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LKAS 12 : Income Tax

AAT Level III
FAR - Financial Reporting

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1

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AAT Level III Financial Reporting

Sandeepa Jayasekera

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1

LKAS 12 – Income Taxes

2

We are not discussing on

Computation of Taxes

But on

Accounting for

Taxes

3

Accounting for Taxes

- Past Taxes
- Current Taxes
- Future Taxes

4

Current Tax

Tax payable on the taxable profit for the current period

Accounting Profit ± Tax Adjustments = Taxable Profit × Tax % = Current Tax

- Accounting Profit: **Profit Before Tax** included in Profit or Loss Account
- Tax Adjustments:
  - + Disallowable Expenses
  - - Allowable Expenses
  - + Allowable Income
  - - Disallowable Income
- Tax %: According to Income Tax laws

Question 01

The Profit or Loss account of Shalitha PLC for the year ended 31st March 20X1 is as follows:

Sales	100,000
Cost of Sales	(600,000)
Gross Profit	**400,000**
Other Expenses	(150,000)
Profit before Tax	**250,000**

Question 01

The accounting depreciation included under expenses is Rs. 50,000/-.
Capital Allowance applicable for those assets is Rs. 60,000/-.
Non-deductible entertainment expenses Rs. 30,000/-.
Gratuity expense is Rs. 40,000/-. It is not allowed to be deducted.
Actual Gratuity payment is Rs. 25,000/-. It is allowed to be deducted.

If the Tax rate is 28%,
1.1 Calculate the Taxable Profit.
1.2 Calculate the Tax Expense.
1.3 Show the double entry for taxes.

Answer 01

Answer 01

Past Tax

Under/Over provision of Income Tax for the previous year

Income Tax provision of the previous year

Actual payment made for the previous year

Under Provision

Over Provision

These are changes in accounting estimates. Therefore, adjusted to the current year.

Question 02

Sunanda PLC recognized a Tax Expense of Rs. 100,000/- for the year 20X0. But the actual tax payment was Rs. 120,000/-. Tax provision for the year 20X1 is Rs. 75,000/-.

2.1 What is the income tax under/over provision for the prior year?

2.2 Show the double entry for the income tax under/over provision for the prior year.

2.3 Show the double entry for the current year tax provision.

2.4 What is the Total Tax Expense for the year 20X1?

Answer 02

Question 03

Sameera PLC provided Rs. 30,000/- as income tax expense for the year 20X0. Actual tax payment for the year 20X0 was Rs. 20,000/- Income tax provision for the year 20X1 was Rs. 40,000/-.

3.1 Calculate the income tax under/over provision for the prior year.

3.2 Show the double entry for income tax under/over provision for the prior year.

3.3 Show the double entry for the current year tax.

3.4 What is the Total Tax Expense for the year?

Answer 03

Future Tax/ Deferred Tax

15

16

Why do Accounting Profit and Tax Profit differ?

Accounting Profit → Differences (Due to adjustments related to tax laws) ← Tax Profit

Permanent Differences ← Differences → Temporary Differences

Permanent Differences

Permanent Differences between Accounting Profit and Taxable Profit

- Disallowable Personal Expenses
- Disallowable Entertainment Expenses

Temporary Differences

Recognising an Income/Expense in Accounting Profit in one period and in Tax Profit in another period.

- Accounting Depreciation and Capital Allowances
- Gratuity expenses and payments

17

Temporary Differences

Due to this, the tax effect of a certain income or expense arises at a different period where as income or expense recognized in a different period.
Therefore, it affects the **Matching** Concept.

Further, there will be **Temporary Fluctuations** in the Tax Expense

A **Deferred Tax** Adjustment is made to adjust the matching and remove these fluctuations.

18

How are Temporary Differences calculated?

An Asset/Liability

Carrying Amount → Temporary Differences ← Tax Base

Carrying Amount: Amount shown in Statement of Financial Position

Tax Base of an Asset	Tax Base of a Liability
Amount deductible for tax purposes	Carrying Amount of the Liability
When the Carrying Amount of the Asset	Less
Gets recovered	Amount deductible for tax purposes
Either through use or sale of the asset	When the Liability gets settled

19

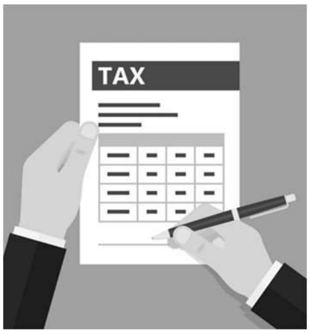
What are the Types of Temporary Differences?

Due to Temporary Differences

If **More** taxes have to be paid in the future	If **Less** taxes have to be paid in the future
Taxable Temporary Differences	Deductible Temporary Differences

20

How to Recognise Deferred Tax Liabilities?



Taxable Temporary Differences × Future Tax Rate = Closing Deferred Tax Liability

Closing Deferred Tax Liability > Opening Deferred Tax Liability = Deferred Tax Expense

Closing Deferred Tax Liability < Opening Deferred Tax Liability = Reduction in Deferred Tax Expense

How to Recognise Deferred Tax Assets?

Deductible Temporary Differences and Recoverable Unused Tax Losses × Future Tax Rate = Closing Deferred Tax Asset

Unused Tax Credits

Closing Deferred Tax Assets < Opening Deferred Tax Assets = Deferred Tax Expense

Closing Deferred Tax Assets > Opening Deferred Tax Assets = Reduction in Deferred Tax Expense

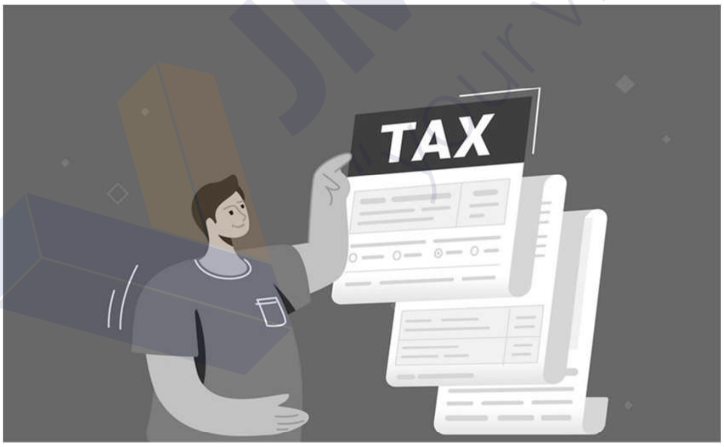
Unused Tax Losses

Unused Tax Losses can be setoff against future tax profits.

Due to tax losses, lesser taxes will be paid in the future

The tax effect of unused recoverable tax losses is a Deferred Tax Asset.

Tax Credits



Taxes paid in advance

It is also a Deferred Tax Asset.

Question 04

Following information is relevant for Moorthi PLC.
Project period 4 years
Cost of Machine Rs. 100/-
Depreciation 25%
Capital Allowance Rate 50%
Tax Rate 10%
Profit Before Tax is Rs. 200/- each year

Question 04

4.1 What is the Depreciation per annum?
4.2 What is the Capital Allowance per annum?
4.3 Calculate the Taxable Profit and the Tax Expense for each year.
4.4 Calculate the Carrying Amount of the Machine for each year.
4.5 Calculate the Tax Base of the Machine for each year.
4.6 Calculate the Deferred Tax adjustment for each year.
4.7 Show the double entries for Deferred Tax.
4.8 Calculate the Profit After Tax with and without Deferred Tax adjustment.

Answer 04

Answer 04

Answer 04

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29

Answer 04

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30

Question 05

Darshana purchased a machine worth of Rs. 200/- on 1st January 20X5. Its useful life of 5 years.
Capital Allowance Rate is 25%.

Deferred Tax Asset as at 31st December 20X4 was Rs. 10/.

Balances as at 31st December 20X5 and 20X6 are as follows:

Question 05

Description	31/12/05	31/12/06
Gratuity Provision	100	80
Brought Forward Tax Losses	50	10
Future Expected Taxable Profit	40	80
Tax Rate	15%	15%

5.1 Calculate the Carrying Amount of the Machine at the end of each year.
5.2 Calculate the Tax Base of the Machine at the end of each year.
5.3 What is the Recoverable Unused Tax Losses for each year?
5.4 Calculate the Deferred Tax Adjustment and show the double entries.

Answer 05

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33

Answer 05

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34

Answer 05

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35

Answer 05

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36

Question 06

Information on Manoj PLC is as follows:

Income Tax Provision for the year ended 31st March 20X6 is Rs. 30,500/-.
The company purchased their only machine on 01st April 20X6 for Rs. 150,000/-.
Useful life is 2 years. Capital Allowance is 33%.
Deferred Tax Asset as at 31st March 20X6 is Rs. 55,000/-.
Following information is relevant for 31st March 20X7 and 20X8.

Question 06

Description	31/03/20X7	31/03/20X8
Gratuity Provision	300,000	350,000
Gratuity Expense	40,000	50,000
Gratuity Payment	60,000	-
Unused Tax Losses	100,000	20,000
Future expected Tax Profits	80,000	80,000
Profit Before Tax	250,000	300,000
Actual Tax Expense for the year	35,000	37,500
Tax Rate	15%	15%

Question 06

6.1 Calculate the Income Tax for the year 20X7 and 20X6.
6.2 Calculate the Prior Year Under/Over Provision of Income Tax.
6.3 Calculate the Deferred Tax Expense for each year.
6.4 What is the Total Tax Expense for each year?

Answer 06

Answer 06

Answer 06

Answer 06

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43

Answer 06

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44