factors:

- taxable temporary differences that result in taxable amounts in the future
- the expiry date for tax losses, if any
- whether the cause of the tax losses is likely to reoccur
- tax planning opportunities

Exempt income earned in the current year reduces the amount of that year's tax loss. That is, where an entity has a tax loss of say \$15 000 and the entity earned \$3 000 in exempt income in that year, then the tax loss that can be carried forward to later years is reduced to \$12 000. In the case of recovering a tax loss from a previous year, the entity must first of all reduce the carry forward tax loss by the amount of exempt income earned in the current period. This situation results in the ATO collecting additional tax from the entity because of the exempt income. For example, assume that an entity has a carry forward tax loss of \$18 000, exempt income for the current period is \$5 000 and the current year's taxable income is \$25 000. Instead of reducing the taxable income down by \$18 000 to \$7 000, the entity must first reduce the carry forward tax loss by the \$5 000 exempt income. This will now result in the entity's taxable income being reduced down by only \$13 000, being (\$18 000 - \$5 000) to \$12 000. Thus the ATO will collect an additional (\$5 000 x Tax Rate) because of the exempt income.

CASE STUDIES

Case Study 1 Tax bases and deferred tax adjustments over time

Aidan Ltd, a profitable company, purchased a machine on 1 July 2014 at a cost of \$120 000. The machine had a useful life of 5 years and the company adopts the straight-line basis of depreciation. On 1 July 2015, the company reassessed the useful life of the machine down from the remaining 4 years to an expected 3 years. The accounting depreciation charge was adjusted accordingly.

Because of a change in economic conditions, the machine was sold for \$55 000 on 30 June 2017. The tax depreciation rate for this type of machine was 15% p.a. The company tax rate is 30%.

Required

For each of the 3 years ended 30 June 2015, 2016 and 2017, calculate the carrying amount and tax base of the asset, and determine the deferred tax entry in relation to the machine. Explain your answer.

1. Year ended 30 June 2015

	Carrying amount		Tax base		Temporary difference
Cost	\$120 000		\$120 000		
Accumulated depn	(24 000)	)	(18 000)	)	
	<u>96 000</u>		<u>102 000</u>		\$6 000

The temporary difference of \$6000 is deductible, as the future taxable amount (\$96 000) is less than the future deductible amount (\$102 000), leading to the recognition of a deferred tax asset of 30% of \$6000 = \$1800:

Deferred Tax Asset (6 000 x 30%)	Dr	1 800	
Income Tax Expense	Cr		1 800

2. Year ended 30 June 2016

	Carrying amount		Tax base		Temporary difference
Cost	\$120 000		\$120 00		
Accumulated depn	(56 000)	)	0	)	\$
	<u>64 000</u>		<u>(36 000)</u>		20 00
Previous temp difference			<u>84 000</u>		0)
Increase					<u>(6 000)</u>
					14 00
					0

The reassessment of useful life down to 3 years increased the depreciation charge from \$24 000 p.a. (i.e. \$120 000 ÷ 5) to \$32 000 p.a. (i.e. \$96 000 ÷ 3).

The temporary difference in the second year increases the deductible difference, leading to an increased deferred tax asset of 30% of \$14 000 = \$4200.

Deferred Tax Asset (14 000 x 30%)	D	4 200	
Income Tax Expense	r		4 200
	Cr		

3. Year ended 30 June 2017

	Carrying amount		Tax base		Temporary difference
Cost	\$120 000		\$120 000		
Accumulated depn	(88 000)	)	(54 000)	)	\$
	<u>32 000</u>		<u>66 000</u>		34 000
Previous temp difference					<u>(20 000)</u>
Increase					14 000

Hence the adjustment is:

Deferred Tax Asset (14 000 x 30%)	D	4 200	
Income Tax Expense	r		4 200
	Cr		

4. On sale of the machine

On sale of the machine when the asset is deleted from the accounting records, the total temporary difference of \$34 000, leading to a total deferred tax asset of \$10 200, is reversed as the tax benefit will be received in the current year. This is because the gain on sale recognised for accounting purposes will far exceed the loss on sale for tax purposes.

Carrying amount	\$32 000	
Tax base		\$66 000
Proceeds	<u>55 000</u>	<u>55 000</u>
Gain (loss)	<u>23 000</u>	<u>(11 000)</u>
Difference		34 000

Hence, the adjustment is:

Income Tax Expense	D	10 200	
Deferred Tax Asset (34 000 x 30%)	r		10 200
	Cr		

Further explanation of adjustments

Owing to differing rates of depreciation for accounting and tax causing a difference between the carrying amount and tax base for the machine, a deferred tax asset has been raised in the years 2015 to 2017. The difference in depreciation rates causes the carrying amount and tax base to differ at the date of sale and thus the gain (loss) on sale also differs. The deductible temporary difference will be reversed via the difference between the gain for accounting and the loss for tax purposes. The deferred tax asset is effectively received in the final year.

Case Study 2 Deferred tax asset of a loss making company

Isa Ltd is a gold exploration company. Isa Ltd has recognised a deferred tax asset balance for tax losses in its statement of financial position for each of the past four years as follows:

Isa Ltd (\$000s)

	2014	2015	2016	2017
Deferred tax asset	24 200	133 200	197 000	300 800

At 30 June 2017, Isa Ltd is in financial distress due to a cash shortage and bank restrictions on providing any further funds.

Required

The auditors of Isa Ltd have asked for your advice on whether a deferred tax asset should be recognised for carried forward tax losses at 30 June 2017. Discuss with reference to AASB 112.

Isa Ltd is in financial distress at 30 June 2017 and the recognition of tax losses is inappropriate in these circumstances because it is not probable that future taxable profit will be available against which the tax losses can be utilised.

Paragraph 56 of AASB 112 requires that a deferred tax asset be reviewed each year and reduced if it is no longer probable that it will be utilised.

Paragraph 25 of AASB 101 indicates that if going concern assumption is not appropriate, then the financial statements should not be prepared on a going concern basis. A deferred tax asset should not be recognised for tax losses if a company is on the verge of liquidation and it is likely the tax losses will not be utilised.

In Isa's case, the recognition of the tax losses as a deferred tax asset in previous years (2014-2016) should also be called into question. The fact that the company has consistently made a tax loss over the three years indicates that a future taxable profit is not around the corner.

Deferred Tax Asset	24 200	133 200	197 000	300 800
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Based on the year-on-year balances of the deferred tax asset, the tax loss for each year is at least the following:

2014: \$24 200

2015: \$109 000

2016: \$63 800

2017: \$103 800

The tax loss for 2017 and 2015 appears to have increased significantly relative to the applicable prior year.

One reason that the management of Isa may have recognised the tax losses as a deferred tax asset is to reduce the loss for the year shown in the statements of profit or loss. As an example, the year to 30 June 2017, could be as follows:

Loss before tax	(\$200 000)
Add: Income Tax Income	<u>103 800</u>
Loss for the year	(96 200)

All available evidence, both positive and negative, must be evaluated before determining whether to recognise a deferred tax asset for a tax loss. **Paragraph 35 of AASB 112** notes that the existence of unused tax losses provides *strong evidence* that future taxable profit may not be available. This evidence has great weight in Isa's case because there is no other

evidence that would suggest a future taxable profit is probable.

Isa Ltd could be a company with high risk such as a junior mining company that spends large amounts on exploration and development activities, which are treated as an asset in the accounting records, but are claimable immediately as tax deductions. These companies often have no or small revenues because they have not reached the stage of having a mine with economic production. In light of the risk associated with taxable profits in future, a deferred tax asset for tax losses should not be recognised.

Case Study 3 Deferred tax balances and discounting

Your fellow student was playing ‘Angry Birds’ on a mobile phone in the lecture theatre when they suddenly stopped, looked up at you and said, ‘Deferred tax liabilities and assets should be measured using a discounted cash flow model. The deferred tax is paid or refunded in the future — that could be years away — so the time value of money should be taken into account.’

Required

Refer to AASB 112 and comment on your fellow student’s argument. Identify other assets and liabilities where discounting is required in the measurement approach.

Paragraph 53 states that deferred tax assets and liabilities shall *not* be discounted.

The expected increase (decrease) in tax to be paid in future periods is recognised on a gross basis. Land revalued from its cost of \$100 000 to its fair value of \$1 100 000 gives rise to a taxable temporary difference of \$1 000 000 and a deferred tax liability of \$300 000. The tax will not be paid until the land is actually sold for \$1 100 000 and such a sale may not happen for 5 or 10 years.

The statement of financial position may show a deferred tax liability of \$300 000 for tax that is not due for 10 years. Based on a discount rate of 5%, the present value of the liability would be $\$300\,000 / (1.05)^{10}$ equal to \$184 174. It is clear that there is a material difference between the gross amount of the liability and its present value.

There is a good argument that the disclosure of the gross amount for deferred tax assets and liabilities may be misleading.

Other liabilities and assets subject to measurement using a present value approach include the following:

AASB 137 Provisions, Contingent Liabilities and Contingent Assets

Liabilities such as the provision for employee benefits and provision for warranty are measured using discounting.

Paragraph 45 of AASB 137 states that “where the effect of the time value of money is material, the provision shall be the present value of the expenditures expected to be required to settle the obligation”.

AASB 117 Leases

Lessees initially recognise finance leases as assets and liabilities using the fair value of the lease property or, if lower, the “present value of the minimum lease payments”.

AASB 1023 General Insurance Contracts and AASB 1038 Life Insurance Contracts

Paragraph 5.1 of AASB 1023 requires that the liability of outstanding claims for a general insurance company is measured using estimates discounted to present value.

In AASB 1038, life insurance contracts are measured on a “net present value” basis.

AASB 13 Fair Value Measurement

AASB 13 includes the valuation technique of “the income approach” where future amounts (eg cash flows or income or expenses) are converted to a single discounted amount.

Fair values based on the income approach may be used in the subsequent measurement of assets in AASB 116 Property, Plant and Equipment, AASB 138 Intangible Assets, AASB 139 Financial Instruments, AASB 140 Investment Property and AASB 141 Agriculture.

Case Study 4 Recognition of deferred tax assets

Shady Sheds Ltd manufactures prefabricated sheds, ranging from industrial sheds and garden sheds down to small items such as dog kennels. In recent years, Shady Sheds Ltd has recorded accounting losses. The company has retrenched several of its staff after struggling to find new markets for its products.

In the prior year, the company recognised expenses and liabilities for long-service leave and potential redundancy payouts. Redundancy costs and long-service leave are not deductible for income tax until paid. The company recognised deferred tax assets as a result of these liabilities.

With the long-service leave and redundancy entitlements being paid out to the retrenched employees in the current year, the company has now been able to claim large

tax deductions for the cash payments made. The effect of these deductions is that the company has recorded a significant tax loss in the current year.

Required

- A. Outline the requirements of AASB 112 in relation to the recognition of deferred tax assets from long-service leave and retrenchment liabilities. How do these requirements differ (if at all) from the recognition requirements for deferred tax assets from tax losses?**
- B. Discuss whether the deferred tax asset from the employee benefits liabilities in the prior year should have been recognised. Should the tax loss in the current year be recognised as a deferred tax asset?**

PART A

Long service leave liabilities and retrenchment liabilities provide tax deductions on the payment of cash to employees. For accounting purposes, an expense is recognised on an accrual basis. Hence, there is a difference between the carrying amount of the liability for accounting purposes and the tax base of zero, caused by the existence of a future deductible amount when cash is paid. The resulting deductible temporary difference leads to the existence of a deferred tax asset.

Paragraph 24 of AASB 112 specifies that a deferred tax asset can be recognised 'to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised'. Para. 28 states:

It is probable that taxable profit will be available against which a deductible temporary difference can be utilised when there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity which are expected to reverse:

- (a) in the same period as the expected reversal of the deductible temporary difference;
or
- (b) in periods into which a tax loss arising from the deferred tax asset can be carried back or forward.

When there are *insufficient* taxable temporary differences for the entity to use against the deductible temporary differences, a deferred tax asset can be recognised only to the extent that it is probable that the entity will have enough taxable income in the same period as the reversal of the deductible temporary difference or recovery of a tax loss, or tax planning opportunities are available to the entity that will create taxable income in appropriate periods (para. 29). All available evidence, both positive and negative, must be evaluated before determining whether to recognise a deferred tax asset. In evaluating whether the entity will have sufficient taxable income in future periods, paragraph 29 states that the entity must ignore the taxable amounts arising from deductible temporary differences expected to originate in *future* periods, because the deferred tax asset from future deductible temporary differences will itself require future taxable income in order to be used.

In relation to tax losses, the recognition criteria are discussed in paragraph 34. A deferred tax asset arising from the carry forward of an unused tax loss must be recognised to the extent that it is probable that future taxable profits will be available against which the unused tax loss can be used. It appears, therefore, that the recognition criteria for deferred tax assets from tax losses are the same as the recognition criteria for other deferred tax assets, described above. AASB 112 also points out, however, that the mere existence of a tax loss provides *strong evidence* that future taxable income may *not* be available to ensure that the deferred

tax asset from the tax loss is recognisable. Para. 35 states that when an entity has a history of recent losses, it can recognise a deferred tax asset from tax losses *only* to the extent that it has sufficient taxable temporary differences, *or* there is *other convincing evidence* that sufficient taxable profits will be available in the future against which the unused tax losses can be used. Para. 36 specifies a number of factors which the entity must consider in assessing the probability that a deferred tax asset from a tax loss can be recognised:

- whether the entity has sufficient taxable temporary differences which will result in taxable amounts in future so that the tax losses can be used
- whether it is probable that the entity will have future taxable profits before the tax losses expire (this is not an issue in Australia as tax losses can be carried forward indefinitely)
- whether the unused tax losses result from identifiable causes which are unlikely to recur
- whether tax planning opportunities are available to the entity that will create sufficient future taxable profits to recover the tax losses.

If, based on an assessment of the evidence, it is not probable that sufficient future taxable income will exist, then a deferred tax asset can be recognised only to the extent that it can be recovered against the future taxable income available.

PART B

Looking at the requirements of AASB 112 concerning the recognition of deferred tax assets from temporary differences and tax losses, there is little evidence in Shady Sheds Ltd to support the recognition of any deferred tax assets. Shady Sheds Ltd is struggling after losing market share and has recorded accounting losses over an extended period of time.

To convince the auditors, Shady Sheds Ltd will have to show clearly the basis for the expectation of returning to profitability and future taxable profits so that it can claim the benefits of the tax loss and of the deferred tax assets from long service leave and retrenchments. Relevant evidence would be:

- recent operating performance in markets including in any significant new markets
- budgets for operating performance in markets in the next 12 months and any other evidence that supports the reliability of the budgets

Case Study 5 Company tax instalment system

The current system for paying company tax was introduced by the Australian Government on 1 July 2000 as part of its legislation introducing the goods and services tax (GST). The effect of this system for most companies is that income tax is paid, under the PAYG (pay as you go) system, in regular quarterly instalments, thereby smoothing out the cash flow requirements for tax payments throughout the year. Basic details for determining tax payments by companies are available on the Australian Taxation Office (ATO) website at www.ato.gov.au. Assume that Chelsey Ltd, for the year ended 30 June 2017, pays quarterly PAYG tax instalments as follows:

- \$8000 on 28 July 2016 (final payment for 30 June 2016)**
- \$4000 on 28 October 2016 (1st payment for 30 June 2017)**
- \$11 000 on 28 February 2017 (2nd payment for 30th June 2017)**

\$12 000 on 28 April 2017 (3rd payment for 30 June 2017)

Chelsey Ltd determines its annual tax for the year to 30 June 2017 is to be \$33 000 on an estimated taxable income of \$110 000. An increase to the deferred tax liability and deferred tax asset of \$3000 and \$6600 was also recognised. As a result of determining the annual tax to be an amount of \$33 000, the company pays a final tax payment for the year on 28 July 2017 as follows:

$$\text{Final tax instalment} = \$33\,000 - \$4000 - \$11\,000 - \$12\,000 = \$6000$$

On 1 October 2017, the ATO notified Chelsey Ltd that its taxable income for the year ended 30 June 2017 was assessed as \$115 000, requiring a total tax payment for that year of \$34 500. This difference was due to the ATO disallowing:

- a depreciation claim of \$3000 made by the company at a depreciation rate higher than that used in the accounting records
- a claim for entertainment expenses of \$2000.

In other words, the underprovision for tax of \$1500 (\$34 500 - \$33 000) was caused by an expected temporary difference between accounting depreciation and tax depreciation (\$3000) that did not eventuate, and a disallowed deduction of \$2000. Hence, an entry must be made, in respect of the depreciation, to reduce the deferred tax liability established at the end of the reporting period (30 June 2017) by \$900 to take into account the taxable temporary difference that did not arise, and to recognise an additional expense of \$600 to record the additional income tax payable. Chelsey Ltd paid the additional tax on 20 October 2017.

Required

Prepare the journal entries to record all payments of tax and the adjustments from the underprovision for tax of Chelsey Ltd in respect of the year ended 30 June 2017.

Journal entries to record all payments of tax and the adjustments from the underprovision for tax in Chelsey Ltd are shown below.

201						
6	28	Current Tax Liability	Dr	8 000		
July		Cash	Cr		8 000	
		(Final payment of tax for year ended 30 June 2016)				
Oct.	28	Income Tax Expense	Dr	4 000		
		Cash	Cr		4 000	
		(Payment of first PAYG instalment for year ended 30 June 2017)				
201						
7	28	Income Tax Expense	Dr	11 000		
Feb.		Cash	Cr		11 000	
		(Payment of second PAYG instalment for year ended 30 June 2017)				
Apri	28	Income Tax Expense	Dr	12 000		
l		Cash	Cr		12 000	
		(Payment of third PAYG instalment for year ended 30 June 2017)				

June	30	Income Tax Expense	Dr	6 000	
		Current Tax Liability	Cr		6 000
		(Recognition of final instalment payable for current tax)			
		Deferred Tax Asset	Dr	6 600	
		Deferred Tax Liability	Cr		3 000
		Income Tax Expense	Cr		3 600
		(End-of-period adjustment determined on the basis of tax-effect accounting recording adjustments to deferred tax asset and liability (ignoring offsets) and tax expense)			
July	28	Current Tax Liability	Dr	6 000	
		Cash	Cr		6 000
		(Final PAYG instalment for year ended 30 June 2017)			
Oct.	1	Deferred Tax Liability	Dr	900	
		Underprovision for Tax (expense)	Dr	600	
		Current Tax Liability	Cr		1 500
		(Adjustment for income tax underprovided)			
	20	Current Tax Liability	Dr	1 500	
		Cash	Cr		1 500
		(Additional tax paid after assessment by ATO)			

Case Study 6 Income tax disclosures of top Australian companies

Select three companies listed on the ASX from different industries; for example, Telstra Corporation, Woolworths, and Fortescue Metals. Go to www.asx.com.au and find the most recent annual financial report of the three companies. Compare the information relating to income tax in the financial statements and report your findings to class. The presentation should address the following:

- the income tax expense included in the profit or loss for the year
- any income tax included in other comprehensive income
- the current and deferred tax components of income tax expense
- whether a deferred tax asset or deferred tax liability or both is disclosed in the statement of financial position and the magnitude of these balances.

This is an open-ended case for student presentation. Students should use the ASX website by clicking on “Prices and Research” and then use the drop down menu for “Company Information” and follow the link for the “Listed Companies Directory”. You will find the companies in each industry as per the “GICS Industry Group”. Select three companies from three different industries and go from there to the annual reports of each company in the “Announcements” section to view the income tax disclosures in the financial statements and notes. Alternatively students can use a search engine, such as Google, to find the financial statements and notes of three appropriate companies.

The presentation should consider if deferred tax liabilities or deferred tax assets are expected based on what the company’s operations are. For example, Telstra has large capital expenditure commitments that involving property, plant and equipment at accelerated tax depreciation rates and should be expected to have a large deferred tax liability.

PRACTICE QUESTIONS

Question 6.1 Calculation of current and deferred tax

The following data applies to the two unrelated companies Lloyd Ltd and Cole Ltd:

	Lloyd Ltd	Cole Ltd
Profit before tax for the year to 30 June 2017	\$1 300 000	\$136 000
Taxable income for the year to 30 June 2017	340 000	150 000
Deferred tax liability 1 July 2016	—	90 000
Deferred tax asset 1 July 2016	—	15 000
Taxable temporary differences at 30 June 2017	960 000	306 000
Deductible temporary differences at 30 June 2017	—	70 000

All taxable and deductible temporary differences relate to the profit or loss. Assume a corporate tax rate of 30%.

Required

- For each company, prepare the journal entries to record the current and deferred tax for 30 June 2017.
- For each company, prepare the income tax section of the statement of profit or loss and other comprehensive income for the year ended 30 June 2017, and show the note disclosure for the current and deferred components of income tax expense.

PART A

LLOYD LTD

Taxable income	\$340 000
Corporate tax rate	30%
Current tax liability at 30 June 2017	\$102 000

Journal entry for current tax:

Income Tax Expense	Dr	102 000	
Current Tax Liability	Cr		102 000

Taxable temporary differences	\$960 000
Corporate tax rate	30%
Deferred tax liability at 30 June 2017	\$288 000

Journal entry for deferred tax:

Income Tax Expense	Dr	288 000
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Deferred Tax Liability	Cr	288 000
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PART B

LLOYD LTD
Statement of Profit or Loss and Other Comprehensive Income (EXTRACT)
for the year ended 30 June 2017

Profit before income tax	\$1 300 000
Income tax expense	<u>(390 000)</u>
Profit for the year	910 000

Note:

Income tax

(a) Major components of income tax expense

Current tax	\$102 000
Deferred tax from origination of temporary differences	<u>288 000</u>
Income Tax expense	<u>390 000</u>

COLE LTD

PART A

Taxable income	\$150 000
Corporate tax rate	30%
Current tax liability at 30 June 2017	\$45 000

Journal entry for current tax:

Income Tax Expense	Dr	45 000	
Current Tax Liability	Cr		45 000

Taxable temporary differences at 30 June 2017	\$306 000
Corporate tax rate	30%
Deferred tax liability at 30 June 2017	\$91 800
Deferred tax liability at 30 June 2016	<u>90 000</u>
Increase in Deferred tax liability for the year	\$ 1 800

Deductible temporary differences at 30 June 2017	\$70 000
Corporate tax rate	30%
Deferred tax asset at 30 June 2017	\$21 000
Deferred tax asset at 30 June 2016	<u>15 000</u>
Increase in Deferred tax asset for the year	\$ 6 000

Journal entry for deferred tax:

Deferred Tax Asset	Dr	6 000	
Deferred Tax Liability	Cr		1 800
Income Tax Expense	Cr		4 200

PART B

COLE LTD

Statement of Profit or Loss and Other Comprehensive Income (EXTRACT) for the year ended 30 June 2017

Profit before income tax	\$136 000
Income tax expense	<u>(40 800)</u>
Profit for the year	95 200

Note:

Income tax

(a) Major components of income tax expense

Current tax	\$45 000
Deferred tax from origination and reversal of temporary differences	<u>(4 200)</u>
Income Tax expense	<u>40 800</u>

Question 6.2 Current tax liability in four cases

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 four cases.

	Case 1	Case 2	Case 3	Case 4
Accounting profit (loss)	\$40 000	\$20 000	\$5 000	\$(10 000)
<i>After debiting as expense:</i>				
Goodwill impairment loss*	6 000	—	—	8 000
Entertainment costs*	—	6 000	7 000	—
Donation to political party*	1 000	3 000	—	—
Depreciation expense – plant	4 000	2 000	10 000	2 000
Long-service leave expense	600	600	600	1 200
<i>For tax purposes:</i>				
Tax depreciation for plant	8 000	4 000	20 000	4 000
Long-service leave paid	—	—	—	2 400
*These items are non-deductible for tax purposes.				

Assume a tax rate of 30%.

Case 1

Current Tax Worksheet

	\$	\$
Profit before income tax		40 000
<i>Add:</i>		
Goodwill impairment loss	6 000	
Donation to political party	1 000	
Depreciation expense	4 000	
Long service leave expense	600	11 600
		51 600
<i>Deduct:</i>		
Long service leave paid	-	
Tax depreciation	8 000	(8 000)
Taxable income		43 600
Current tax liability @ 30%		\$13 080

The journal entry is:

Income Tax Expense	Dr	13 080	
Current Tax Liability	Cr		13 080

Case 2**Current Tax Worksheet**

Profit before income tax	\$	\$ 20 000
<i>Add:</i>		
Entertainment costs	6 000	
Donation to political party	3 000	
Depreciation expense	2 000	
Long service leave expense	600	11 600
		31 600
<i>Deduct:</i>		
Long service leave paid	-	
Tax depreciation	4 000	(4 000)
Taxable income		27 600
Current tax liability @ 30%		\$8 280

The journal entry is:

Income Tax Expense	Dr	8 280	
Current Tax Liability	Cr		8 280

Case 3**Current Tax Worksheet**

Profit before income tax	\$	\$ 5 000
<i>Add:</i>		
Entertainment costs	7 000	
Depreciation expense	10 000	
Long service leave expense	600	17 600
		22 600
<i>Deduct:</i>		
Long service leave paid	-	
Tax depreciation	20 000	(20 000)
Taxable income		2 600
Current tax liability @ 30%		\$ 780

The journal entry is:

Income Tax Expense	Dr	780	
Current Tax Liability	Cr		780

Case 4

Current Tax Worksheet

Loss before income tax	\$	\$ (10 000)
<i>Add:</i>		
Goodwill impairment loss	8 000	
Depreciation expense	2 000	
Long service leave expense	1 200	11 200
		1 200
<i>Deduct:</i>		
Long service leave paid	2 400	
Tax depreciation	4 000	(6 400)
Tax loss		(5 200)
Current tax liability @ 30%		\$0

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

Deferred Tax Asset	Dr	1 560	
Income Tax Income	Cr		1 560

Question 6.3 Current tax worksheet and entries for current and deferred tax

At 30 June 2016, Grace Ltd had the following deferred tax balances:

Deferred tax liability	\$18 000
Deferred tax asset	15 000

Grace Ltd recorded a profit before tax of \$80 000 for the year to 30 June 2017, which included the following items:

Depreciation expense – plant	\$7 000
Doubtful debts expense	3 000
Long-service leave expense	4 000

For taxation purposes the following amounts are allowable deductions for the year to 30 June 2017:

Tax depreciation – plant	\$8 000
Bad debts written off	2 000

Depreciation rates for taxation purposes are higher than for accounting purposes. A corporate tax rate of 30% applies.

Required

- Prepare a current tax worksheet to determine the taxable income for the year to 30 June 2017.
- Determine by what amount the balances of the deferred liability and deferred tax asset will increase or decrease for the year to 30 June 2017 because of depreciation, doubtful debts and long-service leave.
- Prepare all journal entries to account for income tax assuming recognition criteria are satisfied.
- What are the balances of the deferred tax liability and deferred tax asset at 30 June 2017?

A.

**Current Tax Worksheet
for year ended 30 June 2017**

Profit before income tax		\$ 80 000
<i>Add:</i>		
Doubtful debts expense	3 000	
Depreciation expense - plant	7 000	
Long service leave expense	4 000	14 000
		94 000
<i>Deduct:</i>		
Bad debts written off	2 000	
Long service leave paid	-	
Tax depreciation - plant	8 000	(10 000)
Tax loss		84 000
Current tax liability @ 30%		\$25 200

B.

Deferred Tax for the Year

Tax depreciation greater than depreciation expense

- ⇒ Accumulated depreciation for tax purposes greater than for accounting purposes
- ⇒ The carrying amount of the depreciable asset is greater than the tax base
- ⇒ Deferred tax liability

$$\text{Increase in deferred tax liability} = (\$8\,000 - \$7\,000) \times 30\% = \$300$$

Doubtful debts expense greater than bad debts written off

- ⇒ Allowance for doubtful debts for accounting purposes but not tax purposes
- ⇒ The carrying amount of accounts receivable is less than the tax base
- ⇒ Deferred tax asset

$$\text{Increase in deferred tax asset} = (\$3\,000 - \$2\,000) \times 30\% = \$300$$

Long service leave expense greater than long service leave paid

- ⇒ provision for long service leave for accounting purposes but not tax purposes
- ⇒ The carrying amount of the liability is greater than the tax base
- ⇒ Deferred tax asset

$$\text{Increase in deferred tax asset} = (\$4\,000 - \$0) \times 30\% = \$1\,200$$

C.

Tax entries for 30 June 2017

The journal entry for current tax is:

Income Tax Expense	Dr	25 200	
Current Tax Liability	Cr		25 200

The journal entry for deferred tax is:

Deferred Tax Asset	Dr	1 500	
Deferred Tax Liability	Cr		300
Income Tax Expense	Cr		1 200

Current tax	\$25 200
Deferred tax from origination and reversal of temporary differences	(1 200)
Income Tax expense	<u>24 000</u>

D.

Deferred tax balances at 30 June 2017

Deferred Tax Liability			
	\$		\$
1/07/16		Beginning balance	18 000
30/06/17	Ending balance	Income tax expense	300
	<u>18 300</u>		<u>18 300</u>

Deferred Tax Asset			
		\$	\$
1/07/16	Beginning balance	15 000	
	Income tax expense	1 500	
		<u>16 500</u>	
30/06/17	Ending balance		<u>16 500</u>
			<u>16 500</u>

The balance of the deferred tax liability at 30 June 2017 indicates that the taxable temporary difference for depreciable assets is \$61 000 at 30 June 2017, that is, the carrying amount of the depreciable assets is \$61 000 greater than the tax base at 30 June 2017.

Taxable temporary difference 30/6/2017 x tax rate = deferred tax liability 30/6/2017
 \$61 000 x 30% = \$18 300

The balance of the deferred tax asset at 30 June 2017 indicates that the deductible temporary differences for accounts receivable and the provision for long service leave are \$55 000 at 30 June 2017.

Deductible temporary differences 30/6/2017 x tax rate = deferred tax asset 30/6/2017
 \$55 000 x 30% = \$16 500

Question 6.4 Current and deferred tax over three years

On 1 July 2014, Rich Ltd was incorporated. The accounting profit and other relevant information of Rich Ltd for the three years to 2017 are as follows:

	2017	2016	2015
Profit before tax	\$1 800 000	\$1 500 000	\$1 200 000
Warranty expense	—	—	500 000
Depreciation expense – plant	20 000	20 000	20 000
Gain on sale of plant for accounting	22 000	—	—
Warranty paid	250 000	250 000	—
Tax depreciation – plant	30 000	30 000	30 000
Gain on sale of plant for tax	52 000	—	—
Provision for warranty – carrying amount	—	250 000	500 000
Provision for warranty – tax base	—	—	—
Plant – carrying amount	—	60 000	80 000
Plant – tax base	—	40 000	70 000

The company tax rate is 30%.

Required

Calculate the current and deferred tax of Rich Ltd for each year, 2015, 2016 and 2017, and prepare the required tax journal entries for each year.

**Current Tax Worksheet
for the year ended 30 June 2015**

Accounting profit		\$1 200 000
<i>Add:</i>		
Warranty expense	500 000	
Depreciation expense - plant	20 000	520 000
		1 720 000
<i>Deduct:</i>		
Warranty paid	0	
Tax depreciation - plant	30 000	(30 000)
Taxable profit		1 690 000
Current tax liability @ 30%		\$507 000

**Deferred Tax Worksheet
as at 30 June 2015**

	Carrying Amount	Deductible Amount	Tax Base	Taxable Temp Diff	Deductible Temp Diff
Asset					
Plant	80 000	70 000	70 000	10 000	
Liability					
Provn for warranty	500 000	500 000	0		<u>500 000</u>
				<u>10 000</u>	<u>500 000</u>
DTL (30%)				3 000	
DTA (30%)					150 000
Beginning balance				<u>0</u>	<u>0</u>
Increase				<u>\$ 3 000</u>	<u>\$ 150 000</u>

The journal entry for current tax for the year to 30 June 2015 is:

Income Tax Expense	Dr	507 000	
Current Tax Liability	Cr		507 000

The journal entry for deferred tax for the year to 30 June 2015 is:

Deferred Tax Asset	Dr	150 000	
Deferred Tax Liability	Cr		3 000
Income Tax Expense	Cr		147 000

In the 30 June 2015 financial statements:

⇒ Income tax expense for the year \$360 000 (\$507 000 – \$147 000)

⇒ Current tax liability \$507 000

- ⇒ Deferred tax liability \$3 000
 ⇒ Deferred tax asset \$150 000

Current Tax Worksheet
for the year ended 30 June 2016

Accounting profit		\$1 500 000
<i>Add:</i>		
Warranty expense	0	
Depreciation expense - plant	20 000	20 000
		1 520 000
<i>Deduct:</i>		
Warranty paid	250 000	
Tax depreciation - plant	30 000	(280 000)
Taxable profit		1 240 000
Current tax liability @ 30%		\$ 372 000

Deferred Tax Worksheet
as at 30 June 2016

	Carrying Amount	Deductible Amount	Tax Base	Taxable Temp Diff	Deductible Temp Diff
Asset					
Plant	60 000	40 000	40 000	20 000	
Liability					
Provn for warranty	250 000	250 000	0		250 000
				<u>20 000</u>	<u>250 000</u>
DTL (30%)				6 000	
DTA (30%)					75 000
Beginning balance				<u>3 000</u>	<u>150 000</u>
Increase/(Decrease)				<u>\$ 3 000</u>	<u>\$ (75 000)</u>

The journal entry for current tax for the year to 30 June 2016 is:

Income Tax Expense	Dr	372 000	
Current Tax Liability	Cr		372 000

The journal entry for deferred tax for the year to 30 June 2016 is:

Income Tax Expense	Dr	78 000	
Deferred Tax Liability	Cr		3 000
Deferred Tax Asset	Cr		75 000

In the 30 June 2016 financial statements:

- ⇒ Income tax expense \$450 000 (\$372 000 + \$78 000)
 ⇒ Current tax liability \$372 000
 ⇒ Deferred tax liability \$6 000 (\$3 000 + \$3 000)
 ⇒ Deferred tax asset \$75 000 (\$150 000 – \$75 000)

Current Tax Worksheet
For the year ended 30 June 2017

Accounting profit		\$1 800 000
<i>Add:</i>		
Warranty expense	0	
Depreciation expense - plant	20 000	
Gain on sale for tax	52 000	72 000
		1 872 000
<i>Deduct:</i>		
Warranty paid	250 000	
Tax depreciation - plant	30 000	
Gain on sale for accounting	22 000	302 000
Taxable profit		1 570 000
Current tax liability @ 30%		\$ 471 000

Deferred Tax Worksheet
as at 30 June 2017

	Carrying Amount	Deductible Amount	Tax Base	Taxable Temp Diff	Deductible Temp Diff
Asset					
Plant	0	0	0	0	
Liability					
Provn for warranty	0	0	0	<u>0</u>	<u>0</u>
				0	0
DTL (30%)					
DTA (30%)					0
Beginning balance				<u>6 000</u>	<u>75 000</u>
Increase/(Decrease)				<u>\$(6 000)</u>	<u>\$ (75 000)</u>

The journal entry for current tax for the year to 30 June 2017 is:

Income Tax Expense	Dr	471 000	
Current Tax Liability	Cr		471 000

The journal entry for deferred tax for the year to 30 June 2017 is:

Income Tax Expense	Dr	69 000	
Deferred Tax Liability	Dr	6 000	
Deferred Tax Asset	Cr		75 000

In the 30 June 2017 financial statements:

- ⇒ Income tax expense \$540 000 (\$471 000 + \$69 000)
- ⇒ Current tax liability \$471 000
- ⇒ Deferred tax liability \$0 (\$6 000 – \$6 000)
- ⇒ Deferred tax asset \$0 (\$75 000 – \$75 000)

The total of the income tax expense and income tax paid for the three years is as follows:

	Income tax expense	Current tax liability (Tax paid for year)
30 June 2015	360 000	507 000
30 June 2016	450 000	372 000
30 June 2017	<u>540 000</u>	<u>471 000</u>
	\$1 350 000	\$1 350 000

In aggregate the income tax expense and income tax paid across the three years is equal because by the end of 30 June 2017, there are no outstanding temporary differences, that is, the temporary differences for plant and the provision for warranty have reversed in full.

Note how the origination of the deductible temporary difference for the provision reduces income tax expense for 30 June 2015. Then note how the reversal the deductible temporary difference for the provision increases income tax expense for 30 June 2016 and 30 June 2017.

The totals for income tax expense and income tax paid highlight how accounting for income tax is itself an application of accrual accounting. The expense is not based on the income tax to be paid for the period but the current and deferred tax that arises in the period.

Question 6.5 Tax bases and adjusting entries for deferred tax

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.
3. In calculating taxable income, the company has deducted \$50 000 of development expenditure incurred at the beginning of the year. For accounting purposes, the \$50 000 has been capitalised as an asset and is amortised on a straight-line basis over 5 years. The company is not entitled to any additional deduction above the 100% of costs incurred.
4. The company has an allowance for doubtful debts of \$8000 at the end of the year. The balance of the allowance account at the beginning of the year was \$5000. In the current period, \$10 000 was written off as being uncollectable. The gross amount of accounts receivable at the beginning and end of the year are \$62 000 and \$60 000 respectively.
5. The company has interest receivable of \$10 000 at the end of the year. No interest was receivable at the beginning of the year. Interest income is included in taxable profit only when received.
6. The company has revalued land at the end of the year. The land was revalued during the year from its original cost of \$90 000 to a fair value of \$150 000.
7. The company revalued plant at the beginning of the year from \$400 000 to \$500 000. The plant is being depreciated at the rate of 10% per year for accounting purposes and 5% per year for tax purposes.
8. The company has goodwill of \$200 000 at the end of the year. The goodwill has a tax base of \$Nil.

1. Depreciable asset

⇒ Carrying amount is \$80 000 (Cost \$100 000 – Accum Depn \$20 000)

⇒ Tax base \$70 000 (Cost \$100 000 – Accum Depn \$30 000)

The tax base is the future deductible amount for the asset.

⇒ Carrying amount > Tax base ⇒ Taxable temporary diff ⇒ Deferred tax liability

The carrying amount (\$80 000) exceeds the tax base (\$70 000) resulting in a taxable temporary difference of \$10 000. A deferred tax liability of \$3 000 must be recognised as follows:

Income Tax Expense	Dr	3 000	
Deferred Tax Liability	Cr		3 000

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 of 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. This results in the origination of a taxable temporary difference and deferred tax liability. 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

⇒ Carrying amount is \$155 000

⇒ Tax base is \$0

The tax base is the carrying amount less future deductible amount of the liability.

⇒ Carrying amount > Tax base ⇒ Deductible temporary diff ⇒ Deferred tax asset

At the beginning of the current year, a balance in the provision for long service leave account is \$160 000 and the deductible temporary difference is \$160 000. Therefore the deferred tax asset account has a balance of \$48 000 at the beginning of the year (\$160 000 x 30%)

At the end of the current year, the provision account and deductible temporary difference amount to \$155 000 and the deferred tax asset balance must be \$46 500 (\$155 000 x 30%) Hence, the deferred tax asset account decreases by \$1 500 in the current year. The entry to record the decrease is:

Income Tax Expense	Dr	1 500	
Deferred Tax Asset	Cr		1 500

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.

Long service leave is usually accrued in the accounting records *before* any tax deduction can be claimed. Tax deductions are available on payment of long service leave to particular employees. Hence prior to any payment for long serve leave, the company would have established a deferred tax asset for deductible temporary differences, representing future tax deductions available to the company.

3. Development asset

⇒ Carrying amount is \$40 000 (Cost \$50 000 – Accum Amortisation \$10 000)

⇒ Tax base is \$0

The tax base is the future deductible amount for the asset.

⇒ Carrying amount > Tax base ⇒ Taxable temporary diff ⇒ Deferred tax liability

At the end of the year, the asset carrying amount (\$40 000) and its tax base (\$0) result in a taxable temporary difference of \$40 000, and a deferred tax liability of \$12 000 (\$40 000 x 30%), which is recognised in the following entry:

Income Tax Expense	Dr	12 000	
Deferred Tax Liability	Cr		12 000

The company has claimed the development expenditure of \$50 000 as a tax deduction when paid, but it has been treated as an asset for accounting purposes under AASB 138 and amortised over time. Hence, tax deductions *exceed* the accounting expense for the

development costs in the current year. In future years, it is anticipated that future taxable amounts will emanate from the development asset and result in additional tax to be paid.

4. **Accounts receivable**

⇒ Carrying amount is \$52 000 (Gross \$60 000 – Allowance \$8 000)

⇒ Tax base is \$60 000

The tax base is the gross amount of the asset as it does not generate future taxable amounts

⇒ Tax base > Carrying amount ⇒ Deductible temporary diff ⇒ Deferred tax asset

The carrying amount of accounts receivables at the beginning of the year is \$57 000 (\$62 000 - \$5 000) and the tax base is \$62 000 resulting in a deductible temporary difference of \$5 000 and deferred tax asset of \$1 500 (\$5 000 x 30%).

At the end of the year, the carrying amount of accounts receivable is \$52 000 and the tax base is \$60 000 resulting in a deductible temporary difference of \$8 000 and deferred tax asset of \$2 400 (\$8 000 x 30%).

Hence, the deferred tax asset must be increased from \$1 500 to \$2 400 as follows:

Deferred Tax Asset	Dr	900	
Income Tax Expense	Cr		900

The allowance is the source of the deductible temporary difference for accounts receivable. Doubtful debts expense and the allowance are recognised for accounting purposes but not tax purposes. Only debts written off accounts receivable are deductible. The allowable tax deduction for bad debts written off in the current period is equal to \$10 000, and the expense for accounting is the total amount credited to the allowance account for doubtful debts, \$13 000, an increase in the allowance account of \$3 000.

5. **Interest receivable**

⇒ Carrying amount is \$10 000

⇒ Tax base is \$0

The tax base is the future deductible amount for the asset

⇒ Carrying amount > Tax base ⇒ Taxable temporary diff ⇒ Deferred tax liability

At the end of the year, the asset carrying amount (\$10 000) and its tax base (\$0) result in a taxable temporary difference of \$10 000, and a deferred tax liability of \$3 000 (\$10 000 x 30%), which is recognised in the following entry:

Income Tax Expense	Dr	3 000	
Deferred Tax Liability	Cr		3 000

Interest received rather than interest revenue is subject to tax. Interest receivable indicates that in a future period interest will be received and increase the taxable profit and tax paid. Hence, interest receivable results in the recognition of a deferred tax liability.

6. **Revalued land**

⇒ Carrying amount is \$150 000

⇒ Tax base is \$90 000

The tax base is the future deductible amount for the asset based on cost.

⇒ Carrying amount > Tax base ⇒ Taxable temporary diff ⇒ Deferred tax liability

At the end of the year, the asset carrying amount (\$150 000) and its tax base (\$90 000) result in a taxable temporary difference of \$60 000 and a deferred tax liability of \$18 000 (\$60 000 x 30%), which is recognised in the following entry:

Tax on revaluation increment (OCI)	Dr	18 000	
Deferred Tax Liability	Cr		18 000

The tax on the revaluation of the land is recognised in other comprehensive income consistent with the recognition of the \$60 000 revaluation increment on the land. In a future period, if the land was sold for its carrying amount of \$150 000 this would give rise to a capital gain of \$60 000 for taxation purposes and increase the taxable profit and tax paid. Hence, the revaluation of the land above its original cost results in the recognition of a deferred tax liability.

7. **Revalued plant**

⇒ Carrying amount is \$450 000 (Fair value \$500 000 – Accum Depn \$50 000)

⇒ Tax base is \$380 000 (Cost \$400 000 – Accum Depn \$20 000)

The tax base is the future deductible amount for the asset based on cost.

⇒ Carrying amount > Tax base ⇒ Taxable temporary diff ⇒ Deferred tax liability

At the end of the year, the asset carrying amount (\$450 000) and its tax base (\$380 000) result in a taxable temporary difference of \$70 000 and a deferred tax liability of \$21 000 (\$70 000 x 30%), which is recognised in the following entry:

Tax on revaluation increment (OCI)	Dr	30 000	
Income tax expense	Cr		9 000
Deferred Tax Liability	Cr		21 000

The tax on the revaluation increment for the plant is \$30 000 (\$100 000 x 30%) and must be recognised in other comprehensive income. However, the tax on depreciation effect on the carrying amount and tax base of the asset is recognised in the profit or loss. The tax depreciation is \$20 000 whereas the depreciation expense is \$50 000. This reduces the taxable temporary difference for the plant by \$30 000 and the deferred tax liability by \$9 000 (\$30 000 x 30%)

8. **Goodwill**

⇒ Carrying amount is \$200 000

⇒ Tax base is \$0

The tax base is the future deductible amount for the asset

⇒ Carrying amount > Tax base ⇒ Taxable temporary diff ⇒ Deferred tax liability

Goodwill is an excluded taxable temporary difference by virtue of paragraph 15 of AASB 112 otherwise it would result in the recognition of a deferred tax liability.

Question 6.6 Current and deferred tax worksheets and tax entries

You have been asked by the management of My Bag Ltd to assist with the preparation of the income tax entries for the year ended 30 June 2017. The company reported a profit before tax for the year to 30 June 2017 of \$900 000. The company's statements of financial position include assets and liabilities as follows:

	2017	2016
Accounts receivable	\$ 245 000	\$ 200 000
Allowance for doubtful debts	(20 000)	(10 000)
Plant – at cost	600 000	600 000
Accumulated depreciation	(190 000)	(120 000)
Development asset – at cost	360 000	200 000
Accumulated amortisation	(130 000)	(80 000)
Interest receivable	10 000	20 000
Provision for long-service leave	48 000	62 000
Deferred tax asset	?	21 600
Deferred tax liability	?	60 000

- (a) The company is entitled to claim a tax deduction of 125% on development costs when incurred.
- (b) Interest revenue of \$10 000 is included in the profit for the year to 30 June 2017.
- (c) Expenses included in profit for the year to 30 June 2017 are as follows:
- parking and other fines \$10 000
 - depreciation expense for plant \$70 000
 - doubtful debts expense \$25 000
 - amortisation of development asset \$50 000
 - long-service leave expense \$36 000.
- (d) Accumulated depreciation on plant for tax purposes is \$280 000 on 30 June 2017 and \$180 000 on 30 June 2016. There have been no acquisitions or disposals of plant during the current year.
- (e) The corporate tax rate is 30%.

Required

Complete the current tax and deferred tax worksheets of My Bag Ltd and prepare the tax entries for 30 June 2017.

**Current Tax Worksheet
for the year ended 30 June 2017**

Accounting profit		\$900 000
<i>Add:</i>		
Parking and other fines	\$10 000	
Depreciation expense - plant	70 000	
Doubtful debts expense	25 000	

Amortisation – development asset	50 000	
Long service leave expense	36 000	
Interest received	20 000	211 000
<i>Less:</i>		
Tax depreciation - plant	100 000	
Bad debts written off	15 000	
Development costs paid	160 000	
Additional deduction for development costs	40 000	
Long service leave paid	50 000	
Interest revenue	10 000	375 000
Taxable profit		736 000
Current tax liability @ 30%		\$220 800

The journal entry for current tax for the year to 30 June 2017 is as follows:

Income Tax Expense	Dr	220 800	
Current Tax Liability	Cr		220 800

Workings

Interest receivable				
		\$		\$
1/07/16	Beginning balance	20 000		Interest received 20 000
	Interest revenue	10 000	30/06/17	Ending balance
		<u>30 000</u>		<u>10 000</u>
				<u>30 000</u>

Development asset - at cost				
		\$		\$
1/07/16	Beginning balance	200 000		
	Develop costs paid	160 000	30/06/17	Ending balance
		<u>360 000</u>		<u>360 000</u>
				<u>360 000</u>

Additional deduction for development costs = 25% x \$160 000 = \$40 000

Allowance for doubtful debts					
		\$			\$
	Bad debts write off	15 000	1/07/16	Beginning balance	10 000
30/06/17	Ending balance	20 000		Doubt debts expense	25 000
		<u>35 000</u>			<u>35 000</u>

Provision for long service leave					
		\$			\$
	LSL paid	50 000	1/07/16	Beginning balance	62 000
30/06/17	Ending balance	48 000		LSL expense	36 000
		<u>98 000</u>			<u>98 000</u>

Accumulated depreciation – for tax purposes					
		\$			\$
			1/07/16	Beginning balance	180 000
30/06/17	Ending balance	280 000		Tax depreciation	100 000
		<u>280 000</u>			<u>280 000</u>

Deferred tax worksheet as at 30 June 2017

	Carrying Amount	Future Deductible Amount	Tax Base		Taxable Temporary Differences	Deductible Temporary Differences
<u>Assets</u>						
Accounts receivable (net)	225 000	0	245 000	[2]		20 000
Plant (net)	410 000	320 000	320 000	[1]	90 000	
Development asset (net)	230 000	0	0	[1]	230 000	
Interest receivable	10 000	0	0	[1]	10 000	
<u>Liabilities</u>						
Provision for LSL	48 000	48 000	0	[1]		48 000
Total Temporary Diffs					330 000	68 000
Deferred tax liability 30%					99 000	
Deferred tax asset 30%						20 400
Beginning balances					60 000	21 600
Increase/(Decrease)					39 000	(1 200)

Tax Bases

Assets that generate future taxable economic benefits: [1] Tax Base = Future deductible amount

Assets that do not generate future taxable economic benefits: [2] Tax Base = Carrying amount

Liabilities except unearned revenue: [1] Tax Base = Carrying amount less Future deductible amount

Liability of unearned revenue: [2] Tax Base = Carrying amount – Untaxed future revenue

The journal entry for the deferred tax for the year to 30 June 2017 is as follows:

Income Tax Expense	Dr	40 200	
Deferred Tax Liability	Cr		39 000
Deferred Tax Asset	Cr		1 200

Question 6.7 Current and deferred tax worksheets and tax entries

You are the accountant of Brand New Friend Ltd, a reporting entity with a year end of 30 June 2017. You are currently preparing the tax information for inclusion in the financial statements. An extract from the statement of profit or loss and other comprehensive income is as follows:

Profit before tax	<u>\$ 500 000</u>
Included in the profit:	
Employee expenses	550 000
Legal expenses	125 000
Exempt income	75 000
Interest revenue	30 000
Audit fees expense	80 000
Rent revenue	20 000
Interest expense	20 000
Bad debts expense	30 000
Depreciation expense – plant and equipment	52 500
Depreciation expense – buildings	10 000
Entertainment expenses	5 000

Additional information

- (a) Exempt income is not subject to tax.
- (b) Interest is assessable on receipt and deductible when paid. Interest receivable at 30 June 2017 is \$25 000 (2016: \$30 000). Interest payable at 30 June 2017 is \$1000 (2016: \$6000).
- (c) The company raised an accrual liability of \$35 000 for work not performed by 30 June 2017 (2016: \$30 000). Fees for audit work are not deductible unless the audit work has been performed.
- (d) Rent revenue relates to a contract where the annual rent is received in advance. The unearned revenue liability at 30 June 2017 is \$20 000 (2016: \$15 000). Rent is assessable when received.
- (e) The bad debts expense relates to an account that has been written off.
- (f) Property, plant and equipment is as follows:

Property, plant and equipment	30 June 2017	30 June 2016
Buildings at cost	\$ 500 000	\$ 500 000
Accumulated depreciation – buildings	<u>(50 000)</u>	<u>(40 000)</u>
	450 000	460 000
Plant and equipment at cost	350 000	150 000
Accumulated depreciation – plant and equipment	<u>(97 500)</u>	<u>(45 000)</u>
	252 500	105 000
	<u>\$ 702 500</u>	<u>\$ 565 000</u>

The company's buildings do not qualify for tax deductions and are not subject to capital gains tax.

Tax depreciation for 30 June 2017 is \$70 000. The tax written down value of plant and equipment at 30 June 2017 is \$220 000 (2016: \$90 000).

- (g) Entertainment expenses are not deductible.
 (g) Legal expenses include \$50 000 related to capital transactions that are not deductible.
 (h) Employee expenses for the year include \$50 000 for annual leave and \$10 000 for long-service leave. The provision for employee benefits at 30 June 2017 is \$180 000 (2016: \$170 000).
 (i) The deferred tax balances at 30 June 2016 are: deferred tax liability \$13 500 and deferred tax asset \$66 300.
 (j) The company tax rate is 30%.

Required

Complete the current and deferred tax worksheets of Brand New Friend Ltd for 30 June 2017 and use the worksheets to prepare the tax entries for the year.

**Current Tax Worksheet
for the year ended 30 June 2017**

Accounting profit		\$500,000
<i>Add:</i>		
Legal expenses (non-deductible)	\$50 000	
Entertainment expenses	5 000	
Depreciation expense - buildings	10 000	
Depreciation expense – plant and equip	52 500	
Interest expense	20 000	
Audit fees expense	80 000	
Employee leave expenses (A/L & LSL)	60 000	
Rent received	25 000	
Interest received	35 000	337 500
<i>Less:</i>		
Exempt income	75 000	
Rent revenue	20 000	
Interest revenue	30 000	
Interest paid	25 000	
Tax depreciation – plant & equip	70 000	
Audit fees deduction	75 000	
Leave paid to employees	50 000	345 000
Taxable profit		492 500

Current tax liability @ 30%		\$147 750
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The journal entry for current tax for the year to 30 June 2017 is as follows:

Income Tax Expense	Dr	147 750	
Current Tax Liability	Cr		147 750

Workings

		Interest receivable	
		\$	\$
1/07/16	Beginning balance	30 000	Interest received 35 000
	Interest revenue	30 000	30/06/17 Ending balance 25 000
		<u>60 000</u>	<u>60 000</u>

		Interest payable	
		\$	\$
	Interest paid	25 000	1/07/16 Beginning balance 6 000
30/06/17	Ending balance	1 000	Interest expense 20 000
		<u>20 000</u>	<u>26 000</u>

		Unearned rent revenue			
		\$			\$
30/06/17	Rent revenue	20 000	1/07/16	Beginning balance	15 000
	Ending balance	20 000		Rent received	25 000
		40 000			40 000

Provision for employee benefits					
		\$			\$
	LSL paid	50 000	1/07/16	Beginning balance	170 000
30/06/17	Ending balance	180 000		Leave expenses	60 000
		230 000			230 000

Deferred tax worksheet as at 30 June 2017

	Carrying Amount	Future Deductible Amount	Tax Base		Taxable Temporary Differences	Deductible Temporary Differences
<u>Assets</u>						
Interest receivable	25 000	0	0	[1]	25 000	
Plant and equip (net)	252 500	220 000	220 000	[1]	32 500	
<u>Liabilities</u>						
Accrued audit fees	35 000	35 000	0	[1]		35 000
Interest payable	1 000	1 000	0	[1]		1 000
Provision emp benefits	180 000	180 000	0	[1]		180 000
Unearned rent revenue	20 000	20 000	0	[2]		20 000
Total Temporary Diffs					57 500	236 000
Deferred tax liability 30%					17 250	
Deferred tax asset 30%						70 800
Beginning balances					13 500	66 300
Increase for the year					3 750	4 500

Tax Bases

Assets that generate future taxable economic benefits: [1] Tax Base = Future deductible amount

Assets that do not generate future taxable economic benefits: [2] Tax Base = Carrying amount

Liabilities except unearned revenue: [1] Tax Base = Carrying amount less Future deductible amount

Liability of unearned revenue: [2] Tax Base = Carrying amount – Untaxed future revenue

The journal entry for deferred tax for the year to 30 June 2017 is as follows:

Deferred Tax Asset	Dr	4 500	
Deferred Tax Liability	Cr		3 750
Income Tax Expense	Cr		750

*Proof of the opening deferred tax balances at 1 July 2016***Deferred tax worksheet as at 30 June 2016**

	Carrying Amount	Future Deductible Amount	Tax Base		Taxable Temporary Differences	Deductible Temporary Differences
<u>Assets</u>						
Interest receivable	30 000	0	0	[1]	30 000	
Plant and equip (net)	105 000	90 000	90 000	[1]	15 000	
<u>Liabilities</u>						
Accrued audit fees	30 000	30 000	0	[1]		30 000
Interest payable	6 000	6 000	0	[1]		6 000
Provision emp benefits	170 000	170 000	0	[1]		170 000
Unearned rent revenue	15 000	15 000	0	[2]		15 000
Total Temporary Diffs					45 000	221 000
Deferred tax liability 30%					13 500	
Deferred tax asset 30%						66 300

The increase in the deferred tax asset for 2016-2017 is attributable to the following

Increase in accrued audit fees	5 000
Increase in provision for employee benefits	10 000
Increase in unearned rent revenue	5 000
Decrease in interest payable	(5 000)
	15 000 x 30% = \$4 500

The increase in the deferred tax liability for 2016-2017 is attributable to the following:

Increase in the difference between tax and accounting written down value of plant	17 500
Decrease in interest receivable	(5 000)
	12 500 x 30% = \$3 750

Question 6.8 Deferred tax worksheets and tax entries

Pretty Gone Ltd commenced operations on 1 July 2015. Extracts from the statements of financial position of Pretty Gone Ltd as at 30 June 2017 and 30 June 2016 are as follows:

PRETTY GONE LTD Statement of Financial Position as at 30 June		
	2017	2016
Assets		
Cash	\$ 65 000	\$ 52 000
Accounts receivable	885 000	858 000
Allowance for doubtful debts	(80 000)	(70 000)
Inventory	640 000	749 000
Prepaid insurance	40 000	30 000
Dividends receivable	36 000	21 000
Plant and equipment – at cost	1 240 000	918 000
Accumulated depreciation – plant and equipment	(380 000)	(315 000)
Goodwill	78 000	78 000
Shares in listed companies at cost	140 000	110 000
Deferred tax asset	?	60 000
Liabilities		
Bank overdraft	209 300	175 500
Accounts payable	191 100	156 000
Current tax liability	50 985	46 270
Provision for employee benefits	137 800	130 000
Provision for dividend	65 000	52 000
Borrowings	—	260 000
Deferred tax liability	?	28 800

Additional information

- Accumulated depreciation based on tax depreciation is \$485 000 at 30 June 2017 and \$360 000 at 30 June 2016. There have been no disposals of plant during the year to 30 June 2017.
- Deferred tax liabilities and assets are not netted off in the statement of financial position.
- The corporate tax rate is 30%.

Required

- Prepare the deferred tax worksheet at 30 June 2016 to prove that the deferred tax liability and asset balances are \$28 800 and \$60 000 respectively.
- Prepare the deferred tax worksheet at 30 June 2017 to determine the deferred tax entries for the year.
- Assume that the company made a profit before tax of \$700 000 for the year to 30 June 2017 and that the differences between accounting profit and taxable profit are apparent from items shown in the statement of financial position and its comparative. Prepare the condensed current tax worksheet for the year to 30 June 2017 and the current tax entries for the year.

Part A

Deferred Tax Worksheet
as at 30 June 2016

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
	\$	\$	\$		\$	\$
<u>Assets</u>						
Cash	52 000	0	52 000	[2]	0	0
A/cs Receivable	788 000	0	858 000	[2]	0	70 000
Inventory	749 000	749 000	749 000	[1]	0	0
Prepaid insurance	30 000	0	0	[1]	30 000	0
Dividend receivable	21 000	0	0	[1]	21 000	0
Plant & equip	603 000	558 000	558 000	[1]	45 000	0
Goodwill	78 000	0	0	[1]	78 000	0
Shares in other companies	110 000	110 000	110 000	[1]	0	0
<u>Liabilities</u>						
Bank overdraft	175 500	0	175 500	[1]	0	0
A/cs payable	156 000	0	156 000	[1]	0	0
Current tax liability	46 270	0	46 270	[1]	0	0
Provision for employee benefits	130 000	130 000	0	[1]	0	130 000
Provision for dividend	52 000	0	52 000	[1]	0	0
Borrowings	260 000	0	260 000	[1]	0	0
Total temporary differences					174 000	200 000
Excluded differences					78 000	0
Temp differences for deferred tax					96 000	200 000
Deferred tax liability (30%)					28 800	
Deferred tax asset (30%)						60 000

Tax Bases

Assets that generate future taxable economic benefits: [1] Tax Base = Future deductible amount

Assets that do not generate future taxable economic benefits: [2] Tax Base = Carrying amount

Liabilities except unearned revenue: [1] Tax Base = Carrying amount less Future deductible amount

Liability of unearned revenue: [2] Tax Base = Carrying amount – Untaxed future revenue

Plant and equipment for tax purposes = Cost less Accum depn = 918 000 – 360 000 = \$558 000

Part B

Deferred Tax Worksheet
as at 30 June 2017

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
	\$	\$	\$		\$	\$
<u>Assets</u>						
Cash	65 000	0	65 000	[2]	0	0
A/cs Receivable	805 000	0	885 000	[2]	0	80 000
Inventory	640 000	64 000	640 000	[1]	0	0
Prepaid insurance	40 000	0	0	[1]	40 000	0
Dividend receivable	36 000	0	0	[1]	36 000	0
Plant & equip	860 000	755 000	755 000	[1]	105 000	0
Goodwill	78 000	0	0	[1]	78 000	0
Shares in other companies	140 000	140 000	140 000	[1]	0	0
<u>Liabilities</u>						
Bank overdraft	209 300	0	209 300	[1]	0	0
A/cs payable	191 100	0	191 100	[1]	0	0
Current tax liability	50 985	0	50 985	[1]	0	0
Provision for employee benefits	137 800	137 800	0	[1]	0	137 800
Provision for dividend	65 000	0	65 000	[1]	0	0
Total temporary differences					259 000	217 800
Excluded differences					78 000	0
Temp differences for deferred tax					181 000	217 800
Deferred tax liability (30%)					54 300	
Deferred tax asset (30%)						65 340
Begin Balances					28 800	60 000
Increase for year					25 500	5 340

The entries to record the deferred tax for the year ended 30 June 2017 are:

Income Tax Expense	Dr	20 160	
Deferred Tax Asset	Dr	5 340	
Deferred Tax Liability	Cr		25 500

Part C

Current Tax Worksheet (Condensed)
for the year ended 30 June 2017

Accounting profit		\$700,000
<i>Add:</i>		
Depreciation expense – plant & equip [380 000 – 315 000]	65 000	
Increase in allowance for doubtful debts	10 000	
Increase in provision for employee benefits	7 800	82 800
<i>Less:</i>		
Tax depreciation – plant & equip [485 000 – 360 000]	125 000	
Increase in prepaid insurance	10 000	
Increase in dividends receivable	15 000	150 000
Taxable profit		632 800
Current tax liability @ 30%		\$189 840

The entries to record the current tax for the year ended 30 June 2017 are:

Income Tax Expense	Dr	189 840	
Current Tax Liability	Cr		189 840

Additional Explanations for Current Tax Worksheet

Increase in allowance for doubtful debts $\Rightarrow$ Doubtful debts expense > Bad debts w/o
 $\Rightarrow$ Add back the increase

Increase in provision for employee benefits $\Rightarrow$ Benefits expense > Benefits paid
 $\Rightarrow$ Add back the increase

Increase in prepaid insurance $\Rightarrow$ Insurance paid > Insurance expense
 $\Rightarrow$ Deduct the increase

Increase in dividends receivable $\Rightarrow$ Dividend revenue > Dividend received
 $\Rightarrow$ Deduct the increase

Additional Explanations for Deferred Tax Worksheet

The deferred tax worksheets shown in the solution for this question are comprehensive because all assets and liabilities are included. But we would still get the same answer if we ignored the assets and liabilities that do not have any future tax consequences as follows:

- Cash
- Inventory
- Goodwill (an excluded temporary difference)
- Shares in listed companies
- Bank overdraft
- Accounts payable
- Current tax liability
- Provision for dividend
- Borrowings

The increase in the deferred tax asset for 2016-2017 is attributable to the following

Increase in provision for employee benefits	7 800
Increase in allowance for doubtful debts	<u>10 000</u>
	17 800 x 30% = \$5 340

The increase in the deferred tax liability for 2016-2017 is attributable to the following:

Increase in prepaid insurance	10 000
Increase in dividends receivable	15 000
Increase in the difference between tax and accounting written down value of plant	<u>60 000</u>
	85 000 x 30% = \$25 500

	Accounting	Tax	Difference
Plant (net) 2017	860 000	755 000	105 000
Plant (net) 2016	603 000	558 000	<u>45 000</u>
Increase in Difference			<u>60 000</u>

Question 6.9 Deferred tax worksheets and tax entries

The financial statements of Forest Fire Ltd for the year ended 30 June 2017 showed a profit before tax of \$480 000. The profit includes non-deductible expenses of \$20 000.

Extracts from the statements of financial position of the company as at 30 June 2017 and 30 June 2016 are as follows:

FOREST FIRE LTD		
Statement of Financial Position (Extract)		
as at 30 June		
	2017	2016
Assets		
Cash	\$ 150 000	\$ 180 000
Inventories	96 000	85 000
Allowance for obsolescence	(7 000)	(5 200)
Prepaid rent	50 000	56 000
Plant	140 000	170 000
Accumulated depreciation – plant	(32 000)	(28 000)
Land	200 000	100 000
Deferred tax asset	?	19 470
Liabilities		
Trade payables	68 000	76 000
Unearned service revenue	60 000	50 000
Provision for annual leave	15 200	9 700
Deferred tax liability	?	18 900

Additional information

- (a) The accumulated depreciation on plant for tax purposes was \$47 000 at 30 June 2017 (2016: \$35 000).
- (b) On 30 June 2017, the company's land was revalued from the historical cost of \$100 000 to its fair value of \$200 000.
- (c) The corporate tax rate is 30%.

Required

- A. Prepare the condensed current tax worksheet for the year to 30 June 2017 and the current tax entries for the year.
- B. Prepare the deferred tax worksheet at 30 June 2016 to prove that the deferred tax liability and asset balances are \$18 900 and \$19 470 respectively.
- C. Prepare the deferred tax worksheet at 30 June 2017 and the deferred tax entries for the year.
- D. Prepare the statement of profit or loss and other comprehensive income for the year ended 30 June 2017.

Part A

Current Tax Worksheet (Condensed) for the year ended 30 June 2017

Accounting profit		\$480 000
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<i>Add:</i>		
Non-deductible expenses	20 000	
Depreciation expense – plant & equip [32 000 – 28 000]	4 000	
Increase in allowance for obsolescence	1 800	
Decrease in prepaid rent	6 000	
Increase in unearned service revenue	10 000	
Increase in provision for annual leave	5 500	47 300
<i>Less:</i>		
Tax depreciation – plant & equip [47 000 – 35 000]	12 000	12 000
Taxable profit		515 300
Current tax liability @ 30%		\$154 590

The entries to record the current tax for the year ended 30 June 2017 are:

Income Tax Expense	Dr	154 590	
Current Tax Liability	Cr		154 590

Additional Explanations for Current Tax Worksheet

Increase in allowance for obsolescence $\Rightarrow$ Inventory expense > Inventory written off
 $\Rightarrow$ Add back the increase

Decrease in prepaid rent $\Rightarrow$ Rent expense > Rent paid
 $\Rightarrow$ Add back the increase

Increase in unearned revenue $\Rightarrow$ Cash received for services > Service revenue
 $\Rightarrow$ Add back the increase

Increase in provision for annual leave $\Rightarrow$ Leave expense > Leave paid
 $\Rightarrow$ Add back the increase

Part B

Deferred Tax Worksheet
as at 30 June 2016

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
	\$	\$	\$		\$	\$
<u>Assets</u>						
Cash	180 000	0	180 000	[2]	0	0
Inventories	79 800	85 000	85 000	[1]	0	5 200
Prepaid rent	56 000	0	0	[1]	56 000	0
Plant	142 000	135 000	135 000	[1]	7 000	0
Land	100 000	100 000	100 000	[1]	0	0
<u>Liabilities</u>						
Trade payables	76 000	0	76 000	[1]	0	0
Unearned revenue	50 000	50 000	0	[2]	0	50 000
Provision for annual leave	9 700	9 700	0	[1]	0	9 700
Total Temporary Differences					63 000	64 900
Deferred tax liability (30%)					18 900	
Deferred tax asset (30%)						19 470

Tax Bases

Assets that generate future taxable economic benefits: [1] Tax Base = Future deductible amount

Inventories deductible amount is at cost = 85 000

Prepaid rent deduction already claimed so deductible amount = \$0

Plant and equipment deductible amount at tax written down value = 170 000 – 35 000 = 135 000

Land deductible amount at cost = 100 000

Assets that do not generate future taxable economic benefits: [2] Tax Base = Carrying amount

Cash = 180 000

Liabilities except unearned revenue: [1] Tax Base = Carrying amount less Future deductible amount

Trade payables = 76 000 – 0 = 76 000

Provision for annual leave = 9 700 – 9 700 = 0

Liability of unearned revenue: [2] Tax Base = Carrying amount – Untaxed future revenue

Unearned service revenue = 50 000 – 50 000 = 0

Part C

Deferred Tax Worksheet

as at 30 June 2017

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
	\$	\$	\$		\$	\$
Assets						
Cash	150 000	0	150 000	[2]	0	0
Inventories	89 000	96 000	96 000	[1]	0	7 000
Prepaid rent	50 000	0	0	[1]	50 000	0
Plant	108 000	93 000	93 000	[1]	15 000	0
Land	200 000	100 000	100 000	[1]	100 000	0
Liabilities						
Trade payables	68 000	0	68 000	[1]	0	0
Unearned revenue	60 000	60 000	0	[2]	0	60 000
Provision for annual leave	15 200	15 200	0	[1]	0	15 200
Total Temporary Differences					165 000	82 200
Deferred tax liability (30%)					49 500	
Deferred tax asset (30%)						24 660
Begin Balances					18 900	19 470
Increase for year					30 600	5 190
OCI*					30 000	0
Profit or loss					600	5 190
					30 600	5 190

* Deferred tax included in other comprehensive income

Revaluation increment on land for the period $\$100\,000 \times 30\% = \$30\,000$

The entries to record the deferred tax in profit or loss for the year ended 30 June 2017 are:

Deferred Tax Asset	Dr	5 190	
Deferred Tax Liability	Cr		600
Income Tax Expense	Cr		4 590

The entries to record the deferred tax in other comprehensive income for the year ended 30 June 2017 are:

Tax on revaluation (OCI)	Dr	30 000	
Deferred Tax Liability	Cr		30 000

Additional Explanations for Deferred Tax Worksheet

The increase in the deferred tax asset for 2016-2017 is attributable to the following:

Increase in allowance for obsolescence	1 800
Increase in provision for annual leave	5 500
Increase in unearned service revenue	<u>10 000</u>
	17 300 x 30% = \$5 190

The increase in the deferred tax liability for 2016-2017 is attributable to the following:

Decrease in prepaid rent	(6 000)
Increase in the difference between tax and accounting written down value of plant	<u>8 000</u>
	2 000 x 30% = \$ 600

Increase in land	100 000 x 30% = \$ 30 000
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	Accounting	Tax	Difference
Plant (net) 2017	142 000	135 000	7 000
Plant (net) 2016	108 000	93 000	<u>15 000</u>
Increase in Difference			<u>8 000</u>

Part D

FOREST FIRE LTD
Statement of Comprehensive Income
for the year ended 30 June 2017

Profit for the year		\$330 000
Other comprehensive income:		
Revaluation of land	\$100 000	
Tax on revaluation of land	<u>(30 000)</u>	<u>70 000</u>
Comprehensive income for the year		<u>\$400 000</u>

Working

Profit before income tax		\$480 000
Less: Income tax expense		
current tax journal	154 590	
deferred tax journal	<u>(4 590)</u>	<u>150 000</u>
Profit for the year		<u>\$330 000</u>

Question 6.10 Current and deferred tax worksheets and tax entries

Fromthehip Ltd's statement of profit or loss for the year ended 30 June 2007 and extracts from its statements of financial position as at 30 June 2017 and 30 June 2016 are shown below. The statements for the current year are yet to be finalised by accounting for income tax.

FROMTHEHIP LTD
Statement of Profit or Loss
for the year ending 30 June

Income**Service revenue****\$ 900 000****Rent revenue****50 000****Insurance claim for loss of profits**
41 200
991 200
Less: Expenses**Employee expenses****660 000****Insurance expense****50 000****Accounting fees****5 500****Bad and doubtful debts**

	19 500
Cleaning and maintenance	3 250
Depreciation of equipment	5 500
Entertainment expenses	4 000
Interest on borrowings	75 000
Legal fees	3 800
Motor vehicle expenses	6 000
Other	3 750
Restructuring costs	<u>23 000</u>
	<u>859 300</u>
<i>Profit before tax</i>	<u>\$ 131 900</u>

FROMTHEHIP LTD
Statement of Financial Position (Extract)
as at 30 June

	2017	2016
Assets		
Cash at bank	\$ 900 100	\$ 800 100
Trade debtors	240 550	200 000
Allowance for doubtful debts	(38 000)	(20 000)
Prepaid insurance	10 950	5 000
Land – at fair value	450 000	300,000
Equipment – at cost	58 000	58 000
Accumulated depreciation	(24 500)	(19 000)
Other debtors	142 400	—
Deferred tax asset	?	18 000
Liabilities		

Trade creditors	239 000
	245 000
Borrowings	543 800
	438 500
Unearned rent revenue	50 000
	—
Provision for employee benefits	49 500
	40 000
Provision for restructuring	23 000
	—
Other creditors	10 000
	—
Current tax liability	—
	13 300
Deferred tax liability	?
	32 700

Additional information

- (a) The original cost of the land is \$200 000.
- (b) The tax written down value of equipment at 30 June 2017 is \$28 000 (2016: \$35 000).
During the 2017 year, there were no additions or disposals of equipment.
- (c) Legal fees of \$3800 are capital in nature and non-deductible for tax purposes.
- (d) Other creditors at 30 June 2017 include an accrual for accounting fees of \$4500 for work not yet performed (2016: \$Nil). For tax purposes, the accounting fees are deductible only if work has been performed.
- (e) For tax purposes, restructuring costs are deductible only when paid.
- (f) Other debtors at 30 June 2017 include \$41 200 relating to an insurance claim that is in-process. Insurance income is only assessable for tax purposes after the insurance proceeds have been received.
- (g) The corporate tax rate is 30%.

Required

- A. Prepare the current tax worksheet for the year to 30 June 2017 and the current tax entries for the year.
- B. Prepare the deferred tax worksheet at 30 June 2016 to prove that the deferred tax liability and asset balances are \$18 000 and \$32 700 respectively.
- C. Prepare the deferred tax worksheet at 30 June 2017 and the deferred tax entries for the year.
- D. Prepare the statement of profit or loss and other comprehensive income for the year ended 30 June 2017.

Part A

**Current Tax Worksheet
for the year ended 30 June 2017**

Accounting profit before income tax		\$131 900
<i>Add:</i>		
Entertainment expense (non-deductible)	\$4 000	
Legal expenses (non-deductible)	3 800	
Insurance expense	50 000	
Accounting fees expense	5 500	
Bad and doubtful debts expense	19 500	
Depreciation expense - equipment	5 500	
Restructuring expense	23 000	
Employee expenses	660 000	
Rent received	100 000	871 300
<i>Deduct:</i>		
Insurance income	41 200	
Insurance paid	55 950	
Accounting fees (for tax)	1 000	
Bad debts written off	1 500	
Tax depreciation - equipment	7 000	
Restructuring costs paid	0	
Employee costs paid	650 500	
Rent revenue	50 000	807 150
Taxable income		196 050
Current tax liability @ 30%		58 815

Income tax expense	Dr	58 815	
Current tax liability	Cr		58 815
(Recognition of current tax liability at 30 June 2017)			

Workings for current tax worksheet

- Tax depreciation charge = \$35 000 – \$28 000 = \$7 000
- Accounting fees for tax = \$5 500 - \$4 500 = \$1 000

- Bad debts written off

Allowance for Doubtful Debts			
Debts written off	1 500	Beginning balance	20 000
Ending balance	38 000	Expense	19 500
	<u>39 500</u>		<u>39 500</u>

- Rent received

Unearned rent revenue			
Rent revenue	50 000	Beginning balance	0
Ending balance	50 000	Rent received	100 000
	<u>100 000</u>		<u>100 000</u>

- Insurance paid

Prepaid Insurance			
Beginning balance	5 000	Expense	50 000
Insurance paid	55 950	Ending balance	10 950
	<u>60 950</u>		<u>60 950</u>

- Employee costs paid

Provision for Employee Benefits			
Leave paid	650 500	Beginning balance	40 000
Ending balance	49 500	Expense	660 000
	<u>700 000</u>		<u>700 000</u>

- Restructuring costs paid

Provision for Restructuring			
Costs paid	0	Beginning balance	0
Ending balance	23 000	Expense	23 000
	<u>23 000</u>		<u>23 000</u>

- Insurance proceeds

Other Debtors – Insurance			
Beginning balance	0	Cash proceeds	0
Insurance revenue	41 200	Ending balance	41 200
	<u>41 200</u>		<u>41 000</u>

Current Tax Worksheet (Condensed)
for the year ended 30 June 2017

Accounting profit before income tax		\$131 900
<i>Add:</i>		
Entertainment expense (non-deductible)	\$4 000	
Legal expenses (non-deductible)	3 800	
Increase in accrued accounting fees	4 500	
Increase in allowance for doubtful debts	18 000	
Depreciation expense - equipment	5 500	
Increase in provision for restructuring	23 000	
Increase in provision for employee benefits	9 500	
Increase in unearned rent revenue	50 000	118 300
<i>Deduct:</i>		
Increase in insurance receivable	41 200	
Increase in prepaid insurance	5 950	
Tax depreciation - equipment	7 000	54 150
Taxable income		196 050
Current tax liability @ 30%		58 815

Part B

Deferred Tax Worksheet
as at 30 June 2016

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
	\$	\$	\$		\$	\$
<u>Assets</u>						
Cash at bank	800 100	0	800 100	[2]	0	0
Trade debtors	180 000	0	200 000	[2]	0	20 000
Prepaid insurance	5 000	0	0	[1]	5 000	0
Land	300 000	200 000	100 000	[1]	100 000	0
Equipment	39 000	35 000	35 000	[1]	4 000	0
Other debtors	0					
<u>Liabilities</u>						
Trade creditors	245 000	0	245 000	[1]	0	0
Borrowings	438 500	0	438 500	[1]		
Unearned revenue	0					
Provision for employee benefits	40 000	40 000	0	[1]	0	40 000
Provision for restructuring	0					
Other creditors	0					
Total Temporary Differences					109 000	60 000
Deferred tax liability (30%)					32 700	
Deferred tax asset (30%)						18 000

Tax Bases

Assets that generate future taxable economic benefits: [1] Tax Base = Future deductible amount

Assets that do not generate future taxable economic benefits: [2] Tax Base = Carrying amount

Liabilities except unearned revenue: [1] Tax Base = Carrying amount less Future deductible amount

Liability of unearned revenue: [2] Tax Base = Carrying amount – Untaxed future revenue

Part C

Deferred Tax Worksheet
as at 30 June 2017

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
	\$	\$	\$		\$	\$
Assets						
Cash at bank	900 100	0	900 100	[2]	0	0
Trade debtors	202 550	0	240 550	[2]	0	38 000
Prepaid insurance	10 950	0	0	[1]	10 950	0
Land	450 000	200 000	250 000	[1]	250 000	0
Equipment	33 500	28 000	28 000	[1]	5 500	0
Other debtors	41 200	0	0	[1]	41 200	
Liabilities						
Trade creditors	239 000	0	239 000	[1]	0	0
Borrowings	543 800	0	543 800	[1]		
Unearned revenue	50 000	50 000	0	[2]		50 000
Provision for employee benefits	49 500	49 500	0	[1]	0	49 500
Provision for restructuring	23 000	23 000	0	[1]		23 000
Other creditors	4 500	4 500	0	[1]		4 500
Total Temporary Differences					307 650	165 000
Deferred tax liability (30%)					92 295	
Deferred tax asset (30%)						49 500
Begin Balances					32 700	18 000
Increase for year					59 595	31 500
OCI*					45 000	0
Profit or loss					14 595	31 500
					59 595	31 500

* *Deferred tax included in other comprehensive income*

Revaluation increment on land for the period $\$150\,000 \times 30\% = \$45\,000$

The entries to record the deferred tax in profit or loss for the year ended 30 June 2017 are:

Deferred Tax Asset	Dr	31 500	
Deferred Tax Liability	Cr		14 595
Income Tax Expense	Cr		16 905

The entries to record the deferred tax in other comprehensive income for the year ended 30 June 2017 are:

Tax on revaluation (OCI)	Dr	45 000	
Deferred Tax Liability	Cr		45 000

Part D

FROMTHEHIP LTD			
Statement of Comprehensive Income			
for the year ended 30 June 2017			
Profit for the year			\$89 990
Other comprehensive income:			
Revaluation of land	\$150 000		
Tax on revaluation of land	(45 000)		<u>105 000</u>
Comprehensive income for the year			<u>\$194 990</u>

Working

Profit before income tax		\$131 900	
Less: Income tax expense			
current tax journal	58 815		
deferred tax journal	(16 905)	<u>41 910</u>	
Profit for the year		<u>\$89 990</u>	

Check

Net assets (Equity) at 30 June 2016	\$527 600
Add comprehensive income for the year	<u>194 990</u>
Net assets (Equity) at 30 June 2017	<u>\$ 722 590</u>

Question 6.11 Current and deferred tax worksheets and tax entries

The following information has been provided in relation to Jennifer Ltd:

1. The company recorded a profit before tax for the 2016–17 period of \$120 000.
2. At 30 June 2017, the company's plant is carried at cost of \$200 000, with accumulated depreciation of \$80 000. Depreciation of \$40 000 was recognised as an expense in the 2016–17 period. The tax deduction allowed in that year is \$50 000, resulting in a carrying amount of plant for tax purposes at 30 June 2017 of \$90 000. No acquisitions or disposals of plant occurred during the 2016–17 period.
3. At 30 June 2016, the company reported an accounts receivable balance of \$140 000, with a balance in the allowance for doubtful debts of \$20 000. In December 2016, the company wrote \$15 000 of the accounts receivable off as bad debts, adjusting the allowance for doubtful debts. In the statement of financial position at 30 June 2017, the company reported an accounts receivable balance of \$160 000 with a related allowance for doubtful debts of \$12 000.
4. As a part of its sales strategy, the company offers a 2-year warranty on its products. At 30 June 2016, the balance in the provision for warranty was \$40 000. In the 2016–17 period, because of a fault in the materials supplied, there was an unusual number of claims under the warranty, these amounting to \$30 000. In anticipation of future claims, the company reported a provision for warranty payable of \$60 000 at 30 June 2017.
5. The company pays its insurance for the following 12 months in May each year. On 1 May 2017, the amount paid was \$21 000, compared with \$18 000 in the previous year. Tax deductions for insurance occur with the cash payment.
6. The company buys inventory on a 30-day credit arrangement. The accounts payable of \$30 000 at 30 June 2017 was only marginally higher than the \$28 000 balance one year earlier.
7. During the 2016–17 period, the company incurred \$20 000 worth of entertainment expenses, which was higher than the previous year expense of \$15 000. These expenses are non-deductible for tax purposes.
8. No other assets and liabilities have tax consequences. The tax rate is 30%.

Required

- A. Prepare the current tax worksheet for the year ended 30 June 2017 and the entries to record the current tax.
- B. Prepare the deferred tax worksheet as at 30 June 2016 to determine the beginning balances for deferred tax liability and deferred tax asset.
- C. Prepare the deferred tax worksheet as at 30 June 2017 and the entries to record the deferred tax for the year.

Part A

**Current Tax Worksheet
for the year ended 30 June 2017**

Profit before tax		\$120 000
<i>Add:</i>		
Entertainment expenses	\$20 000	
Depreciation expense - plant	40 000	
Doubtful debts expense	7 000	
Warranty expense	50 000	
Insurance expense	18 500	135 500
<i>Less:</i>		
Tax depreciation - plant	50 000	
Bad debts written off	15 000	
Warranty paid	30 000	
Insurance paid	21 000	116 000
Taxable profit		139 500
Current tax liability @ 30%		\$41 850

The journal entry for current tax for the year to 30 June 2017 is as follows:

Income Tax Expense	Dr	41 850	
Current Tax Liability	Cr		41 850

Current Tax Worksheet Explanations

Doubtful debts expense = $15\,000 - 20\,000 + 12\,000 = 7\,000$

Insurance expense = $(10/12 \times 18\,000) + (2/12 \times 21\,000) = 18\,500$

Warranty expense = $30\,000 - 40\,000 + 60\,000 = 50\,000$

Part B

Deferred Tax Worksheet
as at 30 June 2016

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
	\$	\$	\$		\$	\$
<u>Assets</u>						
Plant	160 000	140 000	140 000	[1]	20 000	0
A/cs receivable	120 000	0	140 000	[2]	0	20 000
Prepaid insurance	15 000	0	0	[1]	15 000	0
<u>Liabilities</u>						
A/cs payables	28 000	0	28 000	[1]	0	0
Provision for warranty	40 000	40 000	0	[1]	0	40 000
Total Temporary Differences					35 000	60 000
Deferred tax liability (30%)					10 500	
Deferred tax asset (30%)						18 000

Assets that generate future taxable economic benefits: [1] Tax Base = Future deductible amount

Assets that do not generate future taxable economic benefits: [2] Tax Base = Carrying amount

Liabilities except unearned revenue: [1] Tax Base = Carrying amount less Future deductible amount

Liability of unearned revenue: [2] Tax Base = Carrying amount – Untaxed future revenue

PLANT:

2016:		Accounting	Tax
	Cost	\$200 000	\$200 000
	Accum Depreciation	<u>40 000</u>	<u>60 000</u>
		<u>160 000</u>	<u>140 000*</u>

* Carrying amount at 6/16 (\$90 000) plus depreciation for tax purposes in current year (\$50 000) = \$140 000

Taxable temporary difference \$20 000 and Deferred tax liability of \$6 000

ACCOUNTS RECEIVABLE

2016:	Accounts receivable	\$140 000
	Allowance	<u>20 000</u>
		<u>120 000</u>

Deductible temporary difference \$20 000 and Deferred tax asset \$6 000

WARRANTY PAYABLE

2016: Balance of \$40 000
Deductible temporary difference \$40 000 and Deferred tax asset \$12 000

PREPAID INSURANCE

2016: Balance of \$15 000 [\$18 000 – 2 x \$1 500 expired]
Taxable temporary difference \$15 000 and Deferred tax liability of \$4 500

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

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
	\$	\$	\$		\$	\$
<u>Assets</u>						
Plant	120 000	90 000	90 000	[1]	30 000	0
A/cs receivable	148 000	0	160 000	[2]	0	12 000
Prepaid insurance	17 500	0	0	[1]	17 500	0
<u>Liabilities</u>						
A/cs payable	30 000	0	30 000	[1]	0	0
Provision for warranty	60 000	60 000	0	[1]	0	60 000
Total Temporary Differences					47 500	72 000
Deferred tax liability (30%)					14 250	
Deferred tax asset (30%)						21 600
Begin Balances					10 500	18 000
Increase for year					3 750	3 600

The entries to record the deferred tax for the year ended 30 June 2017 are:

Income Tax Expense	Dr	150	
Deferred Tax Asset	Dr	3 600	
Deferred Tax Liability	Cr		3 750

The increase in the deferred tax asset for 2016-2017 is attributable to the following

Decrease in allowance for doubtful debts	(8 000)
Increase in provision for warranty	<u>20 000</u>
	12 000 x 30% = \$3 600

The increase in the deferred tax liability for 2016-2017 is attributable to the following:

Increase in prepaid insurance	2 500
Increase in the difference between tax and accounting written down value of plant	<u>10 000</u>
	12 500 x 30% = \$3 750

	Accounting	Tax	Difference
Plant (net) 2017	120 000	90 000	30 000
Plant (net) 2016	160 000	140 000	<u>20 000</u>
Increase in Difference			<u>10 000</u>

Question 6.12 Current and deferred tax worksheets, amended assessment and tax entries

The accounting profit before tax of She Said Ltd for the year ended 30 June 2017 was \$24 000 and included the income and expense items shown below.

Government grant (exempt from tax)	\$ 5 360
Proceeds on sale of plant	33 000
Carrying amount of plant sold	30 000
Entertainment expense	12 100
Bad debts expense	5 200
Depreciation expense – plant	24 000
Insurance expense	11 900
Annual leave expense	15 400

The statements of financial position of She Said Ltd as at 30 June 2017 and 2016 included the following assets and liabilities:

SHE SAID LTD Statement of Financial Position (Extract) as at 30 June		
	2017	2016
Accounts receivable	\$ 156 000	\$ 147 500
Allowance for doubtful debts	(6 800)	(5 200)
Prepaid insurance	3 400	5 600
Plant – at cost	240 000	290 000
Accumulated depreciation – plant	(134 400)	(130 400)
Deferred tax asset	?	4 470
Provision for annual leave	14 100	9 700
Deferred tax liability	?	9 504

Additional information

- In March 2017, the company received an amended assessment from the ATO for the year ended 30 June 2016 indicating that an amount of \$4500 claimed as a deduction for legal expenses had been disallowed. The company has not yet adjusted its accounts to reflect the amendment.
- For tax purposes the carrying amount of plant sold was \$26 000. There were no other disposals or acquisitions of plant during the year.
- The tax deduction for plant depreciation was \$28 800. Accumulated depreciation at 30 June 2016 for taxation purposes was \$156 480.
- The tax rate is 30%.

Required

- Prepare the journal entry necessary to record the amended assessment of the company for 30 June 2016.
- Prepare the current tax worksheet for the year ended 30 June 2017 and the entries to record the current tax.
- Explain your treatment of annual leave expense in the current tax worksheet.
- Prepare the deferred tax worksheet as at 30 June 2017 and the entries to record the deferred tax.

E. What would be the journal entry for current tax for the year ended 30 June 2017 if company had previously recognised a deferred tax asset for carried forward tax losses of \$18 400.

Part A

Journal entry to record 2016 amendment assessment

March 2017

Income tax expense	Dr	1 350	
Current tax liability	Cr		1 350

Note: the disallowed expense item increases the tax due for the year to 30 June 2016 but it is brought to account in the current period

Part B

**Current Tax Worksheet
for the year ended 30 June 2017**

Profit before income tax		\$24 000
<i>Add:</i>		
Entertainment expense (non-deductible)	\$12 100	
Carrying amount of plant sold (accounts)	30 000	
Depreciation expense – plant	24 000	
Bad debts expense	5 200	
Insurance expense	11 900	
Annual leave expense	15 400	98 600
		122 600
<i>Deduct:</i>		
Government grant (exempt)	5 360	
Carrying amount of plant sold (tax)	26 000	
Depreciation – taxation	28 800	
Bad debts written off	3 600	
Insurance paid	9 700	
Annual leave paid	11 000	(84 460)
Taxable income		38 140
Current tax liability @ 30%		\$11 442

Journal entry

Income tax expense	Dr	11 442	
Current tax liability	Cr		11 442

Explanations for current tax worksheet

Adjusting for carrying amount sold

Adjusting for the carrying amount of plant sold in the current tax worksheet has the same effect as adjusting for any gain/loss on sale. The net adjustment in the worksheet is add \$4 000 (add \$30 000 deduct \$26 000)

Gain on sale for accounting is \$33 000 – \$30 000 = \$3 000

Gain on sale for tax is \$33 000 - \$26 000 = \$7000

⇒ Add \$4 000

Allowance for Doubtful Debts

	\$		\$
Ending balance	6 800	Beginning balance	5 200
Debts written off	3 600	Expense	5 200
	<u>10 400</u>		<u>10 400</u>

Provision for Annual Leave

	\$		\$
Leave paid	11 000	Beginning balance	9 700
Ending balance	14 100	Expense	15 400
	<u>25 100</u>		<u>25 100</u>

Prepaid Insurance

	\$		\$
Beginning balance	5 600	Ending balance	3 400
Insurance paid	9 700	Expense	11 900
	<u>15 300</u>		<u>15 300</u>

Part C

Annual leave in the current tax worksheet

Income tax laws and accounting standards regard annual leave as relevant to the calculation of taxable income and profit before tax however, tax laws use the “cash basis” and accounting standards use the accrual basis.

In the current year, the company recorded an expense of \$15 400 relating to leave that accrues in the period. But the tax deduction allowed is the amount paid of \$11 000.

Accordingly, the leave expense of \$15 400 is added back to accounting profit to remove it from the calculation of taxable income. And then leave paid is deducted from accounting profit to include it into the calculation of taxable income.

The net effect of the two adjustments equals the increase in the provision for the year and results in the taxable income being \$4 400 more than the accounting profit for the year ended 30 June 2017.

The company has a higher taxable income and pays more tax in the current period but it will have lower taxable income and pay less tax in a future period when leave paid is greater than leave expense.

Part D

Deferred Tax Worksheet
as at 30 June 2017

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
	\$	\$	\$		\$	\$
Assets						
A/cs receivable	149 200	0	156 000	[2]	0	6 800
Prepaid insurance	3 400	0	0	[1]	3 400	0
Plant	105 600	78 720	78 720	[1]	26 880	0
Liabilities						
Provision for annual leave	14 100	0	0	[1]	0	14 100
Total Temporary Differences					30 280	20 900
Deferred tax liability (30%)					9 084	
Deferred tax asset (30%)						6 270
Begin Balances					9 504	4 470
Increase/ (Decrease)					(420)	1 800

Assets that generate future taxable economic benefits: [1] Tax Base = Future deductible amount

Assets that do not generate future taxable economic benefits: [2] Tax Base = Carrying amount

Liabilities except unearned revenue: [1] Tax Base = Carrying amount less Future deductible amount

Liability of unearned revenue: [2] Tax Base = Carrying amount – Untaxed future revenue

Deferred Tax Liability	Dr	420	
Deferred Tax Asset	Dr	1 800	
Income Tax Expense	Cr		2 220

*Explanations for deferred tax worksheet*Plant for tax purposes

Cost 240 000

Accumulated depreciation

(156 480 + 28 800 – **24 000) 161 280

Tax base 78 720

**\$24 000 = \$50 000 (cost of plant sold) - \$26 000 (tax carrying amount of plant sold)

Allowance for doubtful debts

In the current year, the allowance for doubtful debts increases by \$1 600 resulting in the deferred tax asset increasing by \$480.

Provision for annual leave

In the current year, the provision for annual leave increases by \$4 400 resulting in the deferred tax asset increasing by \$1 320.

Prepaid insurance

In the current year, prepaid insurance decreases by \$2 200 resulting in the deferred tax liability decreasing by \$660.

Plant

Plant is being depreciated faster for taxation purposes than for accounting purposes. The carrying amount and tax base of plant at 30 June 2017 and 30 June 2016 is as follows:

	Accounting	Tax	Difference
Plant (net) 2017	105 600	78 720	26 880
Plant (net) 2016	159 600	133 520	<u>26 080</u>
Increase in Difference			<u>800</u>

In the current year, the difference between the carrying amount and tax base of plant increases by \$800 resulting in the deferred tax liability increasing by \$240.

Part E**Tax Losses Carried Forward**

Deferred tax asset for tax losses at 1 July 2016 = 18 400 x 30% = \$5 520

Tax losses must be offset against exempt income first before reducing the taxable income of a period. Accordingly, the tax losses that are available to offset the taxable income of \$38 140 are \$13 040 (\$18 400 – \$5 360) resulting in a final taxable income of \$25 100.

Current Tax Worksheet (Extract)
for the year ended 30 June 2017

Taxable income		38 140
Add back exempt income		5 360
		43 500
Less recoupment of tax loss		(18 400)
Taxable income after recoupment of tax loss		25 100
Current tax liability @ 30%		<u>\$7 530</u>

Journal entry:

Income tax expense	Dr	13 050	
Deferred tax asset	Cr		5 520
Current tax liability	Cr		7 530

Question 6.13 Current and deferred tax worksheets, carried forward tax loss and tax entries

The draft statement of profit or loss of That's Alright Ltd for the year ended 30 June 2017 showed a profit before tax of \$22 240, included the following items of income and expense:

Government grant (exempt from tax)	\$	5 000
Proceeds on sale of plant		23 000
Carrying amount of plant sold		20 000
Impairment of goodwill		11 100
Bad debts expense		8 100
Depreciation expense – plant		14 000
Insurance expense		12 900
Long-service leave expense		14 500

The statements of financial position of That's Alright Ltd at 30 June 2017 and 30 June 2016 include the following assets and liabilities:

THAT'S ALRIGHT LTD			
Statement of Financial Position (Extract)			
as at 30 June			
	2017		2016
Assets			
Cash	\$ 6 000	\$	18 000
Accounts receivable	96 000		85 000
Allowance for doubtful debts	(6 800)		(5 200)
Prepaid insurance	3 400		5 600
Plant	140 000		170 000
Accumulated depreciation – plant	(32 000)		(28 000)
Goodwill	22 200		22 200
Accumulated impairment losses	(11 100)		—
Deferred tax asset	?		9 540
Liabilities			
Accounts payable	78 000		76 000
Provision for long-service leave	13 200		9 700
Current tax liability	?		—
Deferred tax liability	?		3 780

Additional information

- For tax purposes the carrying amount of plant sold was \$15 000.
- The tax deduction for plant depreciation was \$20 250. The accumulated depreciation on plant for tax purposes at 30 June 2017 is \$40 250 (2016: \$35 000).
- In the year ended 30 June 2016, the company recorded a tax loss. At 1 July 2016 carry forward tax losses amounted to \$16 900. The company recognised a deferred tax asset in respect of these tax losses at 30 June 2016.
- Tax losses carried forward must be offset against any exempt income before being used to reduce taxable income.
- The company does not set off deferred tax liabilities and assets and the corporate tax rate is 30%.

Required

- A. Prepare the current tax worksheet for the year ended 30 June 2017 and the applicable tax entries.**
- B. Discuss the factors the company should have considered before recognising a deferred tax asset with respect to the tax loss incurred in the year ended 30 June 2016?**
- C. Prepare the deferred tax worksheet as at 30 June 2017 and the applicable tax entries.**
- D. Discuss whether the company should set off deferred tax liabilities and assets based on the requirements of AASB 112.**

Part A

**Current Tax Worksheet
for the year ended 30 June 2017**

Profit before income tax		\$22 240
<i>Add:</i>		
Impairment of goodwill (non-deductible)	\$11 100	
Depreciation expense – plant	14 000	
Carrying amount of plant sold for accounts	20 000	
Bad debts expense	8 100	
Long service leave expense	14 500	
Insurance expense	12 900	80 600
		102 840
<i>Deduct:</i>		
Grant revenue (exempt)	5 000	
Tax depreciation	20 250	
Bad debts written off	6 500	
Long service leave paid	11 000	
Insurance paid	10 700	
Carrying amount of plant sold for tax	15 000	(68 450)
Taxable income		34 390
Add back exempt income		5 000
		39 390
Tax losses recouped		(16 900)
Taxable income		22 490
Current tax liability @ 30%		\$6 747

The journal entry to record the current tax adjustments are:

Income Tax Expense	Dr	11 817	
Current Tax Liability	Cr		6 747
Deferred Tax Asset	Cr		5 070

Explanations for the current tax worksheet

•Reduction in deferred tax asset = Tax losses used \$16 900 x 30% = \$5 070

•Gain/loss on sale of equipment:

	Accounting	Taxation
Proceeds on sale	\$23 000	\$23 000
Carrying amount	<u>20 000</u>	<u>15 000</u>
Gain (loss)	<u>3 000</u>	<u>8 000</u>

Net adjustment in the current tax worksheet is to add \$5 000

• Long service leave paid

Provision for Long Service Leave					
		\$			\$
	Leave paid	11 000	1/07/16	Beginning balance	9 700
30/06/17	Ending balance	13 200		Leave Expense	14 500
		24 200			24 200

• Bad Debts written off

Allowance for Doubtful Debts					
		\$			\$
	Bad debts write off	6 500	1/07/16	Beginning balance	5 200
30/6/17	Ending balance	6 800		Bad Debt Expense	8 100
		13 300			13 300

• Insurance Paid

Prepaid Insurance					
		\$			\$
1/07/16	Beginning balance	5 600		Insurance expense	12 900
	Insurance paid	10 700	30/6/17	Ending balance	<u>3 400</u>
		<u>16 300</u>			<u>16 300</u>

Part B

Recognition of deferred tax asset for tax losses

Deferred tax assets arising from the carry forward of unused tax losses must be recognised to the extent, and only to the extent, that it is probable that future taxable amounts within the entity will be available against which the unused tax losses can be utilised

In completing the financial statements for 30 June 2016, the company and its auditors should have considered whether there were sufficient grounds to form the view that company would probably earn taxable profits of at least \$16 900 in future financial years.

Part C.

Deferred Tax Worksheet
as at 30 June 2017

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
	\$	\$	\$		\$	\$
<u>Assets</u>						
Cash	6 000	0	6 000	[2]	0	0
A/cs Receivable	89 200	0	96 000	[2]	0	6 800
Prepaid insurance	3 400	0	0	[1]	3 400	0
Plant	108 000	99 750	99 750	[1]	8 250	0
Goodwill	11 100	0	0	[1]	11 100	0
<u>Liabilities</u>						
A/cs payable	78 000	0	78 000	[1]	0	0
Provision for LSL	13 200	137 800	0	[1]	0	13 200
Total temporary differences					22 750	20 000
Excluded differences					11 100	0
Temp differences for deferred tax					11 650	20 000
Deferred tax liability (30%)					3 495	
Deferred tax asset (30%)						6 000
Begin Balances					3 780	9 540
Adjustments						(5 070)
Increase/Decrease for year					(285)	1 530

Tax bases

Assets that generate future taxable economic benefits: [1] Tax Base = Future deductible amount

Assets that do not generate future taxable economic benefits: [2] Tax Base = Carrying amount

Liabilities except unearned revenue: [1] Tax Base = Carrying amount less Future deductible amount

Liability of unearned revenue: [2] Tax Base = Carrying amount – Untaxed future revenue

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

Deferred Tax Liability	Dr	285	
Deferred Tax Asset	Dr	1 530	
Income Tax Income	Cr		1 815

Explanations for the deferred tax worksheet

***Plant for tax purposes**

Cost	140 000
Accumulated depreciation (35 000 + 20 250 – 15 000)	<u>40 250</u>
Tax base	<u>99 750</u>

Allowance for doubtful debts

In the current year, the allowance for doubtful debts increases by \$1 600 resulting in the deferred tax asset increasing by \$480.

Provision for long service leave

In the current year, the provision for annual leave increases by \$3 500 resulting in the deferred tax asset increasing by \$1 050.

Prepaid insurance

In the current year, prepaid insurance decreases by \$2 200 resulting in the deferred tax liability decreasing by \$660.

Plant

Plant is being depreciated faster for taxation purposes than for accounting purposes. The carrying amount and tax base of plant at 30 June 2017 and 30 June 2016 is as follows:

	Accounting	Tax	Difference
Plant (net) 2017	108 000	99 750	8 250
Plant (net) 2016	142 000	135 000	<u>7 000</u>
Increase in Difference			<u>1 250</u>

In the current year, the difference between the carrying amount and tax base of plant increases by \$1 250 resulting in the deferred tax liability increasing by \$375.

Part D

Offset of deferred tax asset and deferred tax liability

The company meets the requirements of paragraph 74 of AASB 112 as follows:

- It has a legally enforceable right to set off current tax liabilities with current tax assets from the Australian Tax Office
- The deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority, that is the ATO, and the same taxable entity.

The additional journal entry to offset the closing balances is as follows:

Deferred Tax Liability	Dr	3 495	
Deferred Tax Asset	Cr		3 495

The statement of financial position at 30 June 2017 would show a deferred tax asset of \$2 505.

Question 6.14 Current and deferred tax worksheets, change in tax rate and tax entries

The profit before tax of Perfect Skin Ltd for the year ended 30 June 2017 is \$600 000 and includes the following revenue and expense items:

Rent revenue	\$	30 000
Government grant received (exempt from tax)		10 000
Bad debts expense		60 000
Depreciation expense – plant		50 000
Long-service leave expense		45 000
Annual leave expense		30 000
Office supplies expense		15 000
Entertainment expenses		18 000
Depreciation expense – buildings		8 000

Extracts from the statements of financial position of the company at 30 June 2017 and 30 June 2016 showed the following assets and liabilities:

PERFECT SKIN LTD			
Statement of Financial Position (Extract)			
as at 30 June			
	2017		2016
Assets			
Cash	\$ 80 000	\$	85 000
Inventory	170 000		155 000
Accounts receivable	500 000		480 000
Allowance for doubtful debts	(55 000)		(40 000)
Office supplies	25 000		22 000
Plant	500 000		500 000
Accumulated depreciation	(260 000)		(210 000)
Buildings	300 000		300 000
Accumulated depreciation	(148 000)		(140 000)
Goodwill	70 000		70 000
Deferred tax asset	?		40 500
Liabilities			
Accounts payable	290 000		260 000
Provision for employee benefits	100 000		75 000
Rent received in advance	25 000		20 000
Deferred tax liability	?		38 100

Additional information

- Entertainment costs and depreciation of buildings are not allowed as tax deductions. The buildings are also not subject to capital gains tax. The government grant revenue is not assessable for tax purposes.
- Accumulated depreciation of plant for tax purposes was \$315 000 at 30 June 2016, and depreciation for tax purposes for the year ended 30 June 2017 amounted to \$75 000.
- Office supplies are claimed as a tax deduction when purchased. Rent is taxed when received.

(d) Assume a tax rate of 30% for the year ended 30 June 2017.

Required

- A. Prepare a current tax worksheet for the year ended 30 June 2017 to calculate taxable income and the company's current tax liability, and then record the entries for current tax.**
- B. Prepare a deferred tax worksheet as at 30 June 2017 to calculate the end-of-period adjustments required for the deferred tax asset and liability accounts, and then record the entries for deferred tax.**
- C. Assume that the government decided, after the election in August 2016, to change the income tax rate for the year ended 30 June 2017 from 30% to 35%. Show the impact of the change in the tax rate on the journal entries prepared under requirements A and B, and prepare any additional entries that may be required.**

Part A

**Current Tax Worksheet
for the year ended 30 June 2017**

Accounting profit before tax	\$600 000
<i>Add</i>	
Entertainment expenses	18 000
Depreciation expense – buildings	8 000
Bad debts expense	60 000
Depreciation expense – plant	50 000
Long service leave expense	45 000
Annual leave expense	30 000
Office supplies expense	15 000
Rent received	<u>35 000</u>
	<u>861 000</u>
<i>Deduct</i>	
Rent revenue	30 000
Government grant received	10 000
Tax depreciation	75 000
Bad debts written off	45 000
 Long service leave and Annual leave paid	 50 000
Office supplies paid for	<u>18 000</u>
	<u>228 000</u>
Taxable income	633 000

Current tax liability = 30% x \$633 000 \$189 900

The appropriate journal entry for current tax is:

Income Tax Expense	Dr	189 900	
Current Tax Liability	Cr		189 900

Workings:

- Bad Debts written off

Allowance for Doubtful Debts			
Accs Receivable	45 000	Beginning balance	40 000
Ending balance	<u>55 000</u>	Expense	<u>60 000</u>
	<u>100 000</u>	<u>100 000</u>	

- Rent received

Rent Received in Advance			
Revenue	30 000	Beginning balance	20 000
Ending balance	<u>25 000</u>	Cash	<u>35 000</u>
	<u>55 000</u>	<u>55 000</u>	

- Long service leave and Annual leave paid

Provision for Employee Benefits			
Cash	50 000	Beginning balance	75 000
		LSL Expense	45 000
Ending balance	<u>100 000</u>	A/L Expense	<u>30 000</u>
	<u>150 000</u>	<u>150 000</u>	

- Office supplies

Office Supplies			
Beginning Balance	22 000	Office.S.Expense	15000
Cash	<u>18 000</u>	Ending balance	<u>25000</u>
	<u>40 000</u>	<u>40000</u>	

Part B

Deferred Tax Worksheet
as at 30 June 2017

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
	\$	\$	\$		\$	\$
Assets						
Cash	80 000	0	80 000	[2]	-	-
Inventory	170 000	170 000	170 000	[1]	-	-
A/cs receivable	445 000	0	500 000	[2]		55 000
Office supplies	25 000	0	0	[1]	25 000	
Plant	240 000	110 000	110 000	[1]	130 000	
Buildings	152 000	0	0	[1]	152 000	
Goodwill	70 000	0	0	[1]	70 000	
Liabilities						
A/cs payable	290 000	0	290 000	[1]		
Provision for employee benefits	100 000	100 000	0	[1]		100 000
Rent received in advance	25 000	25 000	0	[2]		25 000
Total temporary differences					377 000	180 000
Excluded differences					222 000	
Temporary Diffs for deferred tax					155 000	180 000
Deferred tax liability (30%)					46 500	
Deferred tax asset (30%)						54 000
Beginning balances					38 100	40 500
Adjustments					0	0
Increase for year					8 400	13 500

Tax bases

Assets that generate future taxable economic benefits: [1] Tax Base = Future deductible amount

Assets that do not generate future taxable economic benefits: [2] Tax Base = Carrying amount

Liabilities except unearned revenue: [1] Tax Base = Carrying amount less Future deductible amount

Liability of unearned revenue: [2] Tax Base = Carrying amount – Untaxed future revenue

The journal entry required for the year ended 30 June 2017 is as follows:

Deferred Tax Asset	Dr	13 500	
Deferred Tax Liability	Cr		8 400
Income Tax Expense	Cr		5 100

*Explanations for the deferred tax worksheet*Plant for tax purposes

Carrying amount at 1 July 2016	(\$500 000 – 315 000)	\$185 000
Tax Depreciation		<u>(75 000)</u>
Tax base at 30 June 2017		<u>110 000</u>

Allowance for doubtful debts

In the current year, the allowance for doubtful debts increases by \$15 000 resulting in the deferred tax asset increasing by \$4 500.

Provision for employee benefits

In the current year, the provision for employee benefits increases by \$25 000 resulting in the deferred tax asset increasing by \$7 500.

Rent received in advance

In the current year, rent received in advance increases by \$5 000 resulting in the deferred tax asset increasing by \$1 500.

Office supplies

In the current year, office supplies increase by \$3 000 resulting in the deferred tax liability increasing by \$900.

Plant

Plant is being depreciated faster for taxation purposes than for accounting purposes. The carrying amount and tax base of plant at 30 June 2017 and 30 June 2016 is as follows:

	Accounting	Tax	Difference
Plant (net) 2017	240 000	110 000	130 000
Plant (net) 2016	290 000	185 000	<u>105 000</u>
Increase in Difference			<u>25 000</u>

In the current year, the difference between the carrying amount and tax base of plant increases by \$25 000 resulting in the deferred tax liability increasing by \$7 500.

Part C

As a result of a change in the tax rate, the current tax would be based on 35% instead of 30% as follows:

Taxable income	633 000
Current tax liability = 35% x \$633 000	\$221 550

The journal entry for current tax becomes:

Income Tax Expense	Dr	221 550	
Current Tax Liability	Cr		221 550

As a result of a change in the tax rate, the company must also restate the beginning balances of the deferred tax asset and liability as follows:

Deferred Tax Asset	Dr	6 750	
Deferred Tax Liability	Cr		6 350
Income Tax Expense	Cr		400

Deferred tax asset beginning balance at 35% = \$40 500 x 0.35/0.30 = \$47 250

⇒ Increase by \$6 750 from \$40 500 to \$47 250

Deferred tax liability beginning balance at 35% = \$38 100 x 0.35/0.30 = \$44 450

⇒ Increase by \$6 350 from \$38 100 to \$44 450

The deferred tax worksheet would change as follows:

					Taxable Temp Diffs	Deductible Temp Diffs
Temporary Diffs for deferred tax					155 000	180 000
Deferred tax liability (35%)					54 250	
Deferred tax asset (35%)						63 000
Beginning balances					38 100	40 500
Adjustments					6 350	6 750
Increase for year					9 800	15 750

Deferred Tax Asset	Dr	15 750	
Deferred Tax Liability	Cr		9 800
Income Tax Expense	Cr		5 950

Question 6.15 Current and deferred tax worksheets, change in tax rate, tax entries and note disclosures

Mister Malcontent Ltd's profit before tax for the year ended 30 June 2017 was \$252 450. Included in this profit are the following items of income and expense:

Amortisation of development costs	\$30 000
Depreciation expense – equipment (15%)	40 000
Entertainment expense	12 450
Insurance expense	24 000
Doubtful debts expense	14 000
Proceeds on sale of equipment	30 000
Carrying amount of equipment sold	36 667
Rent revenue	25 000
Annual leave expense	54 000
Royalty revenue (non-assessable)	2 000

At 30 June, the company's draft statements of financial position showed the following balances:

MISTER MALCONTENT LTD			
Statement of Financial Position (Extract)			
as at 30 June			
	2017		2016
Assets			
Cash	\$ 55 000	\$	65 000
Accounts receivable	295 000		277 000
Allowance for doubtful debts	(16 000)		(18 000)
Inventories	162 000		185 000
Prepaid insurance	30 000		25 000
Rent receivable	3 500		5 500
Development costs	120 000		—
Accumulated amortisation	(30 000)		—
Equipment	200 000		266 667
Accumulated depreciation	(90 000)		(80 000)
Deferred tax asset	?		28 220
Liabilities			
Accounts payable	310 500		294 000
Provision for annual leave	61 000		65 000
Mortgage loan	100 000		150 000
Deferred tax liability	?		19 437
Current tax liability	?		12 500

Additional information

- A tax deduction for development expenditure of 125% of the \$120 000 spent during the year is available under income tax legislation. The profit before tax reflects the amount of development costs amortised in the current period.
- All equipment was purchased on 1 July 2014. The tax depreciation rate for equipment is 20%. The equipment sold on 30 June 2017 cost \$66 667.
- Rent is assessed for tax when received in cash.

(d) The company pays tax in quarterly instalments. The following payments were made during the year ended 30 June 2017.

28 July 2016 (Final payment for 30 June 2016)	\$12 500
28 October 2016 (1st payment for 30 June 2017)	8 420
28 February 2017 (2nd payment for 30 June 2017)	9 380
28 April 2017 (3rd payment for 30 June 2017)	9 750

(e) The company tax rate applicable for the year ended 30 June 2016 was 34%, but as a result of the government's taxation reform package the company tax rate dropped to 30% effective from 1 July 2016. No entry has yet been made in the current period for the change in tax rates.

Required

- Prepare the current tax worksheet to determine taxable income and calculate the current tax liability for the year ended 30 June 2017 (show all workings).
 - Prepare the journal entries relevant to current tax for the year.
 - Explain the rationale behind your treatment of the following items in the current tax worksheet:
 - insurance costs
 - rent income
 - entertainment costs
- Do future tax consequences arise from these items? Explain.
- Prepare the deferred tax worksheet to calculate the deferred tax asset and liability balances as at 30 June 2017.
 - Prepare the journal entries relevant to deferred tax for the year.
 - Prepare the income tax note disclosures of the financial statements for 30 June 2017 in accordance with the requirements of AASB 112.

Part A

Current Tax Worksheet for year ended 30 June 2017

Accounting profit before income tax		\$252 450
<i>Add:</i>		
Entertainment expense (non-deductible)	\$12 450	
Amortisation of development costs	30 000	
Insurance expense	24 000	
Depreciation expense - equipment	40 000	
Carrying amount of equip sold (accounts)	36 667	
Doubtful debts expense	14 000	
Annual leave expense	54 000	
Rent received	27 000	238 117
		490 567
<i>Deduct:</i>		
Royalty revenue (exempt)	2 000	
Rent revenue	25 000	
Carrying amount of equip sold (for tax)	26 667	
Tax depreciation - equipment	53 333	
Bad debts written off	16 000	

Insurance paid	29 000	
Development costs paid	120 000	
Additional deduction 25% of devp't costs	30 000	
Annual leave paid	58 000	(360 000)
Taxable income		130 567
Tax on taxable income @ 30%		39 170
Less tax paid during the year		(27 550)
Current tax liability		\$11 620

Workings for current tax worksheet

- Tax depreciation charge = $\$266\,667 \times 20\% = \$53\,333$
- Gain/loss on sale of equipment at end of year:

	Accounting	Tax
Cost	\$66 667	\$66 667
Accum dep'n	<u>30 000</u>	<u>40 000</u>
Carrying amt/tax base	36 667	26 667
Proceeds	<u>30 000</u>	<u>30 000</u>
Gain (loss)	(6 667)	3 333

Accumulated depreciation for tax = $\$66\,667 \times 20\% \times 3 \text{ years} = \$40\,000$

Accumulated depreciation for accounts = $\$66\,667 \times 15\% \times 3 \text{ years} = \$30\,000$

- Bad debts written off

Allowance for Doubtful Debts			
Ending balance	16 000	Beginning balance	18 000
Debts written off	16 000	Expense	<u>14 000</u>
	<u>32 000</u>		<u>32 000</u>

- Rent received

Rent Receivable			
Beginning balance	5 500	Ending balance	3 500
Revenue	<u>25 000</u>	Rent received	27 000
	<u>30 500</u>		<u>30 500</u>

- Insurance paid

Prepaid Insurance			
Beginning balance	25 000	Ending balance	30 000
Insurance paid	29 000	Expense	<u>24 000</u>
	<u>54 000</u>		<u>54 000</u>

- Annual leave paid

Provision for Annual Leave

Leave paid	58 000	Beginning balance	65 000
Ending balance	61 000	Expense	54 000
	<u>119 000</u>		<u>119 000</u>

- Development costs paid

Development Costs

Beginning balance	0	Ending balance	120 000
Costs paid	120 000		
	<u>120 000</u>		<u>120 000</u>

Current Tax Worksheet (Condensed)
for the year ended 30 June 2017

Accounting profit before income tax		\$252 450
<i>Add:</i>		
Entertainment expense (non-deductible)	\$12 450	
Depreciation expense - equipment	40 000	
Gain on sale of plant (for tax)	3 333	
Loss on sale of plant (accounts)	6 667	
Decrease in rent receivable	2 000	
		64 450
<i>Deduct:</i>		
Royalty revenue (exempt)	2 000	
Tax depreciation - equipment	53 333	
Increase in development asset (net)	90 000	
Additional deduction 25% of devp't costs	30 000	
Decrease in allowance for doubtful debts	2 000	
Increase in prepaid insurance	5 000	
Decrease in provision for annual leave	4 000	186 333
Taxable income		130 567
Tax on taxable income @ 30%		39 170
Less tax paid during the year		(27 550)
Current tax liability		\$11 620

Part B**Journal entry for current tax liability**

Income tax expense	Dr	11 620	
Current tax liability	Cr		11 620
(Recognition of current tax liability at 30 June 2017)			

Journal entry/ies for current tax paid

Income tax expense	Dr	27 550	
Cash	Cr		27 550

Part C

Rationale for treatment

Insurance costs

Income tax legislation includes insurance costs as an item in taxable profit using the cash basis whereas accounting standards recognise insurance expense using the accrual basis. As \$29 000 was spent in cash in the current year, the ATO allows this as a tax deduction; however, for accounting purposes, under the accrual system, the company capitalises this cost as an asset until the insurance is used up, \$24 000 being regarded as insurance services used up in the current year. As the allowable deduction is \$5 000 greater than the accounting expense, the company's taxable income will be less than its accounting profit for the year. Accordingly, the company will pay less tax this year but more in a future year when the accounting expense is greater than the amount paid. At the end of the current year, the company will also record a deferred tax liability for a taxable temporary difference arising from the prepaid insurance asset recorded by the company.

Rent income

Income tax legislation includes rent income as an item in taxable profit using the cash basis whereas accounting standards recognise rent revenue using the accrual basis. In this question, \$3 500 of revenue has not yet been received and has been recorded in the company's statement of financial position as a receivable. Rent receivable at 30 June 2016 of \$5 500 together with the rent received that relates to the current year of \$21 500 (\$25 000 - \$3 500) equals rent income of \$27 000 for tax purposes. As the company has recorded rent revenue of \$25 000, an adjustment is made in the worksheet to deduct the accounting figure and replace with the tax figure. The company still has rent receivable at the end of the current year and it will be subject to tax when received. At the end of the current year, the company records a deferred tax liability for a taxable temporary difference arising from rent receivable.

Entertainment costs

Income tax legislation does not allow a deduction for entertainment costs unless the costs relate to employee costs, that is, the costs are part of an employment package. Accordingly there are no current or future tax consequences for these entertainment costs. In contrast, the employment costs are recognised as an accounting expense as incurred and must be added back to accounting profit in the current tax worksheet.

Part D

Deferred Tax Worksheet
as at 30 June 2017

	Carrying Amount	Deductible Amount	Tax Base		Taxable Temp Diffs	Deductible Temp Diffs
Assets						
Cash	55 000	0	55 000	[2]		
A/cs receivable	279 000	0	295 000	[2]		16 000
Inventories	162 000	162 000	162 000	[1]		
Prepaid insurance	30 000	0	0	[1]	30 000	
Rent receivable	3 500	0	0	[1]	3 500	
Develop't costs	90 000	0	0	[1]	90 000	
Equipment	110 000	80 000	80 000	[1]	30 000	-
Liabilities						
A/cs payable	310 510	0	310 510	[1]		
Provision for annual leave	61 000	61 000	0	[1]		61 000
Mortgage loan	100 000	0	100 000	[1]		
Total temporary differences					153 500	77 000
Excluded differences					0	0
Temp differences for deferred tax					153 500	77 000
Deferred tax liability (30%)					46 050	
Deferred tax asset (30%)						23 100
Beginning balances					19 437	28 220
Adjustments					(2 287)	(3 320)
Increase/ (Decrease)					28 900	(1 800)

Tax bases

Assets that generate future taxable economic benefits: [1] Tax Base = Future deductible amount

Assets that do not generate future taxable economic benefits: [2] Tax Base = Carrying amount

Liabilities except unearned revenue: [1] Tax Base = Carrying amount less Future deductible amount

Liability of unearned revenue: [2] Tax Base = Carrying amount – Untaxed future revenue

Tax base for equipment = cost \$200 000 less accum depn \$120 000 = \$80 000

Accum depn for tax = (266 667 x 20% x 3 years) – (66 667 x 20% x 3 years) = \$120 000

Part E

Journal entries for deferred tax

The tax rate has changed from 34% to 30%, which means the opening balances for the deferred tax asset and deferred tax liability at 1 July 2016 must be adjusted downwards.

Deferred tax asset opening balance at 30%	\$ 24 900
(\$28 220 x 0.30/0.34)	
Deferred tax asset opening balance at 34%	<u>28 220</u>
Adjustment required (reduction)	\$ (3 320)

Deferred tax liability opening balance at 30%	\$ 17 150
(\$19 437 x 0.30/0.34)	
Deferred tax liability opening balance at 34%	<u>19 437</u>
Adjustment required (reduction)	\$ (2 287)

The change of tax rate requires the following entry to be made:

Deferred Tax Liability	Dr	2 287	
Income Tax Expense	Dr	1 033	
Deferred Tax Asset	Cr		3 320

In accordance with the deferred tax worksheet, the journal entry required to record movements in the deferred tax accounts for the year ended 30 June 2017 is as follows:

Income Tax Expense	Dr	30 700	
Deferred Tax Asset	Cr		1 800
Deferred Tax Liability	Cr		28 900

Additional explanations for deferred tax worksheet

The decrease in the deferred tax asset for 2016-2017 is attributable to the following

Decrease in allowance for doubtful debts	(2 000)
Decrease in provision for annual leave	<u>(4 000)</u>
	(6 000) x 30% = \$(1 800)

The increase in the deferred tax liability for 2016-2017 is attributable to the following:

Increase in prepaid insurance	5 000
Decrease in rent receivable	(2 000)
Increase in development asset (net)	90 000
Increase in the difference between tax and accounting written down value of plant	<u>3 333</u>
	96 333 x 30% = \$28 900

	Accounting	Tax	Difference
Plant (net) 2017	110 000	80 000	30 000
Plant (net) 2016	186 667	160 000	<u>26 667</u>
Increase in Difference			<u>3 333</u>

Part F***Notes to the financial statements for the year ended 30 June 2017:*****Note X***Income tax**(a) Major components of income tax expense*

Current tax	\$39 170
Deferred tax from origination and reversal of temporary differences	30 700
Deferred tax resulting from change in the tax rate	<u>1 033</u>
Tax expense	<u>\$70 903</u>

*(b) Reconciliation of income tax expense with pre-tax accounting profit,
multiplied by the tax rate*

Income tax expense on the accounting profit for the company is reconciled to the tax as follows:

Pre-tax accounting profit	<u>\$252 450</u>
Tax at the Australian tax rate of 30%	75 735
Tax effect of expenses not deductible in calculating taxable income (entertainment)	3 735
Tax effect of non-taxable revenue (royalty)	(600)
Tax- effect of additional tax deductions (development)	(9 000)
Tax effect of net movements in items giving rise to:	

Deferred tax assets	(1 800)
Deferred tax liabilities	<u>(28 900)</u>
Current tax expense	<u>39 170</u>

The tax rate is the national income tax rate.

(c) Change in tax rate

As from 1 July the company tax rate changed from 34% to 30%.

(d) Deferred tax assets and liabilities for each type of temporary difference

The following items have given rise to deferred tax assets:

Allowance for doubtful debts	\$4 800
Employee benefits	<u>18 300</u>
Total deferred tax assets	<u>\$23 100</u>

The following items have given rise to deferred tax liabilities:

Prepayments	\$ 9 000
Development costs	27 000
Rent receivable	1 050
Plant and equipment	<u>9 000</u>
Total deferred tax liability	\$46 050

*(e) Deferred tax expenses and revenues recognised in profit for each type of temporary difference:)**

Deferred tax expense in relation to:

Prepayments	\$1 500
Development costs	27 000
Plant and equipment	1 000
Rent receivable	<u>(600)</u>
Total deferred tax expense	<u>28 900</u>

Deferred tax income in relation to:

Accounts receivable	(600)
Employee benefits	<u>(1 200)</u>
Total deferred tax income	<u>(1 800)</u>

* This disclosure item is only required if the movements in deferred items cannot be readily ascertained from other disclosures made with respect to deferred assets and liabilities.