

Part 2

Chapter 6

Taxation and deferred taxation

Question	Key issues
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6.20	Deferred tax involving accruals with opening & closing balances

Question 6.1

The profit before tax of Look Limited for the year ended 28 February 20X1 is C100 000. Included in this amount are the following:

Capital profits (not taxable)	50 000
Donations (not deductible)	30 000

Expenses prepaid of C40 000 were correctly accounted for. These expenses are allowed as a deduction for tax purposes in 20X1. There were no other temporary or permanent differences other than those evident from the information given.

There is no other information/ transaction that affects the current tax payable/ receivable account. There are no components of other comprehensive income.

The normal tax rate is 30%.

Required:

- Calculate the current tax and deferred taxation for 20X1.
- Show the ledger accounts for current and deferred tax for the 20X1 year.
- Prepare the tax expense note.
- Show the journal entries relating to tax in the 20X1 year.
- Prepare extracts from the statement of comprehensive income for the year ended 28 February 20X1.

Comparatives and notes are not required.

- Prepare extracts from the statement of financial position as at 28 February 20X1.

Comparatives and notes are not required.

Question 6.2

At 30 June 20X6 the statement of financial position of Eye Limited included a deferred tax liability amounting to C11 152. The deferred tax relates to the only item of equipment owned by the company.

The following particulars are supplied:

	For the year ended 30 June	
	20X8	20X7
Profit before tax	282 000	252 000
Tax depreciation	40 000	50 000
Accounting depreciation	48 000	48 000

- The tax base of the equipment at 30 June 20X6 was C356 120.
- The current normal tax for the year ended 30 June 20X7 is paid in July 20X8. No other tax payments were made.
- There are no components of other comprehensive income.
- Assume a constant tax rate of 40%.

Required:

- a) Show the journals relating to tax and depreciation for the years ended 30 June 20X7 and 30 June 20X8.
- b) Prepare extracts from the statement of financial position of Eye Limited at 30 June 20X8 and statement of comprehensive income and notes to the financial statements for the years ended on that date in accordance with the requirements of International Financial Reporting Standards.

Question 6.3

Phobie Limited, with no expenses and no income other than rent income, received the following cash over two years:

- Received in 20X1: rent income of C10 000 in respect of 20X2
- Received in 20X2: rent income of C110 000 in respect of 20X2

The normal tax rate has remained constant at 30% over both years. Rent is taxed on receipt basis.

Required:

- a) Calculate profit before tax, as it would appear in the statement of comprehensive income.
- b) Calculate the taxable profit and current taxation for both 20X1 and 20X2.
- c) Calculate the effective rate of tax over both years (separately and in total) assuming that only current tax is recognised (no deferred tax is recognised).
- d) Show the ledger accounts for 20X1 and 20X2, taking deferred tax into account.
- e) Show how this will be disclosed in the tax expense note.
- f) Show the journal entries relating to tax and year end accruals for 20X1 and 20X2.

Question 6.4

Walnut Limited has a new and inexperienced financial accountant who insists that an estimate of current normal corporate tax should not be processed in its financial statements for the year ended 31 December 20X3. His reasoning is that the official 20X3 tax assessment has not yet arrived and he believes that it is only once this official assessment has been received that the amount will be known and a liability can be recognised.

He is also of the opinion that the deferred tax liability of C50 000 shown in the statement of financial position as at 31 December 20X2 should be reversed since this does not meet the definition of a liability.

Neither current tax nor deferred tax has been processed in Walnut Limited's current 20X3 financial statements. The auditors are therefore requesting that Walnut Limited include the following in the 20X3 financial statements:

- Current normal tax of C80 000 in respect of 20X3;
- An under-provision of current normal tax relating to 20X2 of C7 000; and
- A deferred normal tax liability of C60 000.

Required:

- a) Explain by way of a discussion of the relevant definitions and recognition criteria whether or not the current normal tax liability and related tax expense of C80 000 should be raised.

You are not required to discuss either the under-provision of prior year current tax of C7 000 or the deferred tax liability of C60 000.

- b) Provide all relevant tax-related journal entries that you believe should be processed by Walnut Limited in order to finalise its financial statements for the year ended 31 December 20X3.

Closing transfer entries are not required.

Question 6.5

The following deferred tax working papers of Blue Cheese Limited have been partially prepared at 28 February 20X2.

	Carrying amount	Tax base	Temporary difference	Deferred tax
Property, plant & equipment:				
Balance – 28/02/20X1	145 000	115 000		
Balance – 28/02/20X2	120 000			
Rent received in advance:				
Balance – 28/02/20X1	(2 000)			
Balance – 28/02/20X2	(5 000)			
Interest income receivable:				
Balance – 28/02/20X1	0			
Balance – 28/02/20X2	20 000			

Deferred tax summary	Property, plant and equipment	Rent received in advance	Income receivable	Total
Balance – 28/02/20X1	?	?	?	?
Balance – 28/02/20X2	?	?	?	?

There were no purchases or sales of property, plant and equipment during the year ended 28 February 20X2. The company tax consultant has confirmed the income tax treatment of the above items for the year ended 28 February 20X2 as follows:

Statement of financial position item	Income tax treatment
Rent received in advance	Taxable in the year of receipt
Interest income receivable	Taxable in year interest is earned
Tax depreciation	C30 000

The profit before tax is C100 000 and there are no permanent or temporary differences other than those that may be evident from the information provided.

The normal tax rate is 30%.

The 'current tax payable: normal tax' account had a credit balance of C10 000 on 1 March 20X1. No payments were made to the tax authority during the year ended 28 February 20X2.

Required:

- Complete the deferred tax working paper.
- Calculate current normal tax.
- Show the related ledger accounts.
- Disclose all information possible in the statement of financial position of Blue Cheese Limited.

Notes are not required.

- Show the deferred tax note in the financial statements of Blue Cheese Limited as at 28 February 20X2.
- For each statement of financial position item on the deferred tax working paper, explain the conceptual meaning of the carrying amount and tax base, and thereby justify the resulting temporary difference and deferred tax. In preparing your answer, bear in mind the following quotation:

“The objective of this IFRS is to prescribe the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's statement of financial position”

(IAS 12, *Income taxes, Objective*)

Question 6.6

Fish Ltd is a company operating in the food industry. The following information has been presented to you:

FISH LIMITED
EXTRACT FROM STATEMENT OF FINANCIAL POSITION
AT 31 DECEMBER 20X3

	20X3	20X2
	C	C
Property, plant and equipment	?	355 000
Expenses prepaid (this is allowed as a deduction for tax purposes in 20X3)	10 000	0
Income received in advance (taxable in the year of receipt)	28 000	15 000

Additional information:

- The tax base of the property, plant and equipment balance at 31 December 20X2 was C290 000.
- During 20X3 depreciation was C35 000 and tax depreciation allowed was C25 000. There was no other movement of property, plant and equipment during 20X3.
- Profit before tax is C300 000.
- Dividend income of C5 000 was earned during 20X3. Dividend income is taxable at 10%
- There are no other temporary or permanent differences other than those evident from the information provided.
- The normal income tax rate is 30%.

Required:

- Calculate the deferred normal income tax balance at 31 December 20X2 and 31 December 20X3.
- Calculate the current normal income tax for the year ended 31 December 20X3.
- Journalise the current and deferred normal income tax adjustments for the year ended 31 December 20X3.
- Disclose the deferred tax note to the statement of financial position as at 31 December 20X3 in accordance with International Financial Reporting Standards.

Question 6.7

The information given below is in respect of Factory Limited, a manufacturing company:

- Factory Limited owned two manufacturing plants: one had been purchased on 1 January 20X1 for C200 000 and the company then built a second plant at a cost of C500 000. The first plant was put into operation on 1 January 20X1 (the same day of

acquisition), whereas the second plant was completed on 30 June 20X1 but only became available for use on 1 January 20X2, on which date it was brought into production.

- Depreciation is provided at 20% per annum on the straight-line basis to nil residual values. The tax authorities allow tax depreciation on the full cost of plant over four years, apportioned from the date on which it was brought into use.
- The company earned profits before taxation and before depreciation of C200 000 in all three years.
- The opening balance on the deferred tax account in the statement of financial position was zero on 1/1/20X1.
- There are no other temporary or permanent differences other than those that may be evident from the information provided.

Part A:

Assuming that the normal tax rate remained at 35% for all years affected:

Required:

- a) Calculate the current normal taxation for the years ending 31 December 20X1 to 20X3.
- b) Calculate the deferred normal tax charge using the income statement approach for the years ending 31 December 20X1, 20X2 and 20X3.
- c) Journalise the entries for current tax and deferred tax for each of the years ended 31 December 20X1, 20X2 and 20X3.
- d) Prove the balance on the deferred tax asset / liability account using the balance sheet approach (comparing the carrying amounts and tax base of the machines).

Part B:

Assuming that the normal tax rate is 35% in 20X3 but 45% in 20X2 and 40% in 20X1:

Required:

- a) Calculate the current normal taxation for the years ending 31 December 20X1 to 20X3.
- b) Calculate the deferred normal tax charge using the income statement approach for the years ending 31 December 20X1, 20X2 and 20X3.
- c) Journalise the entries for current tax and deferred tax for each of the years ended 31 December 20X1, 20X2 and 20X3.
- d) Prove the balance on the deferred tax asset / liability account using the balance sheet approach (comparing the carrying amounts and tax base of the machines).

Question 6.8

The draft statement of comprehensive income of Hobbit Ltd for the year ended 31 December 20X1 is shown below:

HOBBIT LIMITED	
DRAFT STATEMENT OF COMPREHENSIVE INCOME	
	€
Revenue	1 000 000
Cost of sales	(400 000)
Gross profit	600 000
Other income	300 000
Other expenses	(403 000)
Profit before taxation	497 000
Other comprehensive income	-
Total comprehensive income	497 000

The following end of year adjustments need to be accounted for:

- Rent received in advance of €5 000 is included in 'other income' (taxable in 20X1).
- Rates prepaid of €6 000 in respect of 20X2 are included in 'other expenses' (deductible for tax purposes in 20X1).
- Advertising costs payable at year-end total €10 000 (deductible for tax purposes in 20X1).
- Interest income of €20 000 is receivable at year-end (taxable in 20X1).

Other relevant information:

- Dividend income of €30 000 is included in 'other income' (exempt from tax).
- Fines of €9 000 are included in 'other expenses' (not deductible for tax purposes).
- Dividends of €80 000 have been declared on 30 December 20X1.
- The deferred tax account at 31 December 20X0 had a credit balance of €12 000 which related purely to taxable temporary differences arising from capital allowances on plant. The tax base of the plant at 31 December 20X0 was €115 000. At 31 December 20X1 the carrying amount of the plant amounted to €120 000 and the tax base amounted to €85 000. No plant was sold or purchased during the year.

Part A

Assume that the statutory normal tax rate has remained unchanged for many years at 30%.

Required:

- Prepare an extract from the statement of comprehensive income of Hobbit Limited for the year ended 31 December 20X1, starting with profit before tax.

Comparatives are not required.

- b) Show how deferred tax will be disclosed on the statement of financial position of Hobbit Limited at 31 December 20X1.
- c) Prepare the notes to the financial statements relating to taxation and deferred tax at 31 December 20X1.

Comparatives for the tax expense note are not required.

Part B

Assume that the statutory normal tax rate was 40% up to 31 December 20X0 and that the rate changed to 30% during the year ended 31 December 20X1.

Required:

- a) Prepare an extract from the statement of comprehensive income of Hobbit Limited for the year ended 31 December 20X1, starting with profit before tax.

Comparatives are not required.

- b) Indicate how deferred tax will be disclosed on the statement of financial position of Hobbit Limited at 31 December 20X1.
- c) Prepare the notes to the financial statements relating to taxation and deferred tax at 31 December 20X1.

Comparatives for the tax expense note are not required.

Question 6.9

Make Limited bought a manufacturing plant on 1 January 20X2 and put it into production immediately.

- The plant cost C500 000 and had a useful life of five years.
- Make Limited depreciates plant over 5 years (straight-line to nil residual value).
- The tax authorities allows tax depreciation on the following basis:
 - 50% of the cost in the first year
 - 30% of the cost in the second year
 - 20% of the cost in the third year
- The profit before taxation in 20X5 was C150 000 (20X4: C120 000).
- The tax rate remained constant at 40% from 20X2 to 20X5.
- The company's financial year ends on 31 December.
- There are no other temporary or permanent differences other than those evident from the information given.
- Plant is the only item of property, plant and equipment.

- There are no components of other comprehensive income.

Part A**Required:**

- Calculate deferred tax using the balance sheet approach for 20X2 to 20X6.
- Calculate the taxable profit and current tax expense for 20X4 and 20X5.
- Journalise the deferred tax adjustments for each of the years 20X2 to 20X6 and journalise the current tax for 20X4 and 20X5.

Part B

Use the same information but that the plant was sold for C100 000 on 31 December 20X5:

Required:

- Calculate deferred tax using the balance sheet approach for 20X2 to 20X5.
- Calculate the taxable profit and current tax expense for 20X4 and 20X5.
- Journalise the deferred tax adjustments for each of the years 20X2 to 20X5 and the current tax for 20X4 and 20X5.
- Disclose the relevant information, with comparatives, in the financial statements of Make Limited for the year ended 31 December 20X5 in accordance with International Financial Reporting Standards.

Question 6.10

The following information relates to Root Limited for its financial year ended 31 December 20X6:

- Profit before tax for the year ended 31 December 20X6 has been correctly calculated at C344 000.
- Included in the profit before tax for the year ended 31 December 20X6 are the following items, amongst others:

	C
Dividend income- taxable at 10%	200 000
Profit on sale of vehicle	100 000
Depreciation	(150 000)

- The following balances have been extracted from the trial balance at 31 December 20X6:

	C
Income received in advance: 31 December 20X6 (31 December 20X5: 10 000)	130 000
Expenses prepaid: 31 December 20X6 (31 December 20X5: 15 000)	7 000

- The tax authorities:
 - granted tax depreciation of C270 000 as a deduction in 20X6;
 - tax income received in advance in the year of receipt; and
 - allow the expenses prepaid as a deduction for tax purposes in the year in which they are paid.
- A vehicle was sold during 20X6. On the date of sale, its carrying amount was C700 000, and its tax base was C650 000. Its original cost was C750 000.
- The tax assessment for the 20X5 tax year was received in August 20X6 and showed an assessed tax on taxable profit amounting to C 48 000. The total tax expense as reported on the 20X5 statement of comprehensive income amounted to C98 000, comprising current normal tax of C52 000, deferred normal tax of C46 000. No journal entries have yet been processed to take into account any adjustments that may be necessary.
- The deferred tax balance at the beginning of the year is C16 500 (credit) whereas the deferred tax balance at the end of the year is C900 (debit).
- Dividends of C220 000 were declared in 20X6.
- The normal tax rate is 30%.
- There are no permanent or temporary differences other than those presented in the above information. All amounts are considered material.
- There are no components of other comprehensive income.

Required:

- a) Show how the tax expense note is disclosed in the annual financial statements of Root Limited for the year ended 31 December 20X6 in accordance with International Financial Reporting Standards.

Comparatives are not required.

- b) Prepare an extract from the statement of comprehensive income of Root Limited for the year ended 31 December 20X6 beginning with the line item 'profit before tax'.
Notes are not required.

Comparatives are not required.

Question 6.11

Tree Limited is preparing its annual financial statements for the year ended 31 December 20X6. The following information is relevant:

TREE LIMITED**EXTRACT OF TRIAL BALANCE AT 31 DECEMBER**

	20X6	20X5
	Dr/ (Cr)	Dr/ (Cr)
Income received in advance	(123 000)	(0)
Expenses prepaid	0	5 000
Property, plant and equipment	150 000	1 000 000
Current tax payable: normal tax	?	(6 000)
Deferred tax: normal income tax	?	(16 500)

- Income received in advance is taxed in the year of receipt whereas expenses prepaid are deducted for tax purposes in the year of the payment.
- The tax base of property, plant and equipment at 31 December 20X6 was C30 000.
- During 20X6, the assessment showed that the current normal tax in 20X5 was overprovided by C4 000.
- The current normal tax was calculated at C57 600 for the 20X6 tax year.
- Provisional normal tax payments made during 20X6 amounted to C30 000.
- There are no other temporary differences other than those evident from the information provided above.
- The normal tax rate is 30% (unchanged for many years).
- There are no components of other comprehensive income.

Required:

- Process all journal entries affecting the tax expense account for the year ended 31 December 20X6.
- Prepare, in accordance with International Financial Reporting Standards, the following extracts from the annual financial statements of Tree Limited:
 - the statement of financial position at 31 December 20X6
 - the deferred tax note at 31 December 20X6

Comparatives are required

Question 6.12

Bean Limited is a company that assembles, distributes and rents cappuccino and espresso machines for the coffee shop, society and the home market. It began operations on 1 July 20X4 and uses one major item of equipment to assemble its products.

- The company purchased the assembly equipment on 1 July 20X4 at a cost of C900 000. The equipment is depreciated on the straight line basis over its estimated useful life of ten years, with no residual value. The tax authority grants an allowance of 20% per annum, not apportioned for time.

The financial accountant has prepared the following schedule relating to deferred taxation at 30 June 20X6, *before* the impairment of the asset:

	Accounts	Tax Base	Timing Difference	Deferred Tax (X29%)
Equipment				
01/07/X4	Cost	900 000	900 000	
30/06/X5	Depreciation / tax allowance	(90 000)	(180 000)	
		810 000	720 000	90 000
30/06/X6	Depreciation / tax allowance	(90 000)	(180 000)	
	Preliminary balance	720 000	540 000	180 000
				52 200

At 30 June 20X6, there are indications that the equipment is impaired. An impairment test is performed and the recoverable amount is estimated at C600 000. The remaining useful life is estimated to be five years with no residual value. The impairment is recorded correctly in the accounting records.

The equipment was sold on 30 October 20X6 for an amount of C500 000.

- The directors decided to rent equipment rather than buying new equipment. The rent is payable six monthly in advance and an amount of C270 000 was *paid* on 1 November 20X6 and on 1 May 20X7. Expenses paid in advance are deductible for tax purposes when paid.
- Bean Limited *receives* rental income in advance in relation to coffee machines that it rents to coffee shops. Rental income received in advance at 30 June 20X7 amounts to C20 000. There was no rental income received in advance at 30 June 20X6. Income received in advance is taxed when received.
- The financial accountant has prepared the following schedule relating to current taxation:

	Year end 30/06/X7	Year end 30/06/X6	Year end 30/06/X5
Amount provided for current normal tax	?	?	135 100
1 st and 2 nd provisional payments	146 000	142 000	130 000
Balance on current tax payable account	?	?	5 100
Amount of assessed normal tax on taxable profit	Not yet received	162 100	132 200

The company paid the balance owing on assessment in December 20X5 (for the year ended June 20X5) and in December 20X6 (for the year ended June 20X6).

- The profit before taxation of the company has been correctly calculated at C520 000 for the year ended 30 June 20X6 and at C700 000 for the year ended 30 June 20X7. All accounting entries relating to the equipment, the rent paid and the rent received have been correctly included in the calculation. The profit before tax for both years also includes dividend income of C40 000 for 20X6 and C30 000 for 20X7. No dividends were paid during either year.
- The financial accountant has extracted the following balances relating to the trading activities:

	Year end 30/06/X7		Year end 30/06/X6	
	Debit	Credit	Debit	Credit
Sales		3 500 000		2 600 000
Accounts receivable	196 000		184 000	
Bad debts expense	14 000		9 000	
Inventory	240 000		115 000	
Accounts payable		174 000		102 000

- There are no components of other comprehensive income.
- The normal company tax rate for all years is 29%.

Required:

- a) Show how deferred tax would be reported on the statement of financial position of Bean Limited at 30 June 20X7.

Comparative figures are required.

- b) Show how current tax would be reported on the statement of financial position of Bean Limited at 30 June 20X7.

Comparative figures are required.

- c) Prepare the accounting policies note (incorporating policies for basis of preparation, deferred tax and equipment) **and** the taxation note of Bean Limited for the year ended 30 June 20X7.

Comparative figures are required.

- d) Prepare the *operating activities* section of the statement of cash flows of Bean Limited for the year ended 30 June 20X7.

*Comparative figures are **not** required*

Question 6.13

Universal Fitness is a company that operates a chain of gyms in Gauteng. The trial balance of Universal Fitness at 31 December 20X7 is as follows:

UNIVERSAL FITNESS		
TRIAL BALANCE AT 31 DECEMBER		
20X7		
	Debit	Credit
Ordinary share capital		200 000
Retained earnings		1 770 725
Long-term loan		500 000
Deferred tax (31/12/X6)		66 525
Accounts payable		286 000
Unearned income		63 750
Profit before dividend income and interest		2 410 000
Dividends received		15 000
Land at cost	2 470 000	
Administration buildings (at carrying amount)	1 600 000	
Equipment (at carrying amount)	630 000	
Accounts receivable	380 000	
Prepaid expenses	25 000	
Current tax asset/ liability	102 000	
Interest expense	75 000	
Dividends	30 000	
	<u>5 312 000</u>	<u>5 312 000</u>

The following information is relevant:

1. Profit before dividend income and interest has been correctly calculated and includes the depreciation on both the administration building and the equipment as well as a donation to 'Save the Penguin Fund' of C20 000. The 'Save the Penguin Fund' is not a recognised charity in terms of the Income Tax Ordinance.
2. Assume that the tax authority does not grant any tax allowance on the administration buildings. The depreciation for the year ended 31 December 20X7 amounts to C120 000.
3. The tax base of the equipment at 31 December 20X7 is C364 000. For the year ending 31 December 20X7, depreciation on equipment amounts to C170 000 and the tax allowance amounts to C188 000.
4. The unearned income is taxed in the year of receipt and the prepaid expenses are deductible in the year of payment.
5. The deferred tax balance at 31 December 20X6 comprises a taxable temporary difference on the equipment of C248 000 and a deductible temporary difference on the unearned income of C26 250.
6. The tax assessment for the 20X6 year was received during 20X7 and showed that the amount of the assessed tax on taxable profit was C5 000 less than the amount provided for current normal tax in the previous year.
7. Other than mentioned above, all income is taxable and all expenses are deductible.
8. The normal tax rate is 30%.

Required:

- a) Prepare the journal entries to be processed at the end of the year to account for the current tax, deferred tax and overprovision.
- b) Prepare all the notes relating to tax expense and deferred tax in accordance with International Financial Reporting Standards.

Accounting policies are not required

Question 6.14

Rainy Limited is a company involved in the manufacture of wellington boots. Its financial year ends on 31 December.

- The following balances (not yet recognized in statement of comprehensive income) have been extracted from its trial balance at 31 December 20X6:

Rent income received in advance: 31 December 20X5	10 000
Expenses prepaid: 31 December 20X5	15 000

- The following has been recognised in statement of comprehensive income:
 - Rent income received in advance at 31 December 20X6 totalled C8 000. Income received in advance is taxed in the year of receipt.
 - Expenses prepaid at 31 December 20X6 totalled C7 000. Expenses prepaid are deductible for tax purposes in the year in which they are paid.
- Other than the processing of provisional payments made during 20X6 (which totalled C180 000), no other journal entries have yet been processed regarding tax expense.
- Tax depreciation of C270 000 was granted as a deduction in 20X6 by the tax authorities.
- The tax assessment for the tax year 20X5 was received in August 20X6. It reflected an amount of C48 000 for the assessed normal tax on taxable profit for 20X5. The total tax expense in the statement of comprehensive income in 20X5 was disclosed as C98 000, being made up of current normal tax of C52 000, deferred normal tax of C46 000. No journal entries have yet been processed to take into account any adjustments that may be necessary.
- A vehicle with a carrying amount of C700 000 (and tax base of C650 000) was sold during 20X6. Its original cost was C750 000.

The draft results of operations for the year ended 31 December 20X6 is shown below.

RAINY LIMITED**DRAFT RESULTS OF OPERATIONS****FOR THE YEAR ENDED 31 DECEMBER 20X6**

	20X6 C
Sales	800 000
Rent income	50 000
Dividend income	200 000
Profit on sale of vehicle	100 000
Cost of sales	(300 000)
Depreciation (all depreciation relates to sales representative vehicles)	(150 000)
Interest expense	(120 000)
Other expenses	(80 000)
Dividends declared (30 June 20X6)	(220 000)
Amount to be carried forward to Retained Earnings	280 000
Retained earnings: 1 January 20X6	60 000
Retained earnings: 31 December 20X6	340 000

- Other expenses are allocated to the entity's core functions as follows:
 - Distribution: 30%
 - Administration: 20%
 - Other: 50%
- All amounts are considered material.
- The deferred tax balance at the beginning of the year is C42 000 (debit) whereas the deferred tax balance at the end of the year is C22 800 (debit).
- There are no components of other comprehensive income.
- The normal tax rate is 30% and dividend income is exempt from tax.

Required:

- a) Process all journal entries required to finalise the financial statements for the year ended 31 December 20X6.

Closing journal entries are not required.

- b) Prepare the statement of comprehensive income, using the function method (disclosing the analysis of costs by function on the face of the statement of comprehensive income)
- c) Prepare the tax expense note to be included in the annual financial statements of Rainy Limited for the year ended 31 December 20X6 in accordance with International Financial Reporting Standards.

Question 6.15

Liquid Limited is a listed company in the retail industry. The financial statements are currently being prepared for the year ended 31 December 20X3.

- Liquid limited made a profit before tax of C30 000 in 20X3 (20X2: C20 000 and 20X1: C14 000)
- Dividend income received during the year was C10 000 (20X2:C10 000 and 20X1:C10 000)
- Information relating to property plant and equipment

	20X0	20X1	20X2	20X3
Carrying amount	70 000	64 000	48 000	36 000
Tax base	90 000	70 000	50 000	30 000

- There are no other temporary or permanent differences other than those referred to above.
- Liquid Limited has sufficient appropriate evidence available to suggest that they will be able to utilise their deferred tax assets.
- The normal income tax rate is constant at 30% and dividend income is taxed at 10%.

Required:

- Calculate the current normal tax and deferred normal tax.
- Prepare the tax-related journals for the years ended 31 December 20X1, 20X2 and 20X3.
- Prepare the tax expense and deferred tax note for the years ended 31 December 20X1, 20X2 and 20X3.

Question 6.16

Reflection Limited is a listed company manufacturing mirrors. The financial results for the year ending 20X3 are:

- Profit before tax is C30 000 in 20X3 (20X2: C20 000 and 20X1: C14 000)
- Dividend income received during the year was C10 000 (20X2:C10 000 and 20X1:C20 000)
- Information relating to property, plant and equipment

	20X0	20X1	20X2	20X3
Carrying amount	70 000	64 000	48 000	36 000
Tax base	90 000	70 000	50 000	30 000

- There are no other temporary or permanent differences other than those referred to above.
- There is insufficient evidence for Reflection Limited to realise deferred tax assets.
- The tax rate is constant at 30% and dividend income is taxed at 10%.

Required:

- a) Prepare a current normal tax computation and deferred tax calculation.
- b) Prepare the tax-related journals for the years ended 31 December 20X1, 20X2 and 20X3.
- c) Prepare the tax expense and deferred tax note for the years ended 31 December 20X1, 20X2 and 20X3.

Question 6.17

Beans Limited a listed company manufacturing coffee. Their financial results for the year ending 20X3 are:

- Loss before tax is C20 000 in 20X3 and 20X2: C10 000. Profit before tax is C10 000 in 20X1.
- Dividend income received during the year was C20 000 (20X2:C20 000, 20X1:C20 000).
- An assessed loss of C100 000 is carried forward from 20X0.
- There are no other temporary or permanent differences other than those referred to above.
- Sufficient appropriate evidence was available to recognise deferred tax assets in 20X1. In 20X2, however, it did not appear probable that the tax loss would be able to be utilised. In 20X3 evidence was once again available to recognise deferred tax assets in full.
- The tax rate is constant at 30% whereas dividend income is taxable at 10%.

Assume that tax on dividend income can not be adjusted against unused tax losses and unused tax credits.

Required:

- a) Prepare a current normal tax computation and deferred tax calculation.
- b) Prepare the tax-related journals for the years ended 31 December 20X1, 20X2 and 20X3.
- c) Prepare the tax expense and deferred tax note for the years ended 31 December 20X1, 20X2 and 20X3.

Question 6.18

Avi Limited operates in the food industry. It commenced operations on 1 January 20X6. The following information is available for its year ended 31 December 20X8:

- Profit before tax for the year ended 31 December 20X8 is C650 000. This is arrived at after correctly taking into account all the information below.
- The tax assessment for 20X7 arrived during 20X8 and indicated taxable profits of C650 000. Current normal tax of C195 000 was processed in 20X7.

- A building was sold for C100 000. It was purchased for C200 000. On the date of sale, 1 January 20X8, the building had a carrying amount of C120 000 and a tax base of C130 000.
- Plant was revalued to a fair value of C60 000 on 1 January 20X8. This is the first revaluation of any item of property, plant and equipment to date. The plant originally cost C100 000 and had a carrying amount on 1 January 20X8 of C50 000.
- No transfers of the realized portion of the revaluation surplus to retained earnings are made.
- No other items of property, plant and equipment were revalued.
- Depreciation is provided on the revalued property, plant and equipment. It had a remaining useful life of 5 years on 1 January 20X8 (consistent with previous estimates of useful life).
- The tax authorities allows tax depreciation on the item of plant (revalued above) at 25% p.a. on cost, but the item of plant already had a tax base of zero on 1 January 20X8.
- Depreciation and capital allowances on all items of property, plant and equipment (other than the revalued plant) were C50 000 and C35 000 respectively.
- Dividend income of C20 000 was earned in the current year.
- The following items appeared in the draft 31 December 20X8 statement of financial position:
 - accrued income (taxed when earned) C10 000
 - expenses prepaid (deductible when paid) C30 000
- The following items appeared on the 31 December 20X7 statement of financial position:
 - accrued income (taxed when earned) C20 000
 - expenses prepaid (deductible when paid) C0
 - property, plant and equipment (including plant and buildings) C700 000
- Property, plant and equipment (including plant and buildings) had a tax base at 31 December 20X7 of C680 000.
- The current normal tax rate is 30% (20X7: 29%) where as dividend income is taxable at 10%.
- There are no permanent or temporary differences other than those evident from the information provided.

Required:

- a) Calculate the deferred tax balance at 31 December 20X8 using the balance sheet approach.
- b) Calculate the current tax expense for the year ended 31 December 20X8

Question 6.19

The following is the trial balance of ABC Limited at 31 December 20X4:

TRIAL BALANCE AS AT 31 DECEMBER 20X4	
	Dr/ (Cr)
Revenue from services	(1 510 000)
Dividend income	(5 000)
Profit on sale of plant (carrying amount: 30 000 on date of sale)	(25 000)
Depreciation on plant	50 000
Donations made (not deductible)	25 000
Finance charges (deductible)	55 000
Other expenses (deductible)	600 000
Dividends declared	10 000
Revenue received in advance: 1 Jan X4 (taxable in 20X3)	(5 000)
Rent expense prepaid: 1 Jan X4 (deductible for tax purposes in 20X3)	20 000
Share capital	(200 000)
Retained earnings: 1 Jan X4	(320 000)
Total non-current liabilities (including deferred tax liability)	(150 000)
Property, plant and equipment	1 075 000
Inventory	400 000
Debtors	30 000
Creditors	(40 000)
Bank overdraft	(10 000)
	<u>0</u>

The trial balance was given to you by the director of ABC Limited. He studied accounting at university twenty years ago and received a first in Accounting 101. When his accountant threatened to resign two weeks ago due to low pay, he accepted the resignation thinking that he would be able to process the outstanding journal entries himself.

Looking at the material he found in the accountant's office after he had packed up and left the building, he discovered that things seemed to be a lot more involved than in Accounting 101, which was essentially focussed on basic book-keeping. He has requested you to resolve this crisis for him since he has to have the draft financial statements ready for a directors' meeting in an hour.

The following information is relevant:

- Revenue from services includes revenue received in advance at 31 December 20X4 is C15 000 (this is taxable in 20X4).
- Rent expense includes rent expense prepaid at 31 December 20X4 C30 000 (this is deductible for tax purposes in 20X4).
- The taxable capital gain on the sale of plant is C7 500 and the original cost of Plant is C 50 000.
- Tax depreciation granted as a deduction in 20X4 is C30 000.
- The tax base of property, plant and equipment was C800 000 at 31 December 20X4.

- Dividend of C30 000 were declared during 20X4 (C10 000 as an interim and C20 000 as a final dividend).
- The final dividend has not yet been journalised.
- Current normal tax in 20X3 was recognised at C110 000. The tax assessment of 20X3, received during late 20X4, indicated total assessed normal tax of C120 000.
- There was no movement in share capital during 20X4.
- The rate of normal tax is 40% (20X3: 30%) and dividend is taxed @ 10%.
- No journal entries relating to tax have yet been processed.

Required:

Process any outstanding journal entries for the year ended 31 December 20X4 (closing entries are not required).

Question 6.20

Sozorsted Limited is a company that specializes in luxury bedding, including mattresses, duvets, bed linen and pillows. It even offers a sleep clinic for customers wishing to have sleep disorders diagnosed.

You are at a dinner party, where the accountant of Sozorsted Limited confesses to you that he has been battling with their company tax calculations for a few days now and has asked you to please take a look at the information he has been working with.

SOZORSTED LIMITED**TRIAL BALANCE AS AT 31 DECEMBER 20X4**

	Debit	Credit
Revenue from services		1 510 000
Dividend income		5 000
Profit on sale of plant (carrying amount: C30 000 on date of sale)		25 000
Depreciation on plant	50 000	
Donations made (not deductible for tax purposes)	25 000	
Finance charges (deductible for tax purposes)	55 000	
Other expenses (deductible for tax purposes)	600 000	
Dividends declared	10 000	
Revenue received in advance: 1/1/X4 (taxable in 20X3)		5 000
Rent expense prepaid: 1/1/X4 (deductible for tax purposes in 20X3)	20 000	
Share capital		200 000
Retained earnings: 1/1/X4		320 000
Total non-current liabilities (including deferred tax liability)		150 000
Property, plant and equipment	1 075 000	
Inventory	400 000	
Debtors	30 000	
Creditors		40 000
Bank overdraft		10 000
	2 265 000	2 265 000

The following information is relevant:

- Revenue from services received in advance at 31 December 20X4 is C15 000 (this is taxable in 20X4).
- Rent expense prepaid at 31 December 20X4 is C30 000 (this is deductible for tax purposes in 20X4).
- The tax base of the plant on date of sale was C10 000.
- Tax depreciation on plant granted as a deduction in 20X4 is C30 000.
- The tax base of property, plant and equipment was C800 000 at 31 December 20X4.
- There was no movement in property, plant and equipment during 20X4 other than is evident from the information provided.
- There was no movement in share capital during 20X4.
- Dividends of C30 000 were declared during 20X4 (C10 000 was declared on 15 May 20X4 as an interim dividend and C20 000 was declared on 29 December 20X4 as a final dividend).
- The final dividend has not yet been journalized.
- Current normal tax in 20X3 was recognized at C110 000. The tax assessment of 20X3, received during late 20X4, indicated total assessed normal tax of C120 000.
- The rate of normal tax is 30% (20X3: 40%).
- No journal entries relating to tax have yet been processed.
- Apart from any deferred tax liabilities, the only other non-current liability is a long-term loan.
- There are no temporary or permanent differences other than those evident from the information provided.
- There are no items of other comprehensive income in 20X4.

Required:

Disclose the above information in the financial statements of Sozorsted Limited for the year ended 31 December 20X4 in accordance with IFRSs. Only the following notes are required:

- Taxation
- Deferred tax

Comparatives are only required for the deferred tax note.

