Chapter 9:
PAS 12; ACCOUNTING FOR INCOME TAXES

The income tax expense reported in the balance sheet and the income tax expense due to BIR are sometimes different and with these differences arises *temporary* and *permanent* differences. PAS 12 addresses the accounting treatment and reconciliation of these items.

PERMANENT DIFFERENCES

- Arises when income and expenses enter either accounting profit or taxable profit but **not both.**
- This usually arises from *non-taxable* and *non-deductible expenses* and those that have already been subjected to *final taxes*.
- These are items excluded in the income tax return (ITR)
- Do not give rise to deferred tax assets and liabilities.

- Interest Income on Deposit
- Dividends Received
- Life Insurance Premium
- Tax Penalties Charges

TEMPORARY DIFFERENCES

- Includes timing differences – when income and expenses are recognized for financial reporting purpose in one period but are recognized for taxation purpose in another period.
- The effect reverses in one of more subsequent periods.
- Have deferred tax assets and or deferred tax liabilities.

Taxable Temporary Difference	Deductible Temporary Difference
Arises when financial income > taxable income	Arises when financial income < taxable income
If multiplied by the tax rate = deferred tax liability	If multiplied by the tax rate = deferred tax asset

Examples of circumstances that results in TTD or DTD

1. Revenue is recognized at the point of sale but taxable only when installment payments are received. **FI > TI = TTD**
2. Prepayment is capitalized and amortized as expense under financial reporting but deducted in full upon payment under taxation. **FI > TI = TTD**
3. income is accrued for financial reporting but is taxable only when cash is collected. **FI > TI = TTD**
4. Straight line depreciation is used under financial reporting while accelerated depreciation is used for taxation purposes. **FI > TI = TTD**
5. Rent received in advance is treated as unearned income for financial reporting purposes but is included as taxable income upon receipt of cash. **FI < TI = DTD**
6. Warranty obligation is accrued for financial reporting, but warranty cost is tax deductible only when actually paid. **FI < TI = DTD**

INCOME TAX EXPENSE VS. CURRENT TAX EXPENSE

Income Tax Expense

- current + deferred tax expense
- Computed using PFRS
- Income statement

Current Tax Expense

- Amount of income taxes payable for the period.
- Computed using Tax Laws
- Income tax return

Current Tax Expense → Current Tax Asset (Prepaid) / Current Tax Liab (Payable)

Acctg. Profit (Pretax Income)	XX		
Permanent Differences			
Add: Non-deductible exp	XX		
Less: Non-taxable income	(XX)		

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Acctg. Profit subject tax	XX	%	Income Tax Exp
Temporary Differences			
Add: ^ TTD	XX	%	^ (Deferred Tax L)
Less: ^ DTD	(XX)	%	^ Deferred Tax A
Taxable Profit	XX	%	Current Tax Exp

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