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Olsztyn Economic Journal 6/1, 121-131

2011

OLSZTYN ECONOMIC JOURNAL
Abbrev.: Olszt. Econ. J., 2011, 6(1)

ASSETS AND PROVISIONS FOR THE DEFERRED INCOME TAX – NATURE AND PRESENTATION IN THE FINANCIAL STATEMENT

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Key words: assets for the deferred income tax, provisions for the deferred income tax, positive and negative temporary differences of assets and liabilities, balance sheet and tax value of the balance sheet assets and liabilities items.

Abstract

The article is devoted to the nature of the deferred income tax. It presents the terms concerning the presented issue as well as the principles and records for establishing and releasing the assets and provisions for the deferred income tax. The considerations were supported by an example of determining the deferred tax for the basic balance sheet items and the method of presenting them in the financial statements of the entity.

AKTYWA I REZERWY Z TYTUŁU ODROCZONEGO PODATKU DOCHODOWEGO – ISTOTA ORAZ PREZENTACJA W SPRAWOZDANIU FINANSOWYM

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Słowa kluczowe: aktywa z tytułu odroczonego podatku dochodowego, rezerwy z tytułu odroczonego podatku dochodowego, dodatnie i ujemne różnice przejściowe aktywów i pasywów, wartość bilansowa i podatkowa pozycji aktywów i pasywów bilansu.

Abstrakt

Artykuł poświęcono istocie odroczonego podatku dochodowego. Przedstawiono w nim terminy dotyczące omawianego zagadnienia oraz zasady i ewidencję tworzenia i rozwiązywania aktywów i rezerw z tytułu odroczonego podatku dochodowego. Rozważania poparto przykładem ustalania podatku dla podstawowych pozycji bilansowych oraz sposób ich prezentacji w sprawozdaniu finansowym jednostki.

Introduction

The International Accounting Standards Committee devoted the International Accounting Standard 12 Accounting for Taxes on Income that became effective as of 1981 to the issue of the income tax. In 1998 the IAS 12 was updated and reissued under the name of Income Taxes. It consists of more than 90 paragraphs with examples (Międzynarodowy Standard Rachunkowości nr 12 Podatek dochodowy, 1999, p. 1375)

In Poland, the history of accounting for the income tax goes back to the year 1995 and it was introduced by the Act of the 29th of September 1994 on accounting. In the Act just one article, art. 37, consisting of 10 paragraphs was devoted to the deferred tax. The domestic regulations in that field are complemented by the National Accounting Standard 2 Income Tax published in 2004, which contains the detailed development of the provisions of the Act and has similar content, structure and volume as the IAS 12 (KAMIENIECKA 2009b, p. 36).

On matters not regulated by the provisions of the Act in case of determining the deferred income tax, the entities may use the National Accounting Standard (KSR) No. 2 Income tax. It defines the principles concerning inclusion, valuation and presentation of receivables and payables for the income tax and assets and provisions concerning the deferred income tax as well as the principles of revealing the information concerning them in the financial statement (*Odroczony podatek dochodowy*. 2010, p. 64).

The deferred income tax is determined only by legal entities conducting business activity that are payers of the income tax the financial statements of which are subject to audit and publication according to art. 64 section 1 of the Act on accounting. Other entities may resign determination of the deferred income tax (legal entities the financial statements of which are not subject to compulsory publication) if this does not have a material influence on their assets and financial standing as well as the financial result. The decision on resignation from determining the deferred income tax should be reflected in the documentation describing the accounting principles (policy) assumed for application by the entity (*Rezerwy i aktywa z tytułu odroczonego podatku dochodowego – wybrane zagadnienia*. 2008, p. 9).

The aim of the article is to discuss the nature of the deferred income tax by means of the presentation of the basic terms and definitions concerning the analyzed subject. The presented example shows the method of determining, recording and presenting the assets and provisions for the deferred income tax in the financial statement.

Assets and provisions for the deferred income tax

As a consequence of the temporary differences between the value of assets and liabilities represented in the accounting ledgers and their tax value and the tax loss that might be deductible in the future, entities are required to establish provisions and determine assets for the deferred income tax of which they are payers. We deal with temporary differences when according to both the regulations on accounting and on the income tax they influence the gross financial result and the tax base in the same amount but this occurs during different reporting periods (*Odroczony podatek dochodowy*. 2010, p. 65).

The differences between the tax value and balance sheet (accounting) value of components of assets and liabilities that are temporary differences in their nature, from the perspective of the consequences to the tax settlements are divided into: (1) positive (taxable) temporary differences, which – when the carrying amount of the asset or liability is recovered or settled – will result in the future periods in an increase of the tax base, and (2) negative (deductible) temporary differences, which – when the carrying amount of the asset (its book value) or liability is recovered or settled – will result in the future periods in a decrease of the tax base.

The so-called balance sheet approach is applied for including the deferred income tax in the accounting ledgers and its representation in the financial statements. The key of that approach is that balance sheet items related to the temporary differences (assets and provisions) are determined and only later the influence of those differences on the financial result is established. The opposite philosophy is applied in the result approach (OLCHOWICZ 2003, p. 70). The temporary differences appearing when the balance sheet method is applied are presented in table 1.

Table 1

Appearance of temporary differences while applying the balance sheet method

ASSETS
(*Wb*) Balance sheet value > Tax value (*Wp*) Positive temporary difference “Reserve for the deferred income tax” appears
(*Wb*) Balance sheet value < Tax value (*Wp*) Negative temporary difference “Assets for the deferred income tax” appear
LIABILITIES
(*Wb*) Balance sheet value > Tax value (*Wp*) Negative temporary difference “Assets for the deferred income tax” appear
(*Wb*) Balance sheet value < Tax value (*Wp*) Positive temporary difference “Reserve for the deferred income tax” appears

Source: own work based on (FIJAŁKOWSKI 2005, p. 483).

The value of assets and provisions for the deferred income tax depends on: the amount and sign of the amount of temporary differences (negative or positive) as well as the income tax rates that will be effective during the years during which, according to the projections, accounting for the assets and provisions will take place and during which they will influence an increase or decrease of the tax base.

The assets for the deferred income tax are set at the amount projected in the future for deduction from the income tax as a consequence of the negative temporary differences that will cause a decrease of the income tax computation base and the deductible tax loss computed considering the prudential principles.

Negative temporary differences develop when the tax value of assets is higher than their book value or when the book value of liabilities exceed their tax value. Those are the differences then that will be deductible from the taxable income. They may appear in both the assets and the liabilities.

Provisions for the deferred income tax are established at the amount of the income tax payable in the future as a consequence of positive temporary differences, i.e. the differences that will cause increasing the base for computation of the income tax in the future.

The amounts of assets and provisions for the deferred income tax are established considering the income tax rates effective during the year in which the tax liability appears (in 2009 that rate was 19%).

The deferred income tax is not established for permanent differences between the balance sheet value and the tax value of items of assets and liabilities, as the permanent differences are the differences that will never be settled. They cover the assets or liabilities recovery or settlement of which – according to the provisions of the Act of the 15th of February 1992 on corporate income tax – is not considered a tax cost or income and as a consequence they do not influence the tax base.

The (1) depreciation of cars on the part of the value that exceeds EUR 20 000 equivalent, (2) reimbursed, amortized or neglected taxes, payments to the PFRON, (3) costs of enforcement related to nonperformance of liabilities, (4) interest for arrears in payment of budget or other liabilities to which the regulations of the Tax Ordinance are applicable may be treated as permanent differences (*Ustalamy odroczony podatek dochodowy*. 2009, p. 5)

Determination and recording of the temporary differences of assets and liabilities

The inclusion of assets and provisions for the deferred income in accounting ledgers takes place by means of: (1) booking the change only between the status as at the end and the beginning of the reporting period in the balances of the provisions and assets for the deferred income tax or (2) countering the entries of their status as at the beginning of the reporting period and booking the status determined as at the end of the reporting period (*Rezerwy i aktywa z tytułu odroczonego podatku dochodowego – wybrane zagadnienia*. 2008, p. 5) The choice of the booking solution depends on the entity.

Table 2

The typical transactions concerning the assets and provisions for the deferred income taxes represented in the ledgers

Operation	Debit account	Credit account
Assets for the deferred income tax determined with negative temporary differences	65–0*	87**
Writing off the excessive item of assets for the deferred income tax or resignation from activating it	87**	65–0*
Provisions for the deferred income tax established for the positive temporary differences	87**	83–0***
Release of the excessive provisions or resignation from establishing them	83–0***	87**

* 65–0 "Assets for the deferred income tax"
** 87 "Income tax and other compulsory charges on the financial result"
*** 83–0 "Provisions for the deferred income tax"
Source: Rezerwy i aktywa z tytułu odroczonego podatku dochodowego – wybrane zagadnienia (2008, pp. 6, 7).

Table 3 presents the balance sheet (book) and tax value of assets as at the balance sheet date of the 31st of December 2009. As at the 1st of January 2009 the balance on account 65–0 "Assets for the deferred income tax" amounted PLN 14 000.

The entity decided that the deferred income tax is booked in the accounting ledgers only by means of changes (increase or decrease) in the balances of assets for the deferred income tax as at the end and as at the beginning of the reporting period. The assets for the deferred income tax as at the end of the reporting period amount: (8170 PLN + 16 340 PLN) = 24 510 PLN while at the beginning of the period they amounted to PLN 14 000. As at the balance sheet date the assets for the deferred income tax should be increased by the amount of (24 510 PLN – 14 000 PLN) = 10 510 PLN.

Booking description:
PK – Assets for the deferred income tax: 10 510 PLN
Debit account 65-0 "Assets for the deferred income tax"

Table 3
Balance sheet and tax values and temporary differences of assets as at the balance sheet date – the 31st of December 2009 [PLN]

Balance sheet items of assets	Value [PLN]		Ratio of balance sheet to tax value	Temporary differences (col. 2 – col. 3)		Deferred tax [PLN] (19% * col.5 or 6)	
	balance sheet	tax		positive	negative	provisions	assets
Fixed assets: – initial value: 300 000 – balance sheet depreciation: 60 000 – tax depreciation: 50 000	240 000	250 000	*Wb<Wp*	–	10 000	–	1 900
Stocks and shares: – according to purchase prices: 65 000 – according to market prices: 50 000	50 000	65 000	*Wb<Wp*	–	15 000	–	2 850
Finished goods: – according to manufacturing costs: 100 000 – according to the net sale price: 82 000	82 000	100 000	*Wb<Wp*	–	18 000	–	3 420
Domestic liabilities: – principal: 8 000 – interest accrued as at the balance sheet date: 1000	9 000	8 000	*Wb>Wp*	1 000	–	190	–
Foreign liabilities: – principal: 50 000 – exchange rate differences accrued as at the balance sheet date: 5000	55 000	50 000	*Wb>Wp*	5 000	–	950	–
Total				6 000	43 000	1 140	8 170

Source: own work based on *Rezerwy i aktywa z tytułu odroczonego podatku dochodowego – wybrane zagadnienia* (2008, p. 7).

Credit account 87 "Income tax and other compulsory charges on the financial result"

Table 4 presents the balance sheet (book) and tax values of liabilities as at the balance sheet date of the 31st of December 2009. As at the 1st of January 2009 the balance on account 83–0 "Provisions for the deferred income tax" amounted 3000 PLN.

Table 4
Balance sheet and tax values and temporary differences of liabilities as at the balance sheet date – the 31st of December 2009 [PLN]

Balance sheet items of liabilities	Value [PLN]		Ratio of balance sheet to tax value	Temporary differences (col. 2 – col. 3)		Deferred tax [PLN] (19% * col.5 or 6)	
	balance sheet	tax		positive	negative	provisions	assets
Domestic liabilities: – principal: 20 000 – interest accrued as at the balance sheet date: 1000	21 000	20 000	*Wb>Wp*	–	1 000	–	190
Foreign liabilities: – principal: 40 000 – negative exchange rate differences accrued as at the balance sheet date: 5000	45 000	40 000	*Wb>Wp*	–	5 000	–	950
Liabilities for not disbursed remunerations for work and retainer contracts: 30 000	30 000	0	*Wb>Wp*	–	30 000	–	5 700
Provisions for retirement compensations of employees: 10 000	10 000	0	*Wb>Wp*	–	10 000	–	1 900
Provisions for warranty repairs: 25 000	25 000	0	*Wb>Wp*	–	25 000	–	4 750
Bank loans: – loan principle: 100 000 – interest accrued: 15 000	115 000	100 000	*Wb>Wp*	–	15 000	–	2 850
Total				–	86 000	–	16 340

Source: own work based on *Rezerwy i aktywa z tytułu odroczonego podatku dochodowego – wybrane zagadnienia* (2008, p. 7).

Provisions for the deferred income tax as at the end of the reporting period amounted to 1140 PLN and as at the beginning of that period amounted to 3000 PLN. As at the balance sheet date the provisions for the deferred income tax should be decreases by the amount of (3000 PLN – 1140 PLN) = 1860 PLN.

Booking description:

PK – Release of the excessive provisions established: 1860 PLN

Debit account 83–0 “Provisions for the deferred income tax”

Credit account 87 “Income tax and other compulsory charges on the financial result”

Presentation of assets and provisions for the deferred income tax in the financial statements

Balance sheet

The provisions and the assets for the deferred income tax are presented in the balance sheet separately. The Provisions and assets can be compensated if the entity possesses the title authorizing it to consider them simultaneously in computations of the tax liability amount. This applies to the situations when assets and provisions for the deferred income tax concern one title of settlements. Compensation in also possible when reversing the differences to which they apply occurs at the same time and as a consequence of the specified legal transactions (FIJAŁKOWSKI 2005, p. 496), (GIERUSZ 2002, p. 155).

The provisions and assets for the deferred income tax are treated as long-term provisions and assets respectively and they are presented in the following balance sheet items:

ASSETS
A. Fixed assets
V. Long-term accruals
1. Assets for the deferred income tax
(the data in tables 3 and 4 indicate that those will amount to PLN 10,510)

Liabilities
B. Liabilities and provisions for liabilities
I. Provisions for liabilities
1. Provisions for the deferred income tax
(the data in tables 3 and 4 indicate that those will amount to PLN 1860)

Profit and loss account

The income tax influencing the financial result and presented in the profit and loss account for a given reporting period covers: the current part (for payment) and the deferred part. The deferred income tax decreases or increases the current tax. The deferred part presented in the profit and loss account represents the difference between the status of provisions and assets for the deferred income tax as at the end and as at the beginning of the reporting period.

O*. or L**. Income tax, including:
– current tax
– deferred tax
or
O. or L. Income tax, including:
– current tax
– provisions established for the deferred income tax
– released provisions for the deferred income tax
– assets established for the deferred income tax
– released assets for the deferred income tax

*Comparative version of the profit and loss account
** Computation based version of the profit and loss account

Determination of the deferred income tax influencing the gross financial result on the base of the data from tables 3 and 4

1. Assets for the deferred income tax:

(End balance – Start balance) = (24 510 PLN – 14 000 PLN) = 10 510 PLN

2. Provisions for the deferred income tax:

(End balance – Start balance) = (1140 PLN – 3000 PLN) = (-) 1860 PLN

3. Deferred income tax:

(-) 1860 PLN – 10 510 PLN = (-) 12 370

This is the deferred income tax that will influence decreasing the current part of the income tax.

Cash flow statement

In the cash flow statement prepared by means of the indirect method the changes in the status of assets and liabilities for the deferred income tax will be represented in the following way:

A. Cash flows from operational activities
II. Total adjustments
5. Change in the status of provisions
9. Change in the status of accruals

Specification of changes in equity capital (fund)

In case of allocation of the assets and provisions for the deferred income tax to the equity capital (fund) (capital from valuation update) they influence changes of that capital (fund) in item:

1.a.5.1. Change in the capital (fund) from valuation update for the deferred income tax

Introduction to the financial statements and Supplementary information and clarifications

In the introduction to the financial statements, in point 7, the company accounting policy concerning accounting of income tax over time should be presented among other items.

The data on a change in the status of assets and provisions for the deferred income tax should be presented and discussed in the following positions of the supplementary information and clarifications:

Section 1 point 8 Data on the status of provisions according to the purpose of establishing them as at the beginning of the financial year, increases, utilization, release and final status.

Provisions for the deferred income tax

Section 1 point 11 List of important items of active and passive accruals Assets for the deferred income tax

Conclusion

The duty of determining the deferred income tax is a consequence of the divergences between the regulations on accounting and the regulations on the income tax. The value of provisions for the deferred tax is the amount of the income tax payable in the future determined according to the positive temporary differences. The value of assets for the deferred income tax is the amount of tax that is projected to be deductible from the income tax in the future determined according to the negative temporary differences and deductible tax loss.

The ways for identifying the temporary differences, determining their nature, methods of analyzing changes in temporary differences (i.e. "reversing" them) and determining on that base the adjustments (release of assets and provisions for the deferred income tax) are the issues to be decided by each economic entity. It is recommended to undertake the effort to solve the problem by tabulation using a computer spreadsheet, e.g. Excel, which facilitates transfer of data for consecutive periods, automation of computations, particularly important on input of various changes and updates, possibility of automatic obtaining of collective data needed for bookings (FIJAŁKOWSKI 2005, p. 490).

Correct determination of the temporary differences is a difficult issue in accounting and it requires deep knowledge on the accounting law and the tax law.

Provisions and assets for the deferred income tax are determined and recorded in ledgers as at the end of the financial year for correct preparation of the year financial statements. If the deferred income tax is determined as at the end of each reporting period then with the same frequency the current tax must be determined, even if it is determined with lower frequency for ordinary tax settlements (e.g. half-yearly or yearly return).

Economic practice shows that entities are willing to establish assets for the deferred income tax and avoid revealing and presenting reserves for that tax. This is one of the instruments that serve creating the financial result (increasing the net profit or decreasing the loss, higher dividend disbursements) (KAMIENIECKA 2009a, p. 96) Both the KSR No. 2 and IAS No. 12 require applying the principles of prudential computation during recording of assets and provisions for the deferred income tax. This involves the duty of presenting the assets for the differences the settlement of which is possible and the necessity of including write offs for impossibility of settlement of the assets established during the earlier years.

Translated by JERZY GOZDEK

Accepted for print 15.11.2010

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