**EXERCISE RECONCILIATION OF TAX CHARGE**

Manic Srl’s consolidated financial statements for the year ended 31.12.201X report the following:

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Income before taxes 5,000,000

Income taxes (2,000,000)

Net income 3,000,000

The statutory tax rate is 20%.

The following additional information is available:

1. The tax rates in certain countries in which subsidiaries are located differ from the statutory tax rate as follows together with the amounts of income before taxes included in the consolidated financial statements:

Country Pre-tax income Tax rate

A 1,500,000 40%

B 1,000,000 25%

C 250,000 15%

D 750,000 35%

2. Certain subsidiaries incurred losses during the year amounting to €2,000,000 for which no deferred tax assets have been recorded due to insufficient evidence of future taxable income or taxable temporary differences.

3. At the start of the year Country E had recorded deferred tax assets in respect of previous years’ tax losses amounting to €312,500 which it had estimated would have been deductible against future profits. In the light of of continuing losses in 201X in Country E the company revised its assessment of their recoverability and wrote these off. The tax rate on country E is 40%.

4. Manic Srl incurred expenses during the course of 201X in respect of fines, penalties, political contributions amounting to €125,000 that were not allowable deductions under the tax laws.

**Required:**

Prepare a reconciliation of the effective tax rate to the statutory tax rate.

**Solution**

**Tax at statutory rate 5,000,000 1,000,000 20%**

Effect of different tax rates 450,000 9.0%

DTAs not recognized on tax losses 400,000 8.0%

(€2,000,000 @ 20%)

Write-off of DTAs

(€312,500 @ 40%) 125,000 12.5%

Disallowed expenses

(€125,000 @ 20%) 25,000 0.5%

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**Effective tax rate 5,000,000 2,000,000 40%**

Effect of different tax rates

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Pre-Tax Income | Tax rate | % difference from statutory rate | Tax effect |
| Country A | 1,500,000 | 40% | 20% | 300,000 |
| Country B | 1,000,000 | 25% | 5% | 50,000 |
| Country C | 250,000 | 15% | (5%) | (12,500) |
| Country D | 750,000 | 35% | 15% | 112,500 |
|  |  |  |  | 450,000 |