SAMPLE ONLY

SECURITIES

1.5 Financing Company Operations

Theory: Public companies can raise funds by issuing securities to the public. Part of the process involved in raising company funding is as follows:

a) A disclosure document, also known as a **prospectus**, is issued. This essentially advertises to the public that the company requires funding, and thus invites people to invest. A prospectus has to be approved by ASIC.
b) Accounting treatment begins when **money is received**. However, all money is held in *trust* until the securities are issued, or the money is refunded.
c) Securities are issued up until the minimum required subscription is achieved. **Demand in the marketplace** acts as the determining factor for the number of securities to be issued.

Fund-raising securities usually come in three forms:

- Ordinary Shares – *Equity*
- Preference Shares – *Equity or Liability*
- Debentures – *Liability*

1.5.1 Issuance of Securities

Theory: When a prospectus is issued, the number of shares available has to be stated. This is the **subscription amount**. Following the issuance of shares, one of three scenarios is possible:

- ✓ **Fully Subscribed** – the company receives the exact amount of money for the number of shares issued.
- ✓ **Oversubscribed** – the company receives excess money for the number of shares issued. Excess money can either be:
  - *Refunded*, or;
  - *Held* to offset payment for future amounts payable i.e. when future shares are issued, the oversubscribed amount will be used to issue further shares to the initial payees. Further issuances of shares are known as ***calls***.
- ✓ **Undersubscribed** – the company receives less funding than required for the number of shares issued. In such circumstances, the company can enter into an agreement with an *underwriter*. The underwriter usually agrees to subscribe for shares not taken up by prospective applicants. This *avoids having to refund* monies due to undersubscription.

1.6 The Share Issue Process – Accounting Entries

Theory: When a company issues their share prospectus, no entry is recorded. Only when **money is received** can recording take place.

1.6.1 1 Instalment - *Application*

STEP 1: Money received must be kept in a separate bank account until the company has allotted shares to applicants. This separate bank account is known as the **Cash Trust** account.

DR Cash Trust
CR Application[1]

The 'Application' account represents a **current liability** to applicants. If shares are not issued, the money must be returned to applicants as soon as possible (refunded) or kept in anticipation of future share issuance (held in trust).

STEP 2: Once the minimum subscriptions have been received, the directors will allot the shares to applicants as they see fit. This is represented by the following entry:

DR Application
CR Share Capital

STEP 3: Money received by unsuccessful applicants is then refunded from the Cash Trust account.

DR Application
CR Cash Trust

STEP 4: Money paid by successful applicants is transferred from the Cash Trust account to the general cash account.

DR Cash
CR Cash Trust

1.6.2 2 Instalments – *Allotment*

Theory: It is possible for a company to have required only part of the money payable on application, with a further sum to be paid on allotment of the shares.

STEP 1: If money is **due in the future**, the entry made to reflect the amount owing to a company at the point of allotment is:

DR Allotment
CR Share Capital

STEP 2: When funds are received from shareholders, the entry is:

DR Cash
CR Allotment

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[1] **Application** for either ordinary or preference shares.
[2] The 'Calls in Advance' account is not legally part of capital; however, it is also unlike any normal liability account

1.6.3 3 (or more) Instalments – *Call*

Theory: Following allotment, it is possible for a company to require further amounts to be paid on shares if they are not fully paid up to issue price. These additional amounts are known as 'calls'.

STEP 1: A 'Call' account is used to record the amount receivable whenever a call is made by the company. The entry is:

DR Call
CR Share Capital

STEP 2: On receipt of 'call money', the entry is:

DR Cash
CR Call

1.7 Oversubscription – Accounting Treatment

Theory: Excess application money may be received for the following reasons:

i. An investor pays the required application money for a certain number of shares, but is allotted fewer shares than applied for;
ii. In anticipation of a share allotment, an investor may include money for allotment and/or future calls, in the hope that the application will be treated favourably.

The treatment of excess application money depends on the company's constitution; if, under the company guidelines, excess cash can be held in anticipation of future allotments/calls, the company will do so. Otherwise, excess cash in oversubscriptions will be **refunded**.

A: Where no authority to retain excess money exists –

DR Application
CR Cash Trust

B: Where authority to retain excess money exists:

DR Application
CR Allotment
CR Calls in Advance[2]
CR Cash Trust

STEP B1: Interest[3] may be paid on call money received in advance, if the company's constitution so authorises. In such instances, the journal entry is:

DR Retained Earnings

[2] The 'Calls in Advance' account is not legally part of capital; however, it is also unlike any normal liability account in that, upon liquidation, normal unsecured debts have priority over calls in advance. Thus, it is considered *equity*.
[3] Interest on calls is **not an expense**, as the definition of expense excludes items relating to owner distribution.

CR Cash

1.8 Share Issuance – Other costs

Theory: Other costs associated with the issuance of shares include:

- ***Underwriting costs*** – costs involved with retaining an underwriter to subscribe to all shares outstanding on an undersubscription.
    - *Treatment:* As a *reduction* against contributed equity.
- ***Other share issue costs –*** these include costs such as stamp duty, legal fees etc.
    - *Treatment*: As a *reduction* against contributed equity.
- ***Formation costs*** – costs associated with the construction and registration of the company under the *Corporations Act*.
    - *Treatment:* **Expense**, not an asset - future economic benefit is not probable.

The **Owner's Equity** account should equal the difference between Total Assets and Total Liabilities. It is generally comprised of the following items:

- Share Capital;
- Retained Earnings (*accumulated profits & losses*);
- Reserves
    - Less:
    - Underwriting costs; and
    - Share Issue Costs.

1.9 Forfeiture of Shares

Theory: Directors may be given the power under the company's constitution to forfeit i.e. cancel shares in respect of which have not been paid. A company's constitution needs to be consulted to determine the procedures for forfeiture, if any such procedures have been included. If the constitution does not speak of forfeiture, shares cannot be forfeited. The following journal entry applies to share forfeiture:

DR Share Capital
CR Call
CR Forfeited Shares

Thus, the **forfeited shares account** is credited for the amount of funds previously supplied by shareholders who did not pay the call. In the event of share forfeit, the company either:

- **Retains the balance of money –** in its *forfeited shares reserve* (OE); or
- **Refunds money back to the forfeiting shareholder –** recognising the transaction in the *forfeited shares liability* (L); or

Shares could also be **reissued** to new shareholders with new shareholders paying less than the fully paid value of the share. In the event of a share re-issue, the general journal entry is as follows:

DR Cash

DR Forfeited Shares
CR Share Capital

The proceeds of sale (above) from reissued forfeited shares are applied to pay the a) expenses of sale; b) expenses of forfeiture; and c) the unpaid calls on the shares.

1.10 Corporate Debt – Why finance through Debt?

Theory: Companies will often finance through debt, as opposed to equity. Debt finance comes with several advantages -

1. **There is no dilution of ownership** – share activity can often dilute ownership, such as through buy-backs and consolidations. However, debt isn't owned by the company, so its finance will not affect company stake.
2. **Company receives money in the present** - the company has funds available the moment debt is issued. However, repayment will eventually have to be made.
3. **Fixed costs** – debt comes with a fixed, predictable cost, as determined by the interest rate on the debt.
4. **Interest is tax deductible** – the cost of debt – interest – receives a tax deduction, whilst dividends on shares – the cost of shares – do not.
5. **More attractive to lenders** – because of the fixed, predictable nature of debt costing, debt is easier to sell to lenders.

1.12.1 Debentures & Convertible Notes

Theory: Debentures are a type of debt security. Unlike equity securities, there are no voting rights attached to debentures; they are solely liabilities, which have to be paid off after a period of time, regardless of whether the company has funding or not.

1.12.1.1 Debenture Issuance

Theory: Debentures may be issued payable in full on application, or payable by instalments. When debentures are issued, four accounts are used: 1) Cash, 2) Cash Trust, 3) *Application*, and 4) *Debenture holders* – for 2 or more instalments.

1.13 Convertible Notes

Theory: Many investors may wish to purchase debentures which offer the ability to *convert* their liabilities into fully paid shares of the company, in lieu of cash, at the date of maturity. These are known as **convertible notes**.

1.14 Dividends

Theory: Dividends represent a *distribution of profits* to the shareholders of the company. Dividends may be in the form of **cash**, **bonus shares**, or **assets**, but can only be paid from profits. The power to declare dividends at any time rests with the directors, but only with the approval of shareholders.

Dividends can come in one of two forms: 1) Interim Dividends and 2) Final Dividends.

1.14.1 Interim Dividends

Theory: Interim dividends are dividends declared and paid part way through the financial year.

DR Retained Earnings
CR Cash

1.14.2 Final Dividends

Theory: Final dividends are liabilities recorded when declared *and* when paid:

Declared

DR Retained Earnings
CR Dividend Payable

Paid

DR Dividend Payable
CR Cash

TOPIC 2: Accounting for Income Tax – Current Tax

2.1 Accounting for Income Tax – Intro.

Theory: Income tax is the amount of tax paid to the government. As from 1 July 2001, the amount of company tax payable in Australia is **30%** of taxable income. Tax is not calculated on accounting profit; rather, on *taxable income*, as calculated by a company's tax return.

2.2 Differences between Accounting and Income Tax Treatments

Theory: Many differences can arise between the accounting treatment of a particular item and its treatment under income tax legislation. This is because accounting profit and taxable income take into account different things:

Accounting Profit

- Accounting Income *less* Expenses;
- Based on **accrual** accounting;
- Prepared according to requirements of *Accounting Standards*.

Taxable Income

- Assessable income *less* allowable deductions;
- Based on **cash** accounting (full expense recognised when paid);
- Prepared according to requirements of *Tax Assessment Act*.

Assessable Income ≠ Accounting Income

- Accounting income **not received** is not taxable eg. *Credit Sales*;
- Some income is **exempt** from tax eg. *Government Grants*

Allowable Deductions ≠ Accounting Expenses

- Accounting and tax **depreciation** rates may differ eg. *Depreciation on Buildings* – none from a tax perspective, recognised from an accounting perspective;
- Some expenses are **not deductible** eg. *Entertainment costs*;
- Some expenses are **not deductible until a future period** eg. *Long Service Leave* – not deductible until cash is paid to employees; *Provisions* – not deductible until a future period, such as doubtful debts (only when actually bad) & leave (only once taken).

Further differences between accounting and tax treatments are found in the table below:

Item	Accounting Treatment	Income Tax Treatment
Depreciation of a Depreciable Asset	Expensed as per **AASB116,** often on a straight-line basis	Deduction often based on **accelerated/higher straight-line** rates (the more claimed on depn., the less tax is required to pay)
Bad and Doubtful Debts	Recognised as an accounting **expense** when regarded as doubtful	Tax deduction when actually written off as bad
Employee benefits – sick leave, long-service leave	Accrued as per **AASB119** – regarded as accrued liability	Tax deduction when leave is actually taken by employees
Rental Costs (Expense)	Regarded as a **prepaid asset** until consumed	Tax deduction when paid
Rental Income (Revenues)	Regarded as a **prepaid liability** if received in advance	Taxable when received in cash
Interest	Recognised when receivable/payable (not necessarily when received or paid)	Taxable/deductible when received or paid**. Interest paid is a deduction,** regardless of whether it is capitalised or expensed
Fines and Penalties	Recognised when payable	Not tax deductible
Goodwill	Goodwill recognised when **purchased** (not internally generated), subject to an impairment test	Goodwill write-downs are not tax deductible
Entertainment Costs	Treated as an **expense**	Not tax deductible
Development Costs	Sometimes recognised as an asset – **AASB138** – and amortised	Tax deductible when paid
Foreign Currency Receivables	Exchange gains and losses recognised in accordance with **AASB121**	Tax calculated on **related revenue or expense** (from currency exchange) at initial establishment of the receivable/payable
Tax Losses	No recognition	Allowed to be **offset** against future taxable income
Insurance Costs	Recognised as an **asset,** charged to **expense** when consumed	Tax deduction when paid
Purchase of Supplies	Recognised as an **asset,** charged to **expense** when consumed	Tax deduction when paid
Instalment Sales	Gross profit on sale recognised as per normal sale**; interest income** recognised as each instalment is received.	Portion of total profit is taxable as each instalment is received
Product Warranties	Recognised as a **liability** on sale of merchandise	Tax deduction when warranty costs incurred

2.3 Tax Consequences

Theory: AASB112 - Income Taxes

The relevant accounting standard pertaining to income tax is *AASB112: Income Taxes*. This standard formulated what is known as the balance sheet method – accounting for tax based on a preference for the *balance sheet* over all other reports. As a result of the standard, the balance sheet now places an emphasis upon the determination of **tax assets** and **tax liabilities**, with income tax the residual of the process.

A company's income tax expense is not equal only to the **current tax liability and assets**, but is also a function of the company's **deferred tax liabilities and assets**. Thus, AASB112 prescribes the accounting treatment of both *current* and *future tax consequences*.

"A company must account for the tax consequences of its transactions and events by:

- Recognising the **current tax consequences** of its transaction and other events that give rise to current tax liabilities and current tax assets;
- Recognising the **future tax consequences** of transactions and other events that give rise to deferred tax liabilities and deferred tax assets; and
- Making certain disclosures about income tax".

2.3.1 Current Tax Consequences

Theory: As shown in the table above, differences between Accounting and Income Tax treatments can have both **current** and **future** tax consequences.

Current Tax Consequences

For example, a **non-deductible expense** results in a taxable income that is greater than the accounting profit. Accordingly, this results in *higher tax payments*.

- Consider **depreciation on buildings**. This is an accounting expense, which reduces the overall accounting profit. However, because it is *not deductible* for tax purposes, it must be ***added back*** when calculating the entity's taxable income. As a result, taxable income is higher than the accounting profit.

Future Tax Consequences

For example, an expense which is **not deductible now**, but **will be in future periods** will result in *lower future tax payments*.

- Consider **pre-paid expenses**. These expenses are deductible now, but will not be treated as an expense until the benefits are consumed. This will result in an *increase* to the current period's *accounting profit* and a *reduction* to the current period's *taxable income*.

2.3.1.2 Current Tax Consequences – cont.

Theory: Accounting entries for current tax liabilities and assets are based on an assessment of the entity's current taxable income/loss as determined by Australian tax legislation. Current tax liability is calculated by *adjusting accounting profits (losses)* to allow for differing treatments of revenue and expense items recorded during the year. Thus:

Accounting Profit + Expenses (not deductible for tax) **– Revenues** (not deductible for tax) +/- **Differences between Accounting & Tax Amounts**[4] **= Taxable Income**

Taxable income is then multiplied by the **company tax rate** (30%) to give the *current tax liability*. The general journal entry is:

DR Income Tax Expense
CR Current Tax Liability

2.4 Tax Losses

Theory: A tax loss arises when a company's *tax deductions exceed its taxable income*. The Income Tax Assessment Act (ITAA) allows for tax losses to be carried forward as a **deduction against future taxable income** i.e. as a deferred tax asset. However, a company can only claim a tax loss if they *make future profits*; if they make a loss/losses in future periods, they cannot claim a tax loss. The general journal entry in anticipation of a future tax loss is:

DR Deferred Tax Asset
CR Income Tax Expense

2.4.1 Recognition Criteria

Theory: The amount of loss to be carried forward is dependent on:

- The existence of exempt income;[5] and
- **Satisfaction of recognition criteria –** a 'more likely than less likely' occurrence of a tax loss.

The recognition criterion is as follows:

"A deferred tax asset resulting from a tax loss can only be recognised if it is **probable** that future taxable **profits** will be available against which the unused tax loss can be used"

However, once the company earns a taxable income, a **recoupment of losses** occurs. In such circumstances, the tax loss recouped is recorded in the determination of taxable income, and a journal entry created to *reverse the deferred tax asset*:

DR Income Tax Expense
CR Deferred Tax Asset

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[4] This is done by:
- **Adding back accounting expenses** and **subtracting the tax deduction**; or,
- **Subtracting accounting revenue** and **adding back the assessable amount.**

[5] NOTE: Exempt income cannot contribute to writing off tax losses.

NOTE: If a prior year's loss carried forward is being recouped and there is **exempt income** in the year of recoupment, the *exempt income must first be offset against the loss*.

2.5 Payment of Income Tax

Theory: Company income tax is paid under the *PAYG* ('Pay As You Go') system in **quarterly instalments**, thereby smoothing out cash flow requirements for tax payments throughout the year.[6]

Payments of Income Tax are made as follows:

Quarter Ended	Due Date
30 September (30/9)	28 October (28/10)
31 December (31/12)	28 February (28/2)
31 March (31/3)	28 April (28/4)
30 June (30/6)	28 July (28/7)

Therefore, the **current tax liability** will represent the *last quarterly payment* and *any adjustments necessary* to reflect the fact that annual taxable income **may differ** from the sum of the quarterly returns.

2.6 Under/Over Provision of Current Tax Liability

Theory: A company's *estimate* of taxable income *may differ* from that assessed by the Commissioner of Taxation. This will result in tax payable being *greater or smaller* than the current tax liability.

Upon receipt of an amended assessment, that company must analyse the reasons for the variance, adjusting the appropriate accounts accordingly:

- Adjust **Deferred Tax Asset** or **Deferred Tax Liability** if it is related to a temporary difference;
- Adjust **Tax Expense** for other variances.

These adjustments are usually made in the **last instalment** for the year.

NOTE: The steps for calculating taxable income are as follows:

1. **Identify the Accounting Profit or Loss;**
2. **Remove the effects of any accounting items that are *not included* in the tax calculation** – i.e. *deduct* any items of accounting *income* that are *not assessable* for tax, *add back* any items of *expense* that are not deductible for tax (in order to close their effect to 0);
3. **Include the effects of any taxable items that are *not already included*** – i.e. *add* in any items of assessable *income* not already included, *deduct* any deductible items not already included in the accounting figures;
4. **Calculate current tax liability based on taxable income *multiplied by tax rate*** – 30%.

[6] Under PAYG, certain companies may elect to pay their tax as one annual instalment or in four quarterly instalments.

TOPIC 3: Accounting for Income Tax – Deferred Tax

GENERAL NOTES

3.1 Accounting for Income Tax

Theory: *AASB112 Income Taxes* adopts the tax-effect method of accounting for income tax. Income tax expense is equal to –

- The **current** tax liability; as well as
- The **deferred** tax liabilities (*paying more tax in the future*) and assets (*paying less tax in the future*).

To revise:

Accounting Profit

- Accounting Income *less* Expenses;
- Based on **accrual** accounting;
- Prepared according to requirements of *Accounting Standards*.

Taxable Income

- Assessable income *less* allowable deductions;
- Based on **cash** accounting (full expense recognised when paid);
- Prepared according to requirements of *Tax Assessment Act*.

These differences can have current, as well as **future** tax consequences.

3.2 Future Tax Consequences

Theory: Future tax consequences arise because of the differences between accounting and tax treatments. This is because certain income and expense items *will* be included in the calculation of **accounting profit** for the current year, but *not* included in the calculation of **taxable income**.

These differences give rise to temporary differences. They are termed 'temporary' because they will be reversed in the future.

EXAMPLE:

A non-current asset to the value of $100,000 has an accounting useful life of **5 years** – making accounting depreciation $20,000 a year – but a tax life of **4 years** – making tax depreciation $25,000 a year. In terms of depreciation, the non-current asset will be used up first; however, this difference in time consumption will eventually *lapse*, making the difference temporary.

The temporary differences that arise create disparity between an entity's *carrying amounts* and *tax bases* of its assets and liabilities. Temporary differences can be classified into 3 types:

1. **Taxable temporary differences –** result in more tax payable in the future;
2. **Deductible temporary differences** – result in less tax payable in the future; and
3. **Excluded temporary differences** – items which **are** included in the calculation of *accounting profit*, but **not** in calculating *taxable income*. These differences will never result in tax payments or deductions, and are therefore excluded. They are also termed ***permanent*** *differences*.

3.2.1 Common Examples of Future Tax Consequences

Theory: The most common examples of future tax consequences – and the temporary differences that arise – include:

1. **Non-Current Assets –** non-current assets are often subject to different accounting and depreciation tax rates.
    a. ***Temporary Difference:*** NCAs will eventually be fully expensed from both perspectives – just a matter of time.
2. **Bad and Doubtful Debts –** from an accounting perspective, is accounted for as soon as probability of debts going bad is more likely than less likely; from a tax perspective, is only accounted for when actually goes bad.
    a. ***Temporary Difference:*** Doubtful debts will eventually be written off from both perspectives.
3. **Accruals –** from an accounting perspective, outstanding expenses and revenues are regarded as current liabilities or current assets as soon as they fulfil criteria; from a tax perspective, accruals will only be recognised when paid/received.
    a. ***Temporary Difference:*** A matter of time until paid/received.
4. **Prepayments –** from an accounting perspective, prepayments are only recognised for the current year; from a tax perspective, prepayments are recognised as tax deductible as soon as they are paid.
    a. ***Temporary Difference:*** A matter of time until recognised as an expense from both perspectives.

3.3 Taxable Temporary Differences

Theory: Taxable temporary differences create a scenario where more tax is payable in the future. Taxable temporary differences give rise to *Deferred Tax Liabilities*. That is:

$$Taxable\ Temporary\ Difference\ x\ Tax\ Rate = \boldsymbol{Deferred\ Tax\ Liability}$$

A deferred tax liability is what a company will eventually pay to the ATO.

EXAMPLE: When an asset is **revalued up**, the accounting value of the asset will change. However, from a tax perspective, the value of the asset stays the same – the ATO does not recognise revaluations. Revaluations are made to recognise the probability of a greater return when sold. Greater returns attract more payable tax.

3.4 Deductible Temporary Differences

Theory: Deductible temporary differences create a scenario where less tax is payable in the future. Deductible temporary differences give rise to *Deferred Tax Assets*. That is:

$$Deductible\ Temporary\ Difference\ x\ Tax\ Rate = \boldsymbol{Deferred\ Tax\ Asset}$$

EXAMPLE: **Provision for bad and doubtful debts** – doubtful debts expense is *recognised* as an expense from an accounting perspective, but *cannot be recognised* from a tax perspective until the debt actually goes bad. Doubtful debts attract a tax deduction when they go bad, thus giving rise to a deferred tax asset.

3.4.1 Deferred Tax Assets from Tax Losses

Theory: In accordance with AASB112, par. 34:

> A deferred tax asset arising from the carrying forward of an **unused tax loss** shall be recognise to the *extent that it is probable* that future taxable profits will be available against which the unused tax loss can be used.

However, the Standard points out the mere existence of a tax loss provides strong evidence that future taxable income will not be available to ensure that the **deferred tax asset** from the tax loss is recognisable. Par. 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.

3.5 Excluded Differences

Theory: Certain taxable temporary differences are excluded under the Standard from being recognised as deferred tax liabilities. AASB112, par. 15 provides that:

> A deferred tax liability shall **not** be recognised for any taxable temporary differences arising from:
>
> a) The initial recognition of **goodwill**; or
> b) The initial recognition of an asset or liability in a transaction which:
> i. Is not a business combination; and
> ii. At the time of the transaction, affects *neither accounting nor taxable profit*.

Other examples of excluded differences besides for goodwill include:

- Fines and penalties;
- Entertainment costs; and
- Depreciation of buildings;

Where the Standard prohibits the recognition of a deferred tax liability, any **temporary differences** calculated for these items **must be deducted** before the DTL/DTA figures are determined.

3.6 Calculation of Temporary Differences and Deferred Tax Accounts

Theory: Deferred tax assets and liabilities arise because of differences between the *carrying amount* of assets and liabilities (accounting perspective) and the *tax base* of those same assets and liabilities (tax perspective). Several steps are included in calculating the temporary differences and deferred tax accounts:

STEP 1: Calculate Carrying Amounts

Carrying amounts are taken directly from the Balance Sheet, represented by the **net amount** in the accounting records.

Step 2: Calculate Tax Bases

AASB112, par. 5 defines **'tax base'** as:

> The amount that is attributed to an asset or liability for tax purposes.

Tax Base for Assets

AASB112, par. 7 states that the tax base for an asset is:

> The amount that will be deductible for tax purposes against any taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset. If those **economic benefits will not be taxable**, the tax base of the asset is **equal to its carrying amount**.

Thus, the tax base for an asset is provided for the in the following formula:

$$\boldsymbol{Tax\ Base\ (Asset)} = \text{Carrying amount} - \text{taxable amount} + \text{deductible amount}$$

Where:

- **Carrying amount –** the net amount at which an asset is recorded in the accounting records.
- **Taxable amount –** the amount that is *expected to be* ***recovered*** through use and claimed as either income or expense in the accounting records.
- **Deductible amount** – the *allowable tax deductions* in future years applicable to the item.

Tax Base for Liabilities

There is **no taxable amount for liabilities as this will always equal zero**. Therefore, the formula for calculating the tax base of an asset is:

$$\boldsymbol{Tax\ Base\ (Liabilities)} = \text{Carrying amount} - \text{deductible amount}$$

Where:

- **Carrying amount –** the net amount at which a liability is recorded in the accounting records.
- **Deductible amount** – the *allowable tax deductions* in future years applicable to the item.

Step 3: Recognising items with Carrying Amounts = Tax Bases

Certain items will normally have carrying amounts equal to their tax bases. These include:

Assets

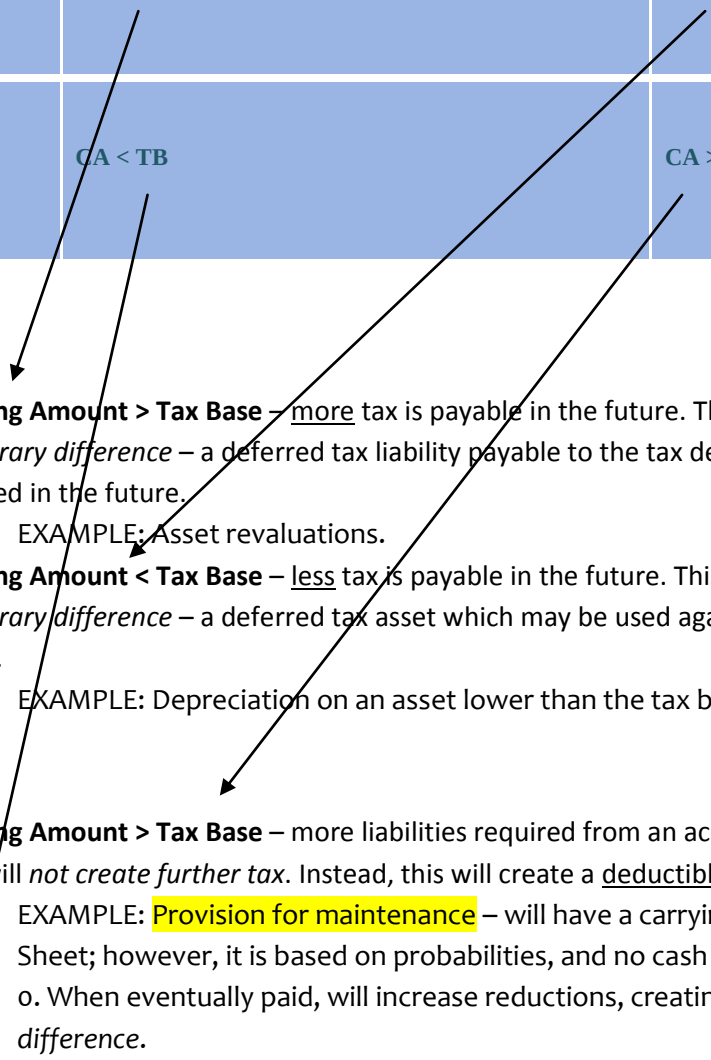
- **Cash**;
- **Inventory**;
- **Depreciable assets** – where tax and accounting rates are the same;
- **Accrued revenue** – where revenue is not assessable eg. Government Grants

Liabilities

- **Loans;**
- **Accounts payable;**
- **Current tax liabilities;**
- **Non-deductible accrued expenses** – from a tax perspective, such expenses do not exist eg. Entertainment expenses;
- **Rent revenue received in advance** – revenue received in advance is taxable at time of receipt. It will not be taxable in the future.

STEP 4: Temporary Differences Rules

	Taxable temporary difference TTD x tax rate = DTL (DTLs are not payable in next 12 months – NCL)	Deductible temporary difference DTD x tax rate = DTA (DTAs are not recoverable in next 12 months – NCA)
Assets	CA > TB	CA < TB
Liabilities	CA < TB	CA > TB



Assets

a. **Carrying Amount > Tax Base** – more tax is payable in the future. This creates a *taxable temporary difference* – a deferred tax liability payable to the tax department when revenue is received in the future.
    a. EXAMPLE: Asset revaluations.
b. **Carrying Amount < Tax Base** – less tax is payable in the future. This creates a *deductible temporary difference* – a deferred tax asset which may be used against taxable profit in the future.
    a. EXAMPLE: Depreciation on an asset lower than the tax base.

Liabilities

1. **Carrying Amount > Tax Base** – more liabilities required from an accounting perspective, but they will *not create further tax*. Instead, this will create a deductible temporary difference.
    a. EXAMPLE: Provision for maintenance – will have a carrying amount in the Balance Sheet; however, it is based on probabilities, and no cash is paid. Therefore, tax base = 0. When eventually paid, will increase reductions, creating a *deductible temporary difference*.
2. **Carrying Amount < Tax Base** - liabilities are smaller than the tax base, meaning tax base will be higher. This will result in more payable tax in the future.

3.7 The Deferred Tax Worksheet

Theory: The deferred tax worksheet enables calculation of a company's *deferred tax asset* and *deferred tax liability*. The worksheet looks as follows:

Item	**Carrying Amount**	**Taxable Amount**	**Deductible Amount**	**Tax Base**	**Taxable Temporary Difference (DTL)**	**Deductible Temporary Difference (DTA)**
Assets						
Asset 1						
Asset 2						
Asset 3						
Liabilities						
Liability 1						
Liability 2						
Liability 3						
Total Temporary Differences						
(Exempt Temporary Differences)						
Net Temporary Differences						
Deferred Tax Liability						
Deferred Tax Asset						
Opening Balances						
Movement						
Adjustment						

Steps

1. **List assets and liabilities** – each net individual asset and liability at carrying amount.
2. **Work out what will be payable as tax, or claimable as deduction** on that item.
3. **Conduct relevant formulas to calculate tax bases.**
4. **ASSETS** – if CA > TB = Taxable temporary difference, more tax payable – *deferred tax liability*; if CA < TB = Deductible temporary difference, less tax payable – *deferred tax asset*.
5. **LIABILITIES** – if CA < TB = Tax base will be higher than liabilities, more tax payable – taxable temporary difference – *deferred tax liability*; if CA > TB, deductible temporary difference, less tax payable – *deferred tax asset*.
6. **TOTAL TEMPORARY DIFFERENCES** – sum temporary differences.
7. **(Deduct exempt temporary differences)** – negative value is added back into worksheet.
8. **NET TEMPORARY DIFFERENCES** – Total Temporary Differences *less* Exempt Temporary Diffs.
9. **Net TDs x Tax Rate** – this will provide the *deferred tax liability* or *deferred tax asset*.
10. **OB (Opening Balance)** – like every asset and liability, deferred tax assets and deferred tax liabilities will have Opening Balances. Bring *last year's* balances, placing them into the table.
11. **Movement** – calculate how much the DTA and DTL has moved in the year, placing into table.
12. **Adjustment** – finally, make OB = CB for DTAs and DTLs.

Once the worksheet is complete, the **movement** in DTA and DTL is recognised as follows:

DTL

Income Tax Expense	
	Deferred Tax Liability

DTA

Deferred Tax Asset	
	Income Tax Expense

The income tax expense account will now consist of both:

- **Current Tax Liabilities**;
- **Deferred Tax Accounts** – the net movement, comprising of DTA and DTL.*

*Both current and deferred tax assets and liabilities are to be *offset against each other*, with the net figure shown in the Statement of Financial Position.

3.8 Changes in Tax Rates

Theory: From time to time, the Australian Government changes the income tax rate payable by Australian companies. Whenever the government announces a change in the income tax rate, AASB112 requires that *adjustments* should be made to the DTA and DTL. They are to be carried at the amounts required to **recover/settle** the asset or liability with the *net increase or decrease* recognised in the current period's tax expense; that is, with the current rate.

The formula for adjustment is as follows:

$$\textbf{Adjustment} = \frac{N - O}{O \times A}$$

Where:

- **A** – Existing Balance of DTL or DTA account
- **O** – Old Rate
- **N** – New Rate

EXAMPLE: For Company A, the current balances of a deferred tax asset and deferred tax liability are **$6,000** and **$3,495** respectively. The treasurer announces a lifting in the tax rate from **30%** to **34%.** What adjustment needs to be made to the accounts?

DTA (Adj.) = **(N-O)/O x A**
= (0.34 – 0.30)/0.34 x 6,000
= **$800**

DTL (Adj.) = **(N-O)/O x A**
= (0.34 – 0.30)/0.34 x 3,495
= **$466**

Deferred Tax Asset	800	
Deferred Tax Liability		466
Income Tax Expense		334