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)
After debiting as expense:				
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
For tax purposes:				
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
Add:		
Goodwill impairment loss	6 000	
Donation to political party	1 000	
Depreciation expense	4 000	
Long service leave expense	600	11 600
		51 600
Deduct:		
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
Add:		
Entertainment costs	6 000	
Donation to political party	3 000	
Depreciation expense	2 000	
Long service leave expense	600	11 600
		31 600
Deduct:		
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
Add:		
Entertainment costs	7 000	
Depreciation expense	10 000	
Long service leave expense	600	17 600
		22 600
Deduct:		
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)
Add:		
Goodwill impairment loss	8 000	
Depreciation expense	2 000	
Long service leave expense	1 200	11 200
		1 200
Deduct:		
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

A. Prepare a current tax worksheet to determine the taxable income for the year to 30 June 2017.

B. 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.

C. Prepare all journal entries to account for income tax assuming recognition criteria are satisfied.

D. 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
Add:		
Doubtful debts expense	3 000	
Depreciation expense - plant	7 000	
Long service leave expense	4 000	14 000
		94 000
Deduct:		
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

Increase in deferred tax liability = ($8 000 – $7 000) x 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

Increase in deferred tax asset = ($3 000 – $2 000) x 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

Increase in deferred tax asset = ($4 000 – $0) x 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	24 000

D.

Deferred tax balances at 30 June 2017

Deferred Tax Liability

		$			$
			1/07/16	Beginning balance	18 000
30/06/17	Ending balance	18 300		Income tax expense	300
		18 300			18 300

Deferred Tax Asset

		$			$
1/07/16	Beginning balance	15 000			
	Income tax expense	1 500	30/06/17	Ending balance	16 500
		16 500			16 500

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 6.5 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. <u>Revalued plant</u>

⇒ 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. <u>Goodwill</u>

⇒ 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 6.8 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

(a) Accumulated depreciation based on tax depreciation is $485 000 at 30 June 2017and $360 000 at 30 June 2016. There have been no disposals of plant during the year to 30 June 2017.

(b) Deferred tax liabilities and assets are not netted off in the statement of financial position.

(c) The corporate tax rate is 30%.

Required

A. 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.

B. Prepare the deferred tax worksheet at 30 June 2017 to determine the deferred tax entries for the year.

C. 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**
	$	$	$		$	$
Assets						
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
Liabilities						
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
	$	$	$		$	$
Assets						
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
Liabilities						
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
Add:		
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
Less:		
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 ⇒ Doubtful debts expense > Bad debts w/o
⇒ Add back the increase

Increase in provision for employee benefits ⇒ Benefits expense > Benefits paid
⇒ Add back the increase

Increase in prepaid insurance ⇒ Insurance paid > Insurance expense
⇒ Deduct the increase

Increase in dividends receivable ⇒ Dividend revenue > Dividend received
⇒ 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 6.13 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	?	3780

Additional information

(a) For tax purposes the carrying amount of plant sold was $15 000.
(b) 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).
(c) 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.
(d) Tax losses carried forward must be offset against any exempt income before being used to reduce taxable income.
(e) 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
Add:		
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
Deduct:		
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	20 000	15 000
Gain (loss)	3 000	8 000

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	3 400
		16 300			16 300

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
	$	$	$		$	$
Assets						
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
Liabilities						
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

*<u>Plant for tax purposes</u>

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

<u>Allowance for doubtful debts</u>
In the current year, the allowance for doubtful debts increases by $1 600 resulting in the deferred tax asset increasing by $480.

<u>Provision for long service leave</u>
In the current year, the provision for annual leave increases by $3 500 resulting in the deferred tax asset increasing by $1 050.

<u>Prepaid insurance</u>
In the current year, prepaid insurance decreases by $2 200 resulting in the deferred tax liability decreasing by $660.

<u>Plant</u>

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	7 000
Increase in Difference			1 250

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.