Financial Accounting and Reporting

Taxation

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Key terms

Current tax	Amount payable(recoverable) for the period based on taxable profit (loss).
Deferred tax expense	Movement in deferred tax assets/liabilities.
Tax expense	Aggregate of current and deferred tax expense (income).
Tax base	Amount attributable to an asset or liability for tax purposes.
Temporary differences	Difference between the carrying amount of an asset and its tax base.
Taxable temporary differences	Result in taxable amounts when asset/liability is recovered/settled.
Deductible temporary differences	Result in deductible amounts when asset/liability is settled/recovered.

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Key terms

Tax expense = Current tax + Deferred tax expense

Temporary difference = Carrying amount of an asset/liability – tax base of the asset/liability.

The tax base of an asset = Amount deductible for tax purposes against taxable economic benefits upon recovery of the asset.

The tax base of a liability = Carrying amount – Future deductible amounts
The tax base of revenue received in advance = Carrying amount – Amount of revenue not taxed in the future

Deferred tax assets/liabilities = Temporary difference X tax rate

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Current tax

Kamau Ltd made a profit of $32 million in the current year. Included in the calculation of profit are warranty costs amounting to $1,200,000.These relate to provisions made in the year.

The company also had non-deductible entertainment expenses of $200,000 and fines amounting to $540,000.

Calculate the current tax expense relating to Kamau Ltd.

	$	$
Profit for the year		32,000,000
Add: Warranty costs	1,200,000	
Add: Non-deductible entertainment expenses	200,000	
Add: Fines	540,000	1,940,000
Taxable profit		33,940,000
Current tax expense	@30%	10,182,000

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Current and deferred tax

Dr: Tax expense account $10,182,000

Cr: Tax payable account $10,182,000

(Recognising current tax expense)

	$	$
Profit for the year		32,000,000
Add: Warranty costs	1,200,000	
Add: Non-deductible entertainment expenses	200,000	
Add: Fines	540,000	1,940,000
Taxable profit		33,940,000
Current tax expense	@30%	10,182,000

Current and deferred tax

Provision for warranty costs was not allowed in the current year because it had not been incurred. It will however be deductible in the future when it is incurred/ there is a cash outflow.

Consequently, there will be a deduction in the future relating to warranty provisions. It, therefore, creates a deferred asset.

Deferred asset = $1,200,000 X 30% = $360,000

Journal entries:

Dr: Deferred tax asset	$360,000
Cr: Tax expense account	$360,000

This asset will be recorded in the balance sheet.

Note that the tax expense account = $10,182,000 - $360,000 = $9,822,000

Tax base

Temporary difference = Carrying amount – Tax base

Note that warranty provisions have a carrying amount of $1,200,000.

What is its tax base? The amount attributable to the asset or liability for tax purposes.

The tax base of a liability = Carrying amount – Future deductible amounts

In the case of warranty provisions, the future deductible amounts to $1,200,000

Therefore tax base = $1,200,000 - $1,200,000 = $0

Deductible temporary difference = $1,200,000 - $0 = $1,200,000

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Tax base of assets

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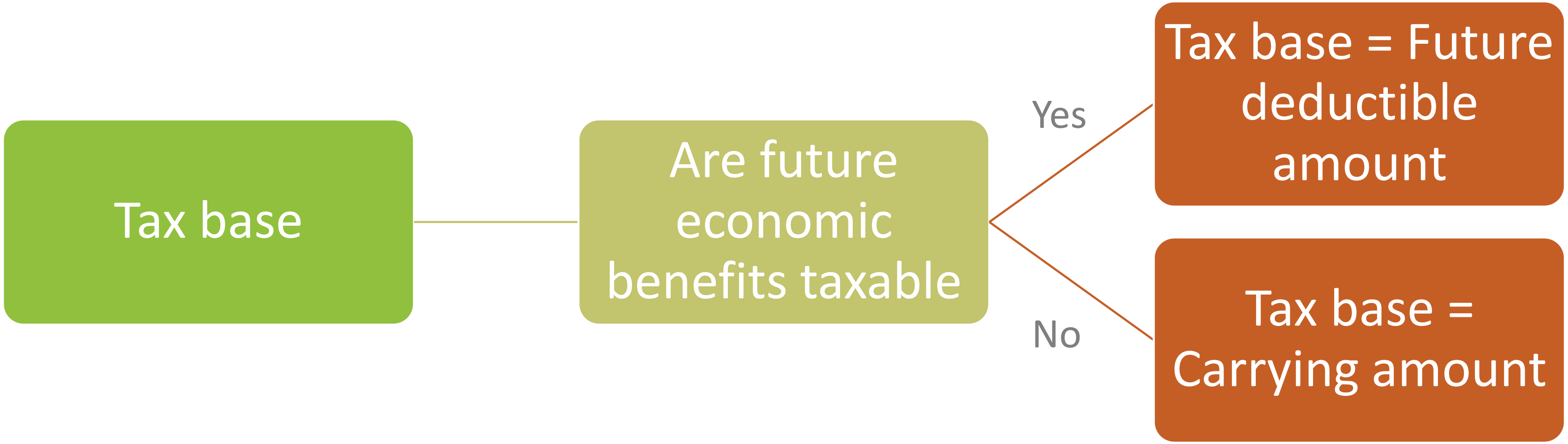
Tax base of assets – Question 10

Tax base of an asset = Amount deductible against economic benefits when the carrying amount of the asset is recovered



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Tax base of assets – Question 10

Question 10: Tax base assets

State the tax base of each of the following assets:

(a) A machine cost $10 000. For tax purposes, depreciation of $3000 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the machine is taxable, any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes.

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Tax base of an asset = Amount deductible against any economic benefits that will flow to the entity when it recovers the carrying amount.

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Source: Financial accounting and reporting Study guide, 9th Edition, CPA Australia

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The amount deductible in this case = $10,000 - $3,000 = $7,000

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(b) Interest receivable has a carrying amount of $1000. The related interest revenue will be taxed on a cash basis.

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The tax base of an asset = Amount deductible against any economic benefits that will flow to the entity when it recovers the carrying amount.

Interest receivable will be taxed in the future. The amount deductible in the future is nil.

The tax base is therefore equal to nil.

Tax base of assets – Question 10

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(c) Trade receivables have a carrying amount of $10 000. The related revenue has already been included in taxable profit (tax loss).

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The tax base of an asset = Amount deductible against any economic benefits that will flow to the entity when it recovers the carrying amount.

The revenue was taxed in the year. Consequently, the trade receivables will not be taxed in the future when the company receives cash from the customer. It is therefore deductible.

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(d) A loan receivable has a carrying amount of \$1m. The repayment of the loan will have no tax consequences.

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(d) A loan receivable has a carrying amount of $1m. The repayment of the loan will have no tax consequences.

The are no amounts recoverable in the future. Since future economic benefits are not taxable, the tax base = carrying amount i.e. $1 million.

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Tax base of liabilities

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Tax base of liabilities – Question 10

Tax base of a liability = Carrying amount less amount that will be deductible for tax purposes in respect of the liability in future years.

Tax base of a liability = Carrying amount – Amounts deductible in the future

Tax base of liabilities – Question 10

Question 11: Tax base liabilities

State the tax base of each of the following liabilities.

(a) Current liabilities include accrued expenses with a carrying amount of $1000. The related expense will be deducted for tax purposes on a cash basis.

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Tax base of liabilities – Question 10

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(a) Current liabilities include accrued expenses with a carrying amount of $1000. The related expense will be deducted for tax purposes on a cash basis.

The tax base of a liability = Carrying amount – Future deductible amounts

Tax base = $1,000 -$1,000 = Nil

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Tax base of revenue received in advance = Carrying amount – Amount of revenue not taxed in the future

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= $10,000 – $10,000 = Nil

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(b) Current liabilities include interest revenue received in advance, with a carrying amount of $10 000. The related interest revenue was taxed on a cash basis.

(c) Current liabilities include accrued expenses with a carrying amount of $2000. The related expense has already been deducted for tax purposes.

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The tax base of a liability = Carrying amount – Future deductible amounts

Accrued expenses = $2,000 – $0 = $2,000

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(d) Current liabilities include accrued fines and penalties with a carrying amount of $100. Fines and penalties are not deductible for tax purposes.

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= $100 – 0 = $100

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The tax base of a liability = Carrying amount – Future deductible amounts
= $1,000,000 – 0 = $1,000,000

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