Income Tax (LKAS 12)

Important Terms

Current tax is amount of income tax payable (recoverable) in respect of the taxable profit (loss) for a period.

Example 01

The statement of comprehensive income of Hi PLC for the year ended 31 March 2017 was as follows:

	Rs
Sales	2 540 000
Expenses	
Cost of goods sold	(1 735 000)
Depreciation—equipment	(12 000)
Other expenses	(40 000)
Profit before tax	753 000

- For tax purposes, depreciation on the equipment for the current period is Rs.14,000.
- Other expenses include non-deductible entertainment expenses of Rs.3,000.

The taxable profit of Hi PLC can be calculated as follows:

	Rs
Profit before tax	753 000
Add:	
Non-deductible entertainment expenses	3 000
	756 000
Less:	
Excess of tax depreciation deduction over	
Accounting depreciation expense	2 000
Taxable profit	754 000

Assume that the tax rate is 30 per cent. We calculate current tax expenses by multiplying taxable profit by the tax rate (Rs.754 000 × 30% = Rs.226 200). The journal entry to recognise current tax liability/current tax expense is as follows:

Current tax expense	Dr	226 200	
Current tax liability	Cr		226 200

(To recognize the current tax expense/current tax liability)

Deferred tax liabilities are the amounts of income tax payable in future periods in respect of taxable temporary differences

Deferred tax assets are the amounts of income taxes recoverable in future periods in respect of

(a) Deductible temporary differences
(b) The carry forward of unused tax losses and
(c) The carry forward of unused tax credits

$Deferred\ tax\ assetsor\ liabilities =$Temporary differences x tax rate

The tax base is the amount attributed to an asset or liability for tax purposes. The tax base can also be described as the written-down value, or carrying amount, of the asset or liability for tax purposes.

Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. It may be either taxable temporary difference or deductible temporary difference.

Examples of temporary differences include:

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- certain types of income and expenditure that are taxed on a cash, rather than on an accruals basis, e.g. Certain provisions
- the difference between the depreciation charged on a noncurrent asset that qualifies for tax allowances and the actual allowances (tax depreciation) given (the most common practical example of a temporary difference).

Taxable temporary differences are temporary differences that will result in taxable amounts in determining taxable profit/loss of future periods when the carrying amount of the asset or liability is recovered or settled.

Deductible temporary differences are the temporary differences that will result in amounts that deductible in determining taxable profit /loss of future periods when the carrying amount of the assets or liability is recovered or settled.

$$Temporary\ differences = \text{Carrying amount of assets or liabilities} - \text{Tax bases of assets or liabilities}$$

The carrying amount is the amount at which an asset or liability is recognized in the statement of financial position. For an asset, this ‘is the amount at which an asset is recognized after deducting any accumulated depreciation (amortization) and accumulated impairment losses thereon’.

Calculating deferred tax

Tax expense (income) for a period is a function of current tax expense (income) plus/minus deferred tax expense (income).Deferred tax reflects the movement in the balances of the deferred tax assets and deferred tax liabilities for the period. Therefore, a central feature of accounting for income taxes is the need to determine the amount of the deferred tax assets and deferred tax liabilities that will be recognized at the end of the reporting period.

There are five key steps to calculating deferred tax:

Step 1—Determine the tax base and carrying amount of the asset or liability.

Step 2—Calculate the temporary difference.

Step 3—Apply recognition exceptions.

Step 4—Apply the appropriate tax rate.

Step 5—Recognise deferred tax movement for the period.

Example 2

An asset which cost of Rs 200 has a carrying amount of Rs.150. Cumulative depreciation for tax purpose is Rs. 100 and tax rate is 30%.
Tax base of the asset - Rs.50 (150 -100)
Temporary difference - Rs.100 (carrying amount 150 – tax base 50)
Differed tax liability – 100 x 30% - Rs.30

Example 03

The following data was extracted from Lloyd PLC and Cole PLC:

	Lloyd PLC (Rs)	Cole PLC (Rs)
Profit before tax for the year ended 31 March 2017	1 300 000	136 000
Taxable income for the year ended 31 March 2017	340 000	150 000
Deferred tax liability as at 1 April 2016	—	90 000
Deferred tax asset as at 1 April 2016	—	15 000
Taxable temporary differences as at 31 March 2017	960 000	306 000
Deductible temporary differences as at 31 March 2017	—	70 000

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

Required to prepare the income tax section of the statement of profit or loss and other comprehensive income for the year ended 31 March 2017

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Answer

LLOYD PLC

Statement of Profit or Loss and Other Comprehensive Income (EXTRACT)
for the year ended 31 March 2017

Profit before income tax	.1 300 000
Income tax expense (Note)	(390 000)
Profit for the year	910 000

Note:

Income tax

Major components of income tax expense

Current tax (340,000 x 30%)	102 000
Deferred tax on temporary Differences (960,000 x 30%)	288 000
Income Tax expense	390 000

COLE PLC

Statement of Profit or Loss and Other Comprehensive Income (EXTRACT)
for the year ended 31 March 2016

Profit before income tax	136 000
Income tax expense (Note)	(40 800)
Profit for the year	95 200

Note:

Income tax

Major components of income tax expense

Current tax (150,000 x 30%)	45 000
Deferred tax on reversal of temporary Differences – w 01 (6,000 – 1,800)	(4 200)
Income Tax expense	40 800

W 01

Taxable temporary differences at 31 March 2017	306 000
Deferred tax liability at 31 March 2017 (306,000 x 30%)	91 800
Deferred tax liability at 31 March 2016	90 000
Increase in Deferred tax liability for the year	1 800
Deductible temporary differences at 31 March 2017	70 000
Deferred tax asset at 31 March 2017 (70,000 x 30%)	21 000
Deferred tax asset at 31 March 2016	15 000
Increase in Deferred tax asset for the year	6 000

Example 04

Profit before tax for the year ended 31st March 2017 of Bag Plc was Rs. 900,000 and the following information was provided

As At 31st March	2017 (Rs.)	2016 (Rs.)
Accounts receivable	245 000	200 000
Allowance for doubtful debts	(20 000)	
Plant – at cost	600 000	600 000
Accumulated depreciation	(190 000)	(120 000)
Interest receivable	10 000	20 000
Accounts payables	48 000	62 000
Provision for gratuity	44,000	32,000
Deferred tax asset	?	21 600
Deferred tax liability	?	20 000

a) Interest Income of Rs.10 000 is included in the profit for the year ended 31 March 2017.

b) Expenses included in profit for the year to 31 March 2017 are as follows:

- fines Rs.10 000
- depreciation expense on plant Rs.70 000
- doubtful debts expense Rs.20 000

c) Accumulated depreciation on plant for tax purposes is Rs.280 000 as at 31 March 2017 and Rs.180 000 as at 31 March 2016. There have been no acquisitions or disposals of plant during the current year.

d) The corporate tax rate is 30%.

Required to calculate current and differed tax for the year ended 31st March 2017

Answer

Current Tax Worksheet
For the year ended 31 March 2017

	Rs	Rs
Accounting profit		900 000
Add:		
Fines	10 000	
Depreciation expense - plant	70 000	
Doubtful debts expense	20 000	
Provision for gratuity (44,000 -32,000)	12,000	
Interest received	20 000	132,000
Less:		
Tax depreciation - plant	100 000	
Interest revenue	10 000	110 000
Taxable profit		922 000
Current tax liability @ 30%		276,600

Workings

Interest receivable

		Rs.			Rs.
1/04/16	Beginning balance	20 000		**Interest received**	**20 000**
	Interest revenue	10 000	31/03/17	Ending balance	10 000
		30 000			30 000

Accumulated depreciation – for tax purposes

		Rs.			Rs.
			1/04/16	Beginning balance	180 000
31/03/17	Ending balance	280 000		**Tax depreciation**	**100 000**
		280 000			280 000

Deferred tax worksheet as at 31 March 2017

	Carrying Amount	**Tax Base**	**Taxable Temporary Differences**	**Deductible Temporary Differences**
Assets				
Accounts receivable (net)	225 000 (245 -20)	245 000		20 000
Plant (net)	410 000 (600-190)	320 000 (600-280)	90 000	
Interest receivable	10 000	0	10 000	
Liabilities				
Accounts payables	48 000	48,000		0
Gratuity provision	44,000			44,000
Total Temporary Diffs			100 000	64 000
Deferred tax liability @ 30%			30 000	
Deferred tax asset @ 30%				19,200
Beginning balances			20 000	21 600
Increase/(Decrease)			10 000	(2,400)

differed tax liability = *10000-2400 = 7,600*

Total tax for the year ended 31st March 2017 = *276,600 +7600 = 284,200*

Tax losses

Where unused tax losses are carried forward, a deferred tax asset can be recognized to the extent that taxable profits will be available in the future to set the losses against.

If an entity does not expect to have taxable profits in the future it cannot recognise the asset in its own accounts.

If, however, the entity is part of a group and may surrender tax losses to other group companies, a deferred tax asset may be recognized in the consolidated accounts.
The asset is equal to the tax losses expected to be utilized multiplied by the tax rate.