

FINANCE AT A GLANCE

Income tax adjusting and closing entries

Lesson 59

The tax on the company's profit, called **Income tax**, is normally based on the profit for a year, and is paid some time after the end of the year. There is unlikely to be any disbursement for Income tax on the profit made in the first month. However, based on the accrual concept, there is a tax expense incurred in the first month, and this has to be accounted for. Since settlement comes at a future date, the recognition of the tax expense entails the recognition of a liability that accrues, particularly known as **Accrued income tax liability**.

Income tax is based on a percent of the **Net profit before tax**. This percent varies from country to country. In our illustration, we shall use 15%. Based on Lesson 58, the Net profit before tax is \$1,282. If the tax rate is 15%, the Income tax expense in January is \$192. The journal entries to recognize Income tax for the month are as follows:

	Dr		192
	Cr	Income taxes	
		Accrued income tax liabilities	192
		<i>To recognize Income tax for the month of January 2010.</i>	

These entries are then posted to the respective ledgers.

5.20 Income taxes		
	Debit	Credit
Beginning bal	192	
Ending bal	0	192

2.03 Accrued income taxes payable		
	Debit	Credit
Beginning bal		0
Jan. 31, 2010		192
Ending bal	192	

Income taxes, like all other expenses, need to be closed to Income summary. The closing entries for this are as follows:

	Dr		192	
	Cr	Income summary		(h)
		Income taxes	192	(h)
		<i>To close Income taxes.</i>		

These closing entries are then posted as follows:

5.20 Income taxes		
	Debit	Credit
Beginning bal	192	
Ending bal	0	192 (h)

Income summary		
	Debit	Credit
Beginning bal		0
(a)		50,000
(b)	35,000	
(c)	5,000	
(d)	2,000	
(e)	2,000	
(f)	550	
(g)	4,168	
(h)	192	
Ending bal	1,090	

Note: The letters (a) through (g) refer to the entries made in Lesson 58.

Having accounted for Income taxes, we now have everything to finally draw up the financial statements. We shall do this in the next lesson.