POPPY LTD Current Tax Worksheet (extract) for the year ended 30 June 2015	
Taxable profit before tax loss	£23 600
Tax loss recouped	(3 200)
Taxable profit	20 400
Current tax liability @ 30%	£ 6 120

The adjusting journal entry is:

30 June 2015			
Income Tax Expense (Current)	Dr	7 080	
Deferred Tax Asset (Tax Losses)	Cr		960
Current Tax Liability	Cr		6 120
(Recognition of current tax liability and reversal of deferred tax asset from tax loss)			

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6.8 CALCULATION OF DEFERRED TAX

As already explained, IAS 12 adopts the philosophy that the tax consequences of transactions that occur during a period should be recognised in income tax expense for that period. Where a transaction has two effects, both have to be recognised. The existence of temporary differences between accounting profit and taxable profit was identified *earlier in the chapter*. These temporary differences result in the carrying amounts of an entity's assets and liabilities being different from the amounts that would arise if a statement of financial position was prepared for the taxation authority. The latter are referred to as the tax base of an entity's assets and liabilities. At the end of the reporting period, a comparison of an entity's carrying amounts of assets and liabilities and their tax bases will reveal the temporary differences that exist, and adjustments will then be made to deferred assets and liabilities. (The reference to 'deferred' tax adjustments comes from the fact that assets and liabilities reflect future inflows and outflows to an entity. The deferred tax balances are related to these future flows, and hence are deferred to the future rather than affecting current tax.) For assets such as goodwill and entertainment costs payable, differences between their tax bases and carrying amounts may be caused by permanent differences. Such differences will not give rise to deferred tax adjustments.

The following steps are required to calculate deferred tax:

1. Determine the carrying amounts of items recognised in the statement of financial position.
2. Determine the tax bases of the items recognised by identifying the taxable and deductible temporary differences relating to the future tax consequences of each item.
3. Calculate and recognise the deferred tax assets and liabilities arising from these temporary differences after taking into account any relevant recognition exceptions *(see section 6.8.5)* and offset considerations *(see section 6.12.1)*.
4. Recognise the net movement in deferred tax assets and liabilities during the period as deferred tax expense or income in profit or loss (unless an accounting standard requires recognition directly in equity or as part of a business combination).

The first three steps are carried out on a worksheet. The final step requires an adjusting journal entry.

6.8.1 Determining carrying amounts

Carrying amounts are asset and liability balances net of valuation allowances, accumulated depreciation, amortisation and impairment losses (for example, accounts receivable less allowance for doubtful debts).

6.8.2 Determining tax bases

Tax bases need to be calculated for assets and liabilities.

Tax bases of assets

The economic benefits embodied in an asset are normally taxable when recovered by an entity through the use or sale of that asset. The entity may then be able to deduct all or part of the cost or carrying amount of the asset against those taxable amounts when determining taxable profits.

Paragraph 7 of IAS 12 describes the tax base of an asset as:

> the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an 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.

The following formula can be applied to derive the tax base from the carrying amount of the asset:

Carrying amount – Future taxable amounts + Future deductible amounts = Tax base

Figure 6.2 contains examples of the calculation of tax bases for assets.

	Carrying amount	Future taxable amounts*	Future deductible amounts	Tax base
Prepayments £3 000: fully deductible for tax when paid	£ 3 000	£(3 000)	£ 0	£ 0
Trade receivables of £52 000 less £2 000 allowance for doubtful debts: sales revenue is already included in taxable profit	50 000	0	2 000	52 000
Plant and equipment costing £10 000 has a carrying value of £5 400: accumulated tax depreciation is £6 500	5 400	(5 400)	3 500**	3 500
Loan receivable £25 000: loan repayment will have no tax consequences	25 000	0	0	25 000
Interest receivable £1 000: recognised as revenue but not taxable until received	1 000	(1 000)	0	0

* Future taxable amounts are equal to carrying amounts unless economic benefits have already been included in taxable profit.

** The deductible amount represents the original cost of the asset less the accumulated depreciation based on taxation depreciation rates (being £10 000 – £6 500 = £3 500).

FIGURE 6.2 Calculation of the tax base of assets

Figure 6.2 illustrates the following situations:

- Where the future benefits are taxable, the carrying amount equals the future taxable amount. Hence, the tax base equals the future deductible amount. This can be seen in figure 6.2 for prepayments, plant and equipment, and interest receivable.
- Where there are no future taxable amounts, generally the deductible amount is zero and the tax base equals the carrying amount. In figure 6.2, this applies to the loan receivable. An exception is trade receivables where, although the future taxable amount is zero, the future deductible amount is not zero because of the existence of doubtful debts. In this case, the tax base equals the sum of the carrying amount and the future deductible amount.

Tax bases of liabilities

Liabilities, other than those relating to unearned revenue, do not create taxable amounts. Instead, settlement gives rise to deductible items.

Paragraph 8 of IAS 12 describes the tax base of a liability as:

> its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods. In the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue that will not be taxable in future periods.

The following formula can be applied to derive the tax base from the carrying amount of the liability:

Carrying amount + Future taxable amounts – Future deductible amounts = Tax base

Figure 6.3 contains examples of the calculation of the tax base for liabilities.

	Carrying amount	Future taxable amounts	Future deductible amounts	Tax base
Provision for annual leave £3 900: not deductible for tax until paid	£ 3 900	£ 0	£(3 900)	£ 0
Trade payables £34 000: expense already deducted from taxable income	34 000	0	0	34 000
Subscription revenue received in advance £500: taxed when received	(500)	(500)	0	0
Loan payable £20 000: loan repayment will have no tax consequences	20 000	0	0	20 000
Accrued expenses £6 700: deductible when paid in cash	6 700	0	(6 700)	0
Accrued penalties £700: not tax-deductible	700	0	0	700

FIGURE 6.3 Calculation of the tax base of liabilities

Figure 6.3 illustrates two situations:

- Where the carrying amount equals the future deductible amount, the tax base is zero. This applies to provisions for annual leave and accrued expenses.
- Where there is no future deductible amount, the carrying amount equals the tax base. This applies to trade payables and the loan payable.

Some items may have a tax base but are not recognised as assets and liabilities in the statement of financial position. Paragraph 9 of IAS 12 provides the example of research costs that are recognised as an expense in determining accounting profit in the period in which they are incurred but are not allowed as a deduction in determining taxable profit until a later period. Additionally, under paragraph 52 the manner in which an asset/liability is recovered/settled may affect the tax base of that asset/liability in some jurisdictions.

6.8.3 Calculating temporary differences

When the carrying amount of an asset or liability is different from its tax base, a temporary difference exists. Temporary differences effectively represent the expected net future taxable amounts arising from the recovery of assets and the settlement of liabilities at their carrying amounts. Therefore, a temporary difference cannot exist where there are no future tax consequences from the realisation or settlement of an asset or liability at its carrying value.

Taxable temporary differences

A taxable temporary difference exists when the future taxable amount of an asset or liability exceeds any future deductible amounts. This is demonstrated in illustrative example 6.4.

ILLUSTRATIVE EXAMPLE 6.4 Calculation of a taxable temporary difference

An asset, which cost 150, has an accumulated depreciation of 50.

Accumulated depreciation for tax purposes is 90 and the tax rate is 25%.

Carrying amount	= 100
Future taxable amount	= 100
Future deductible amount	= 60
Tax base	= 100 − 100 + 60
	= 60 (= 150 cost less 90 tax depreciation)

Because the future taxable amount is greater than the future deductible amount, a temporary taxable difference exists. In other words, the expectation is that the entity will pay income taxes in the future, when it recovers the carrying amount of the asset, because it expects to earn 100 but receive a tax deduction of 60. The entity has a liability to pay tax on that extra 40. As the payment occurs in the future, the liability is referred to as a 'deferred tax liability'.

Source: Adapted from IAS 12, paragraph 16.

Deductible temporary differences

A deductible temporary difference exists when the future taxable amount of an asset or liability is less than any future deductible amounts. This is demonstrated in illustrative example 6.5.

ILLUSTRATIVE EXAMPLE 6.5 Calculation of a deductible temporary difference

Dalal Inc. recognises a liability of 100 for accrued product warranty costs. For tax purposes, the product warranty costs will not be deductible until Dalal Inc. pays claims. The tax rate is 25%.

Carrying amount	= 100
Future taxable amount	= 0
Future deductible amount	= 100
Tax base	= 100 + 0 − 100
	= 0

As the future deductible amount is greater than the future taxable amount, a deductible temporary difference exists. In other words, in settling the liability for its carrying amount, Dalal Inc. will reduce its future tax profits and hence its future tax payments. Dalal Inc. then has an expected benefit relating to the future tax deduction. As the benefits are to be received in the future, the asset raised is referred to as a 'deferred tax asset'.

Source: Adapted from IAS 12, paragraph 25.

6.8.4 Calculating deferred tax liabilities and deferred tax assets

Paragraphs 15 and 24 of IAS 12 require (with some exceptions) that a deferred tax liability and a deferred tax asset be recognised for all taxable temporary differences and all deductible temporary differences, and that a total be determined for taxable temporary differences and for deductible temporary differences. An appropriate tax rate can then be applied to these totals to derive the balance of deferred tax liability and deferred tax asset at the end of the period. Paragraph 47 of the standard specifies that:

> Deferred tax assets and liabilities shall be measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Thus, if the tax rate is currently 30% but will rise to 32% in the next reporting period, deferred amounts should be measured at 32%. Should a change be enacted (or substantively enacted) between the end of the reporting period and the time of completion of the financial statements, no adjustment needs to be made to the tax balances recognised. However, disclosure of any material impacts should be made by note in compliance with IAS 10 *Events after the Reporting Period*.

Different tax rates may be required when temporary differences are expected to reverse in different periods and a change of tax rate is probable, or when temporary differences relate to different taxation jurisdictions. Additionally, consideration should be given to the manner in which an asset/liability is recovered/settled in jurisdictions where the manner of recovery/settlement determines the applicable tax rate (IAS 12 paragraph 52).

Before determining the amounts of deferred tax liabilities and deferred tax assets, consideration must be given to the recognition criteria mandated by the accounting standard. *(See section 6.9.)*

6.8.5 Excluded differences

A deferred tax liability is usually recognised on taxable temporary differences, but if the taxable temporary difference meets the criteria in paragraph 15 of IAS 12, it is exempt from deferred tax. Likewise, a deferred tax asset is normally recognised on deductible temporary differences, but if this difference meets the criteria in paragraph 24 of IAS 12, it may also be exempt from deferred tax.

Paragraph 15 states that a *deferred tax liability* shall be recognised for all *taxable* temporary differences, *except* where the deferred tax liability arises from:

(a) goodwill; or
(b) the initial recognition of an asset or liability, which
  (i) did not arise through a business combination, and which
  (ii) at the time of the transaction, affects neither accounting profit nor taxable profit.

Paragraph 24 states that *a deferred tax asset* shall be recognised for all *deductible* temporary differences, *except* where the deferred tax asset arises from the initial recognition of an asset or liability, which:

(a) did not arise through a business combination, and
(b) at the time of the transaction, affects neither accounting profit nor taxable profit.

Goodwill

Goodwill is the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities (see chapter 14). A taxable temporary difference is created because the tax base of goodwill is always nil. IAS 12 does not permit the recognition of the deferred tax liability relating to goodwill, because goodwill is a residual amount and recognising the deferred tax amount would increase the carrying amount of goodwill (IAS 12 paragraph 21).

Initial recognition of an asset or liability

The tax base and carrying amount of an asset are usually the same on initial recognition but in the case of a non-deductible asset, such as land, a temporary difference arises on initial recognition. Consider the example of a non-deductible asset that is not acquired through a business combination. A non-deductible asset is an asset whose cost is not allowed as a deduction when calculating taxable profits and therefore the tax base on date of purchase is zero. A taxable temporary difference will arise on the initial recognition, being the difference between the carrying amount on date of purchase (the asset's cost) and its tax base (zero).

The initial recognition, in other words, the purchase, does not affect accounting profit or taxable profit. Thus, although a deferred tax liability is normally recognised on taxable temporary differences, no deferred tax is recognised on this taxable temporary difference since it meets the requirements of paragraph 12 of IAS 12 to be exempt from deferred tax.

6.8.6 Deferred tax worksheet

A deferred tax worksheet is shown in illustrative example 6.6. The purpose of the deferred tax worksheet is to calculate the movements in the deferred tax asset and the deferred tax liability accounts during the current period. Determining the temporary differences relating to assets and liabilities allows the closing balances of the deferred tax accounts to be calculated. A consideration of the beginning balances and movements during the year allows the calculation of the adjustments required to achieve those closing balances. All assets and liabilities may be included in the worksheet; alternatively, only those expected to have different accounting and tax bases could be shown.

ILLUSTRATIVE EXAMPLE 6.6 Deferred tax worksheet

Using the information provided in illustrative example 6.2, the deferred tax worksheet for Iris Ltd is shown in figure 6.4.

IRIS LTD
Deferred Tax Worksheet
as at 30 June 2013

	Carrying amount	Future taxable amount	Future deductible amount	Tax base	Taxable temporary differences	Deductible temporary differences
Relevant assets						
Receivables[1]	£279 000	£ 0	£16 000	£295 000		£16 000
Prepaid insurance[2]	30 000	(30 000)	0	0	£ 30 000	
Rent receivable[3]	3 500	(3 500)	0	0	3 500	
Development project[4]	90 000	(90 000)	0	0	90 000	
Equipment[5]	110 000	(110 000)	80 000	80 000	30 000	
Goodwill[6]	21 000	(21 000)	0	0	21 000	
Relevant liabilities						
Provision for annual leave[7]	61 000	0	(61 000)	0	—	61 000
Total temporary differences					174 500	77 000
Excluded differences[8]					(21 000)	—
Temporary differences					153 500	77 000
Deferred tax liability[9]					46 050	
Deferred tax asset[9]						23 100
Beginning balances[10]					(17 150)	(24 900)
Movement during year[11]					—	—
Adjustment[10]					28 900 Cr	(1 800) Cr

FIGURE 6.4 Deferred tax worksheet for Iris Ltd

1. The carrying amount of receivables £279 000 (£295 000 – 16 000) represents the cash that the company expects to receive after allowing for any doubtful debts. Tax on this amount has already been paid via sales revenue recognised in the current year, so the future taxable amount is zero. The allowance for doubtful debts raised as an expense in the current year is not deductible against taxable profit until the debts actually go 'bad' and are written out of the accounts receivable balance. Thus, there is a future deduction of £5000 available. The tax base for receivables is £283 000, being the total of all debts outstanding at 30 June 2013 (doubtful or otherwise). Because the future deductible amount is greater than the future taxable amount, a deductible temporary difference of £5000 exists in respect of receivables.
2. The prepaid insurance asset represents the future benefit of insurance cover at 30 June 2013. The recovery of these benefits results in the flow of taxable economic benefits to Iris Ltd, giving a future taxable amount of £30 000. This amount was paid in the year ended 30 June 2013 and was allowed as a deduction against the taxable profit for that year. This means that no deduction is available when the £30 000 is expensed in the year ended 30 June 2014, giving a tax base for the asset of £0. As the future taxable amount exceeds the future deductible amount, a taxable temporary difference of £30 000 exists in respect of prepaid insurance.
3. The rent receivable asset represents monies to be received at 30 June 2013. The recovery of these benefits results in the flow of taxable economic benefits to Iris Ltd. Hence, a future taxable amount of £3500 exists. As this is a revenue item, no future deduction is available and the tax base is £0. As the future taxable amount exceeds the future deductible amount, a taxable temporary difference of £3500 exists in respect of the rent receivable.
4. The development project asset represents the future economic benefits expected to arise from development work undertaken in the current year. When those benefits are received, they are taxable. The total expenditure on development was deducted from taxable profit in the current year, so no future deduction is available. The tax base is £0 as the cash paid has already reduced taxable profit in the current year. As the future taxable amount exceeds the future deductible amount, a taxable temporary difference of £90 000 exists in respect of the development project.
5. The carrying amount of equipment represents the future economic benefits expected to be received from that asset over the remainder of its useful life, £110 000 (£200 000 – £90 000). When those benefits are received, they are taxable. Iris Ltd will be able to claim a deduction against those taxable benefits, but only to the extent of the tax base of the asset. As the depreciation rate for tax purposes is greater than the accounting rate, the future deduction is only £80 000, being the original cost of £200 000 less £120 000 (i.e. 3 years' accumulated depreciation at 20% per annum). As the future taxable amount exceeds the future deductible amount, a taxable temporary difference of £30 000 exists in respect of equipment.
6. The carrying amount of goodwill represents the future economic benefits expected to be received. Those benefits are taxable when received but, unlike equipment, no deduction against the benefits is available. The tax base of goodwill is £0 as taxation law does not allow a deduction for any amounts paid to acquire goodwill. As the future taxable amount exceeds the future deductible amount, a taxable temporary difference of £21 000 exists in respect of goodwill (however, see exemption in 8 below).
7. The provision for annual leave represents leave accrued by employees as at the end of the reporting period. As the leave represents future payments, there is no future taxable amount. When those payments are made, they are fully deductible against taxable profit. The tax base at 30 June 2013 is £0 because leave payments are only deductible in the year of payment. As the future deductible amount exceeds the future taxable amount, a deductible temporary difference of £61 000 exists in respect of the annual leave provision.
8. The adjustment for excluded differences recognises that IAS 12 (paragraphs 15 and 24) has prohibited the recognition of deferred tax amounts relating to certain temporary differences (*see section 6.9.2*). Paragraph 15 prohibits the recognition of the taxable temporary difference relating to goodwill, so it is removed from the total temporary differences existing at 30 June 2013.
9. The deferred tax liability figure of £46 050 is the future tax payable as a result of the existence of taxable temporary differences of £153 500. The deferred tax asset figure of £23 100 is the future deductions available as a result of the existence of deductible temporary differences of £77 000. These figures represent the closing balances of the deferred tax accounts.
10. Deferred tax amounts may accumulate over time; for example, the taxable temporary difference for equipment represents 3 years' differentials between accounting and taxation depreciation charges. This means that the deferred tax accounts have an opening balance representing prior year differences. If no adjustment is made for the opening balance, the deferred tax amounts are overstated. Accordingly, the opening balances are deducted from the total balances in order to determine the adjustment necessary to account for changes (additions and reversals) to deferred tax items during the current year. These adjustments are shown on the last line of the worksheet and form the basis of the adjusting journal entry for deferred tax. Positive figures are increases and negative figures are decreases in the account balances.

11. Normally, the deferred tax accounts are only adjusted at the end of each reporting period after the worksheet has been completed. Occasionally, however, adjustments are made to the deferred accounts during the year so the 'movements' line is used to adjust for such changes. Adjustments could be made for:
   - recoupment of prior year tax losses *(see section 6.7)*
   - a change in tax rates *(see section 6.10)*
   - an amendment to a prior year tax return *(see section 6.11)*
   - revaluation of property, plant and equipment items *(see section 6.11.2)*
   - business combinations *(see section 6.11.3)*.

The flowcharts in figure 6.5 below summarise the measurement of deferred tax items according to IAS 12. While the flowcharts show the steps in the calculation of deferred tax items, they do not present the steps in determining whether the resultant deferred tax assets or deferred tax liabilities will be recognised. The criteria for the recognition of deferred tax assets and deferred tax liabilities are considered next, *in section 6.9*.

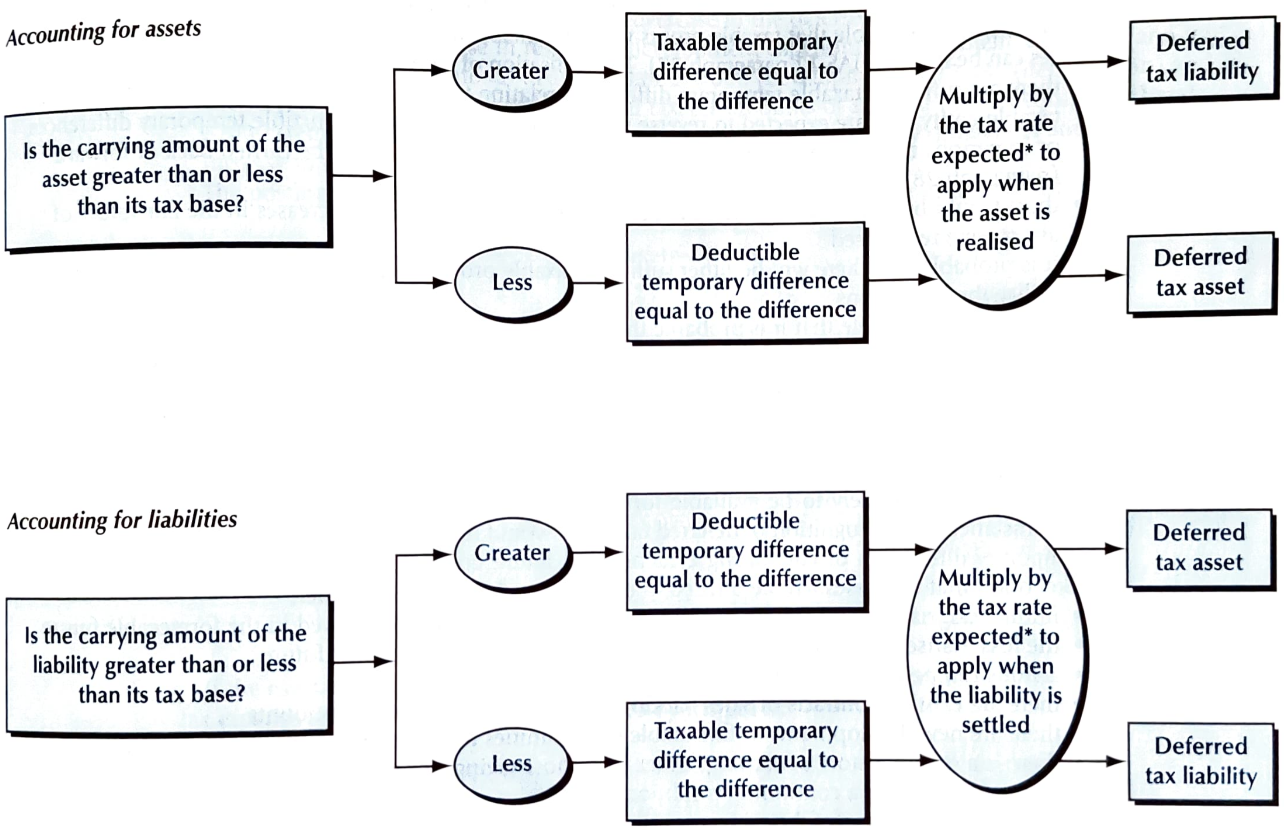

FIGURE 6.5 Accounting for deferred tax items

Note: *refers to the present tax rate or tax laws (tax rates) that have been enacted or substantively enacted by reporting date.

Source: CPA Australia (2010, p. 2).

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6.9 RECOGNITION OF DEFERRED TAX LIABILITIES AND DEFERRED TAX ASSETS

The existence of temporary taxable and deductible differences may not result in the recognition of deferred tax assets and liabilities. Paragraphs 15 and 24 of IAS 12 specify recognition criteria that must be met before recognition occurs.

6.9.1 Deferred tax liabilities

Deferred tax liabilities must be recognised for all taxable temporary differences (except as outlined below). A liability is recognised when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation, and the amount at which the settlement will take place can be measured reliably (*Conceptual Framework* paragraph 4.46). There is no need to explicitly consider the recognition criteria for a deferred tax liability, because it is always probable that resources will flow from the entity to pay the tax associated with taxable temporary differences. As the carrying amount of the asset or liability giving rise to the taxable temporary difference is recovered or settled, the temporary difference will reverse and give rise to taxable amounts in future periods.

6.9.2 Deferred tax assets

Deferred tax assets must be recognised for all deductible temporary differences (subject to certain exceptions) and from the carry forward of tax losses, but only to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

An asset is recognised when it is probable that the future economic benefits will flow to the entity, and the asset has a cost or value that can be measured reliably (*Conceptual Framework* paragraph 4.44). According to paragraph 4.40 of the *Conceptual Framework*, probability refers to the degree of uncertainty about whether the future economic benefits associated with the asset will flow to the entity. This probability must be assessed using the best evidence available based on the conditions at the end of the reporting period. The reversal of deductible temporary differences results in deductions against the taxable profits of future periods. Economic benefits in the form of reductions in tax payments will flow to the entity only if it earns sufficient taxable profits against which the deductions can be offset. Therefore, an entity recognises deferred tax assets only when it is probable that taxable profits will be available against which the deductible temporary differences can be utilised (IAS 12 paragraph 27). The realisation of a deferred tax asset would be probable where:

- there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity that are expected to reverse in the same period as the deductible temporary differences, or in periods to which a tax loss arising from the deferred tax asset can be carried back or forward (paragraph 28)
- there would be taxable temporary differences arising if unrecognised increases in the fair values of assets were recognised
- it is probable that there will be other sufficient taxable profits arising in future periods against which to utilise the deductions
- other factors indicate that it is probable that the deductions can be realised.

If there are insufficient taxable temporary differences available against which to offset the deductible temporary differences, an entity can recognise a deferred tax asset only to the extent that sufficient taxable profits will be made in the future or that tax planning opportunities are available to create future taxable profits (IAS 12 paragraph 29).

A history of accounting losses, or the existence of unused tax losses, provides evidence that future taxable profits are unlikely to be available for the utilisation of deductible temporary differences. In these circumstances, the recognition of deferred tax assets would require either the existence of sufficient taxable temporary differences or convincing evidence that future taxable profits will be earned. In assessing the likelihood that tax losses will be utilised, the entity should consider whether:

- future budgets indicate that there will be sufficient taxable income derived in the foreseeable future
- the losses arise from causes that are unlikely to recur in the foreseeable future
- actions can be taken to create taxable amounts in the future
- there are existing contracts or sales backlogs that will produce taxable amounts
- there are new developments or favourable opportunities likely to give rise to taxable amounts
- there is a strong history of earnings other than those giving rise to the loss, and the loss was an aberration and not a continuing condition.

Where, on the balance of the evidence available, it is not probable that deductible temporary differences will be utilised in the future, no deferred tax asset is recognised. This probability assessment must also be applied to deferred tax assets that have previously been recognised and, if it is no longer probable that the benefits of such assets will flow to the entity, the carrying amount must be derecognised by passing the following entry:

30 June			
Income Tax Expense	Dr	XXX	
Deferred Tax Asset	Cr		XXX
(Derecognition of deferred tax assets where recovery is no longer probable)			

At the end of each reporting period, the entity should reassess the probability of recovery of all unrecognised deferred tax assets; it should recognise these assets to the extent that it is now probable that future taxable profit will allow the deduction of the temporary difference on its reversal. Changes in trading conditions, new taxation legislation, or a business combination may all contribute to improving the chance of recovering the deferred tax benefits. Paragraph 60 of IAS 12 requires that any adjustment to deferred tax be recognised in the statement of comprehensive income except to the extent that it relates to items previously charged or credited to equity.

ILLUSTRATIVE EXAMPLE 6.7 Recognition of deferred tax adjustments

Using the figures calculated in illustrative example 6.6 and assuming that the recognition criteria for deferred tax assets can be met, the adjusting journal for deferred tax movements is:

30 June 2013			
Income Tax Expense	Dr	30 700	
Deferred Tax Asset	Cr		1 800
Deferred Tax Liability	Cr		28 900
(Recognition of movements in deferred tax balances for the year)			

These movements can be checked back to the current worksheet as follows:

- Deferred tax assets arise in respect of doubtful debts and annual leave. In the current year, additional deductions of £2000 (doubtful debts) and £4000 (leave) are received. This indicates that more deductible temporary differences had been reversed than had been created, resulting in a decrease of £6000 in future deductions and a £1800 decrease in the deferred tax asset.
- Deferred tax liabilities arise in respect of development expenditure, equipment, insurance and rent. In the current year, additional deductions of £90 000 (development), £13 333 (depreciation) and £5000 (insurance) are offset by additional taxable amounts of £10 000 (sale of equipment) and £2000 (rent revenue), giving a net extra increase in taxable temporary differences and a £28 900 increase in the deferred tax liability.

The posting of this entry results in the deferred tax ledger accounts appearing as follows:

Deferred Tax Asset

1/7/12	Balance b/d	24 900	30/6/13	Income Tax Expense	1 800
			30/6/13	Balance c/d	23 100
		24 900			24 900
1/7/13	Balance b/d	23 100			

Deferred Tax Liability

30/6/13	Balance c/d	46 050	1/7/12	Balance b/d	17 150
			30/6/13	Income Tax Expense	28 900
		46 050			46 050
			1/7/13	Balance b/d	46 050

If the two taxation adjusting journals — current and deferred — are combined, then the total income tax expense recorded for the year ended 2013 by Iris Ltd is:

Income Tax Expense (Current) (see section 6.5)	£41 270
Income Tax Expense (Deferred) (see above)	30 700
Total	£71 970

This figure represents the total tax consequences of the transactions recorded in profit or loss for the year. It can be checked in this way: The accounting profit for the year is £250 450. All items of revenue and expense are taxable or deductible with the exception of goodwill impairment and entertainment expense. The development expenditure during the year gave rise to an 'extra' deduction of £30 000 against taxable profit. If the accounting profit adjusted for these permanent differences is multiplied by the tax rate, the result represents the total tax payable above (both now and in the future):

Accounting profit	£250 450
Add: Non-deductible amortisation	7 000
Add: Non-deductible entertainment expense	12 450
Less: Additional deduction for development	(30 000)
Taxable net profit	239 900
Tax @ 30%	£ 71 970