# Tax Reconciliation

Training Material – Prepared by Afzal

# What is a Tax Reconciliation?

- A Tax Reconciliation is the process of reconciling the net profit or loss shown on the profit and loss statement (Accounting Profit/Loss) with the net income or loss for income tax purposes.

## Accounting Profit

**Profit & Loss**
Demo Company (AU)
For the 12 months ended 30 June 2020

Add Summary

| | Jun-20 |
|---|---|
| **Income** | |
| Sales | 150,000.00 |
| **Total Income** | **150,000.00** |
| **Less Cost Of Sales** | |
| Purchases | 75,000.00 |
| **Total Cost Of Sales** | **75,000.00** |
| **GROSS PROFIT** | **75,000.00** |
| **Less Operating Expenses** | |
| Advertising | 2,500.00 |
| Motor Vehicle Expenses | 2,000.00 |
| Rent | 24,000.00 |
| Superannuation | 2,850.00 |
| Wages and Salaries | 30,000.00 |
| **Total Operating Expenses** | **61,350.00** |
| **NET PROFIT** | **13,650.00** |

## Tax Profit

| | | Current Year |
|---|---|---|
| **Accounting Profit** | | |
| **Net Accounting Profit Before Utilising C/Fwd Losses** | | 13,650.00 |
| Carry Forward Accounting Losses Utilised | | - |
| **Net Accounting Profit After Utilising C/Fwd Losses** | | **13,650.00** |
| **Net Profit from P&L** | | **13,650.00** |
| **ADD:** | | |
| **Items NOT allowed as Deductions** | | |
| Accrued Superannuation (Closing Balance) | 200.00 | |
| | | **200.00** |
| **Items to be included in Income** | | |
| | | **-** |
| **SUBTRACT:** | | |
| **Items to be included in Deductions** | | |
| Accrued Superannuation (Opening Balance) | 350.00 | |
| | | **350.00** |
| **Items NOT included in Income** | | |
| **Taxable Income To Be Distributed** | | **13,500.00** |

# Why do we prepare a Tax Reconciliation?

- A Tax Reconciliation is prepared to determine the income or loss position for an entity for income tax purposes. This is required to complete the annual tax return for an entity and record the correct taxable profit or loss position.
- There are items such as Depreciation which may have different accounting and tax figures, therefore the Tax Reconciliation in this instance would addback the accounting depreciation and subtract the tax depreciation to reflect the tax position.

# How do we prepare a Tax Reconciliation?

- Firstly, you need to have completed the Financial Statements for an entity and have the completed Profit and Loss statement and Balance Sheet for the specific financial year.
- The second step is to complete the Tax Reconciliation Workpaper, which will then be reflected in the entities tax return.
- Confirm your Accounting Net Profit for the financial year and then do the following.
- Add –
  - Items Not Allowed as Deductions
  - Items to be included in Income
- Subtract –
  - Items to be included in Deductions
  - Items not included in Income
- Once the above is done you would have your Taxable Income or Loss figure

# Addback the following items

Increase Tax Profit

| Items NOT allowed as Deductions | |
|---|---|
| Provision for Annual Leave (Closing Balance) | |
| Provision for Long Service Leave (Closing Balance) | |
| Provision for Sick Leave (Closing Balance) | |
| Accrued Superannuation (Closing Balance) | |
| Work in Progress (Opening Balance) | |
| Non- Deductible Entertainment | |
| Accounting Depreciation | |
| Taxable Loss for PSI entities | |
| Fines & Penalties | |
| Non Deductible Legal Expenses | |
| Accounting Capital Losses | |
| Other Timing Differences | |
| Other Permanent Differences | |

Increase Tax Profit

| Items to be included in Income | |
|---|---|
| Taxable Capital Gains | |
| Franking Credit Tax Offset | |
| Gross Up of Dividends | |
| Gross up of Foreign Income | |
| Trust Distributions | |
| Other Timing Differences | |
| Other Permanent Differences | |

# Subtract the following items

Decrease Tax Profit

| Items to be included in Deductions | |
|---|---|
| Provision for Annual Leave (Opening Balance) | |
| Provision for Long Service Leave (Opening Balance) | |
| Provision for Sick Leave (Opening Balance) | |
| Accrued Superannuation (Opening Balance) | |
| Tax Depreciation | |
| Work in Progress (Closing Balance) | |
| Accounting Capital Losses | |
| Other Timing Differences | |
| Other Permanent Differences | |

Decrease Tax Profit

| Items NOT included in Income | |
|---|---|
| Accounting Capital Gains | |
| ATO Cash Flow Boost | |
| June Jobkeeper Accrual | |
| Other Timing Differences | |
| Other Permanent Differences | |

# Tax Reconciliation Example

| | Current Year | | Previous Year | |
|---|---|---|---|---|
| **Accounting Profit** | | | | |
| **Net Accounting Profit Before Utilising C/Fwd Losses** | | 135,000.00 | | 100,000.00 |
| Carry Forward Accounting Losses Utilised | | - | | - |
| **Net Accounting Profit After Utilising C/Fwd Losses** | | **135,000.00** | | **100,000.00** |
| | | | | |
| **Net Profit from P&L** | | **135,000.00** | | **100,000.00** |
| | | | | |
| **ADD:** | | | | |
| **Items NOT allowed as Deductions** | | | | |
| Accrued Superannuation (Closing Balance) | 2,000.00 | | 2,500.00 | |
| Non- Deductible Entertainment | 450.00 | | 500.00 | |
| Accounting Depreciation | 13,000.00 | | 15,000.00 | |
| Fines & Penalties | 100.00 | | 250.00 | |
| | - | **15,550.00** | - | **18,250.00** |
| **Items to be included in Income** | | | | |
| Gross Up of Dividends | 15,172.00 | | - | |
| | - | **15,172.00** | - | - |
| **SUBTRACT:** | | | | |
| **Items to be included in Deductions** | | | | |
| Accrued Superannuation (Opening Balance) | 2,500.00 | | 3,000.00 | |
| Tax Depreciation | 20,000.00 | | 25,000.00 | |
| | - | **22,500.00** | - | **28,000.00** |
| **Items NOT included in Income** | | | | |
| | - | - | - | - |
| | | | | |
| Taxable Income Before Carry Forward Losses | - | **143,222.00** | - | **90,250.00** |
| | | | | |
| Carry Forward Losses Applied | | - | | - |
| | | | | |
| **Taxable Income** | | **143,222.00** | | **90,250.00** |

# Common Tax Reconciliation Adjustments

- Depreciation
- Superannuation
- Entertainment
- Fines & Penalties
- Accounting & Tax Distributions
- Dividends – Gross up the Franking Credits
- Provisions for Leave (Annual, Sick and Long Service Leave)
- Work in Progress

# When do we prepare a Tax Reconciliation?

- A Tax Reconciliation is completed when preparing the Financial Statements and Tax Return for an entity, for a specific financial year.
- The main reason for preparing a Tax Reconciliation is to determine the Tax Profit or Loss position of an entity to complete the tax return for that entity.
- However, we may prepare tax reconciliations at any point in time for a client throughout a financial year as a tax planning mechanism to provide early insight into the expected tax position.

# Thank You