ACCT 6120. Corporate Income Tax. Chapter 6. Spring, 2017.

Note: this assignment has more problems than usual. You may choose to work all of these problems if you need to a thorough review of the rules, or you may choose to work fewer if you feel confident about your grasp of the material.

To help students recognize "out-of-date" questions dealing with the balance sheet classification of deferred tax assets and liabilities, the instructor has marked some of these questions as out of date. "obsolete based on FASB"

Current GAAP requires the deferred taxes for each jurisdiction (or tax-paying component of a jurisdiction) to be presented as a net *current* asset or liability and net *noncurrent* asset or liability. This requires a jurisdiction-by-jurisdiction analysis based on the classification of the assets and liabilities to which the underlying temporary differences relate, or, in the case of loss or credit carryforwards, based on the period in which the attribute is expected to be realized. Any valuation allowance is then required to be allocated on a pro rata basis, by jurisdiction, between current and noncurrent deferred tax assets.

To simplify presentation, the new FASB guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. As a result, each jurisdiction will now only have one net noncurrent deferred tax asset or liability. Importantly, the guidance does not change the existing requirement that only permits offsetting within a jurisdiction – that is, companies are still prohibited from offsetting deferred tax liabilities from one jurisdiction against deferred tax assets of another jurisdiction.

The new guidance conforms US GAAP and IFRS and is intended to reduce complexity in financial reporting.

Effective for years beginning after December 15, 2016.

Part 1. Concepts

1. Which of the following represent temporary book-tax differences? (Test page 6-8) **A**

- **a.** Compensation-related expenses
- **b.** Municipal bond interest.
- **c.** Nondeductible penalties.
- **d.** Meals and entertainment expense deduction
- **e.** All the above.

2. Which of the following items are not included in the financial statement income tax note containing the effective tax rate reconciliation? **C**

- **a.** Hypothetical tax on book income at U.S. Federal corporate tax rate
- **b.** Tax effect of permanent differences
- **c.** Tax effect of temporary differences
- **d.** Total tax expense per financial statements

3. How are deferred tax liabilities and assets categorized on the balance sheet? **X**

- **a.** Capital and ordinary
- **b.** Domestic and foreign
- **c.** Current and non-current
- **d.** Positive and negative

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4. Tax rates other than the current tax rate may be used to calculate the deferred income tax amount on the balance sheet if **C**

- **a.** it is probable that a future tax rate change will occur.
- **b.** it appears likely that a future tax rate will be greater than the current tax rate.
- **c.** the future tax rates have been enacted into law.
- **d.** it appears likely that a future tax rate will be less than the current tax rate

5. Recognizing a valuation allowance for a deferred tax asset requires that a company

a. consider all positive and negative information in determining the need for a valuation allowance. **A**

b. consider only the positive information in determining the need for a valuation allowance.

c. take an aggressive approach in its tax planning.

d. pass a recognition threshold, after assuming that it will be audited by taxing authorities.

6. Uncertain tax positions (Test page 6-24)

I. Are positions for which the tax authorities may disallow a deduction in whole or in part.

II. Include instances in which the tax law is clear and in which the company believes an audit is likely.

III. Give rise to tax expense by increasing payables or increasing a deferred tax liability.

a. I, II, and III. **c.** II only. **D**

b. I and III only. **d.** I only.

7. The FASB requires that companies recognize a tax benefit for uncertain tax positions when

a. it is probable and can be reasonably estimated. **C**

b. there is at least an 80% probability that the uncertain tax position will be approved by taxing authorities.

c. it is more likely than not that the tax position will be sustained upon audit.

d. Any of the above exists. (Test page 6-24)

8. Deferred taxes should be presented on the balance sheet

a. as one net debit or credit amount. **X**

b. in two amounts: one for the net current amount and one for the net noncurrent amount.

c. in two amounts: one for the net debit amount and one for the net credit amount.

d. as reductions of the related asset or liability accounts.

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9. Deferred tax amounts that are related to specific assets or liabilities should be classified as current or noncurrent based on

a. their expected reversal dates. **X**

b. their debit or credit balance.

c. the length of time the deferred tax amounts will generate future tax deferral benefits.

d. the classification of the related asset or liability.

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10. Tanner, Inc. incurred a financial and taxable loss for 2017. Tanner therefore decided to use the carryback provisions as it had been profitable up to this year. How should the refund amounts related to the carryback be reported in the 2017 financial statements?

a. The reduction of the loss should be reported as a prior period adjustment. **D**

b. The refund claimed should be reported as a deferred charge and amortized over five years.

c. The refund claimed should be reported as revenue in the current year.

d. The refund claimed should be shown as a reduction of the loss in 2017.

Part 2. Problems

11. Best, Inc. earned book net income before tax of $600,000 in 2017. Best acquired a depreciable asset in 2017 and first year tax depreciation exceeds book depreciation by $120,000. Best had no other temporary or permanent differences. Assume the U.S. tax rate is 35%.
How much total income tax expense is reported on the financial statements for 2017?

a. $252,000 **b.** $210,000 **c.** $168,000 **d.** $42,000 **e.** Other **B**

12. Continue preceding question.
How much deferred income tax liability is reported on its financial statements for 2017?

a. $252,000 **b.** $210,000 **c.** $168,000 **d.** $42,000 **e.** Other **D**

13. North, Inc. earned book net income before tax of $500,000 in 2016 (first year of operations). In computing its book income, North deducted $50,000 more in warranty expense for book purposes than allowed for tax purposes. North had no other temporary or permanent differences. Assume the U.S. tax rate is 35%. No valuation allowance is required.
How much <u>total income tax expense</u> is reported on its financial statements for 2016?

a. $175,000 **b.** $192,500 **c.** $157,500 **d.** $17,500 **e.** Other **A**

14. Continue preceding question.
How much <u>current</u> income tax expense is reported on its financial statements for 2016?

a. $175,000 **b.** $192,500 **c.** $157,500 **d.** $17,500 **e.** Other **B**

15. South, Inc. earned book net income before tax of $400,000 in 2016.
South acquired a depreciable asset in 2016 and first year tax depreciation exceeded book depreciation by $50,000. At the end of 2016, South's deferred tax liability account balance is $17,500.
In 2017, South earned $500,000 book net income before tax and its book depreciation exceeded tax depreciation by $20,000.
South had no other temporary or permanent differences. Assume the U.S. tax rate is 35%.
What is South's balance in its deferred tax liability account at the end of 2017?

a. $7,000 **b.** $10,500 **c.** $17,500 **d.** $0 **e.** Other **B**

16. Cold, Inc. reported a $100,000 total tax expense for financial statement purposes in 2016.
This total expense consisted of $150,000 in current tax expense and a deferred tax benefit of $50,000.
The deferred tax benefit consisted of $90,000 in deferred tax assets reduced by a valuation allowance of $40,000. In 2017, Cold reported $600,000 in book net income before tax.
Cold had no permanent or temporary book-tax differences for 2017.
At the end of 2017, Cold's auditors determine that the existing valuation allowance of $40,000 should be reduced to zero. What is Cold's total tax expense for 2017?

a. $210,000 **b.** $170,000 **c.** $250,000 **d.** $40,000 **e.** Other **B**

17. Beach, Inc. (a domestic corporation) owns 100% of Mountain, Ltd., a manufacturing facility in Ireland. Mountain has no operations or activities in the United States. The U.S. tax rate is 35% and the Irish tax rate is 10%. For the current year, Beach earns $500,000 in taxable income. Mountain earns $300,000 in taxable income from its operations, pays $30,000 in taxes to Ireland, and makes no distribution to Beach.
Assume Beach does not make the permanent reinvestment assumption of ASC 740-30.
What is Beach's effective tax rate for book purposes?

a. 38.75%. **b.** 31.25%. **c.** 35%. **d.** 25.63%. **e.** Other **C**

18. Continue preceding question.
Assume Beach makes the permanent reinvestment assumption of ASC 740-30.
What is Beach's effective tax rate for book purposes?

a. 38.75%. **b.** 31.25%. **c.** 35%. **d.** 25.63%. **e.** Other **D**

19. Charlotte Corp.'s books showed pretax income of $800,000 for the year ended December 31, 2017. In the computation of federal income taxes, the following data were considered:

Interest revenue on municipal bonds	$350,000
Depreciation deducted for tax purposes in excess of book depreciation	$50,000
Federal estimated tax payments, 2017	$70,000
Enacted federal tax rates, 2017	30%

What amount should Charlotte report as its **current federal income tax expense** on its 2017 income statement?

a. $ 50,000 **b.** $ 65,000 **c.** $120,000 **d.** $135,000 **e.** Other **C**

20. Continue preceding question. What amount should Charlotte report as its current federal income tax liability on its December 31, 2017 balance sheet?

a. $ 50,000 **b.** $ 65,000 **c.** $120,000 **d.** $135,000 **e.** Other **A**

21. Continue preceding question. What amount should Charlotte report as its **deferred federal income tax expense** on its 2017 income statement?

a. $ 50,000 **b.** $ 65,000 **c.** $120,000 **d.** $15,000 **e.** Other **D**

Also, prepare journal entries for: (1) current provision and (2) deferred income tax.

22. Concord, Inc. began operations in 2016. Included in Concord's 2016 financial statements were:

Bad debts expense	$4,000
Profit from an installment sale of	$6,000

No uncollectible account was charged off.
For tax purposes, the profit from the installment sale will be recognized in 2018.
In 2016, the government enacted income tax rates of 30% for 2017 and 25% for 2018.
In its 2016 income statement, what amount should Concord report as deferred income tax expense?

a. $300 **b.** $360 **c.** $650 **d.** $500 **e.** Other **A**

23. Abbot Corporation reported the following information for 2017

Pretax book income	$500,000
Increase in the reserve for bad debts	$5,000
Tax depreciation exceeded GAAP depreciation by	$40,000
Received life insurance proceeds on death of an officer	$3,000
Income tax rate	34%,

Abbot's current income tax expense or benefit would be

a. $186,320 **b.** $170,000 **c.** $157,080 **d.** $153,680 **e.** Other **C**

24. Mean Green Corporation reported the following information for 2017

Pretax book income	$1,000,000
Increase in the reserve for bad debts	$25,000
Tax depreciation exceeded GAAP depreciation by	$100,000
Dividends received deduction	$25,000
Income tax rate	34%

Mean Green's **accounting effective tax rate** is:

a. 34% **b.** 33.15% **c.** 31.45% **d.** 30.6% **e.** Other **B**

25. Mill, which began operations on January 1, 2015, recognizes income from long-term construction contracts under the percentage-of-completion method in its financial statements and under the completed-contract method for income tax reporting.
Income under each method follows:

Year	Completed Contract	Percentage of Completion
2015	$0	$300,000
2016	$400,000	$600,000
2017	$700,000	$850,000

The income tax rate was 30% for 2015 through 2017.
For years after 2017, the enacted tax rate is 25%. There is no other temporary difference.
Mill should report in its December 31, 2017 balance sheet a deferred income tax liability of:

a. $ 87,500 **b.** $105,000 **c.** $162,500 **d.** $195,000 **e.** Other **C**

Questions 26 and 27 are based on the following:

UNCC's Corporation's tax rate for 2017 is 40%. UNCC prepared this reconciliation of its pretax financial statement income to taxable income for year ended Dec. 31, 2017, its first year of operations.

Pretax financial income	$160,000
Nontaxable interest received on municipal securities	(5,000)
Long-term loss accrual in excess of deductible amount	10,000
Depreciation on tax return in excess of financial statement amount	(25,000)
Taxable income	$140,000

26. In its 2017 income statement, what amount is reported as income tax expense-current portion?

a. $52,000 b. $56,000 c. $62,000 d. $64,000 e. Other **B**

27. What amount should UNCC report as deferred income tax liability on December 31, 2017?

a. $2,000 b. $4,000 c. $6,000 d. $8,000 e. Other **C**

28. Black Co., organized on January 2, 2012, had pretax accounting income of $509,000 and taxable income of $800,000 for the year ended December 31, 2012. The only temporary difference is accrued product warranty costs that are expected to be paid as follows:

2013	$100,000
2014	$50,000
2015	$50,000
2016	$100,000
Total	**$300,000**

Black has never had a net operating loss (book or tax) and does not expect any in the future. There were no temporary differences in prior years.
The enacted income tax rates are 35% for 2012, 30% for 2013 through 2015, and 25% for 2016.
In Black's December 31, 2012 balance sheet, the deferred income tax asset should be

a. $ 60,000 **b.** $ 70,000 **c.** $ 85,000 **d.** $105,000 **e.** Other C

29. Grim's enacted income tax rate is 30%. For the year ended December 31, 2017, pretax financial statement income was $200,000 and taxable income was $150,000. The difference is due to the following:

Interest on municipal bonds	$70,000
Premium expense on keyman life insurance	($20,000)

What is the amount of the current provision for income tax expense on its 2017 income statement?

a. $45,000 **b.** $51,000 **c.** $60,000 **d.** $66,000 **e.** Other A

30. NINER Corp.'s pretax income in 2017 was $100,000. The temporary differences between amounts reported in the financial statements and the tax return are as follows:

Depreciation on tax return exceeded GAAP depreciation in the amount of:	$8,000
The equity method of accounting resulted in financial statement income of:	$35,000

A $25,000 dividend was received during the year, which is eligible for the 80% dividends received deduction. NINER's effective income tax rate was 30% in 2017.
In its 2017 income statement, NINER should report a current provision for income taxes of:

a. $26,400 **b.** $23,400 **c.** $21,900 **d.** $18,600 **e.** Other D

31. As a result of differences between depreciation for financial reporting purposes and tax purposes, the financial reporting basis of Noor Co.'s sole depreciable asset, acquired in Year 1, exceeded its tax basis by $250,000 at December 31, Year 1. The enacted tax rate is 30% for Year 1, and 40% for future years. Noor has no other temporary differences. In its December 31, Year 1, balance sheet, how should Noor report the deferred tax effect of this difference?

a. As an asset of $75,000 **b.** As an asset of $100,000. D
c. As a liability of $75,000. **d.** As a liability of $100,000.

32. Lehman purchased a machine on January 2, 2015, for $3,000,000. The machine has an estimated 5-year life with no salvage value. The straight-line method of depreciation is being used for financial statement purposes and the following MACRS amounts will be deducted for tax purposes:

2015	$600,000	2018	$345,000
2016	$960,000	2019	$345,000
2017	$576,000	2020	$174,000

Assuming an income tax rate of 30% for all years, the net deferred tax liability that should be reflected on Lehman's balance sheet at December 31, 2016 as:

	Deferred Tax Liability			Deferred Tax Liability	
	Current	**Noncurrent**		**Current**	**Noncurrent**
a.	$0	$108,000	c.	$100,800	$7,200
b.	$7,200	$100,800	d.	$108,000	$0

X

"obsolete based on FASB"

Use the following information for the next three questions.

At the end of 2016, its first year of operations, Mathis Co. prepared a reconciliation of pretax financial income and taxable income as follows:

Pretax financial income	$800,000	
Estimated litigation expense	2,000,000	To be paid in 2018.
Gross profit on installment sales	(1,600,000)	Realize equally in next 2 years.
Taxable income	$1,200,000	

The estimated litigation expense of $2,000,000 will be deductible in 2018 when it is expected to be paid. The gross profit from the installment sales will be realized in the amount of $800,000 in each of the next two years. The estimated liability for litigation is classified as noncurrent and the installment accounts receivable are classified as $800,000 current and $800,000 noncurrent.
The income tax rate is 30% for all years.

33. The income tax expense is

a. $240,000. **b.** $360,000. **c.** $400,000. **d.** $800,000. **A**

34. The deferred tax asset to be recognized is

a. $0. **b.** $120,000 current.
c. $600,000 current. **d.** $600,000 noncurrent. **D**

35. The deferred tax liability—current to be recognized is

a. $120,000. **b.** $360,000. **c.** $240,000. **d.** $480,000. **C**

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36. Eckert Corporation's partial income statement after its first year of operations is as follows:

Income before income taxes		$3,750,000
Income tax expense		
Current	$1,035,000	
Deferred	90,000	1,125,000
Net income		$2,625,000

Eckert uses the straight-line method of depreciation for financial reporting purposes and accelerated depreciation for tax purposes. The amount charged to depreciation expense on its books this year was $2,400,000. No other differences existed between book income and taxable income except for the amount of depreciation. Assume a 30% tax rate.

What amount was deducted for depreciation on the corporation's tax return for the current year?

a. $2,100,000 **b.** $1,125,000 **c.** $2,400,000 **d.** $2,700,000 **D**

37. Fleming Company has the following cumulative taxable temporary differences:

12/31/2017	12/31/2016
$1,280,000	$1,800,000

The tax rate enacted for 2017 is 40%, while the tax rate enacted for future years is 30%. Taxable income for 2017 is $3,200,000 and there are no permanent differences. Pretax financial income for 2017 is:

a. $1,920,000 **b.** $2,680,000 **c.** $3,460,000 **d.** $4,480,000 **B**

38. Cross reported these results for the year ended December 31, 2016, its first year of operations:

Income (per books before income taxes)	$1,500,000
Taxable income	2,400,000

The disparity between book income and taxable income is attributable to a temporary difference which will reverse in 2017. Assume the enacted tax rates in effect are 40% in 2016 and 35% in 2017. What should Cross record as a net deferred tax asset or liability for the year ended December 31, 2016?

a. $360,000 deferred tax liability **c.** $360,000 deferred tax asset **B**

b. $315,000 deferred tax asset **d.** $315,000 deferred tax liability

39. In 2016, Krause Company accrued, for financial statement reporting, estimated losses on disposal of unused plant facilities of $2,400,000. The facilities were sold in March 2017 and a $2,400,000 loss was recognized for tax purposes. Also in 2016, Krause paid $100,000 in premiums for a two-year life insurance policy in which the company was the beneficiary. Assume the enacted tax rate is 30% in both 2016 and 2017. Krause paid $780,000 in income taxes in 2016.

The amount reported as net deferred income taxes on Krause's balance sheet at December 31, 2016, should be a

a. $680,000 asset. **b.** $360,000 asset. **D**

c. $360,000 liability. **d.** $720,000 asset.

Use the following information for next two questions.
Rowen, Inc. had pre-tax accounting income of $1,800,000 and a tax rate of 40% in 2017, its first year of operations. During 2017 the company had the following transactions:

Received rent from Jane, Co. for 2018	$64,000
Municipal bond interest income	$80,000
Depreciation for tax purposes in excess of book depreciation	$40,000
Installment sales revenue to be collected in 2018	$108,000

40. For 2017, what is the amount of income taxes payable for Rowen, Inc?
a. $603,200 **b.** $654,400 **c.** $686,400 **d.** $772,800 **B**

41. At the end of 2017, which of the following deferred tax accounts and balances is reported on Rowen, Inc.'s balance sheet?

	Account			Account	
a.	Deferred tax asset	$25,600	c.	Deferred tax asset	$41,600
b.	Deferred tax liability	$25,600	d.	Deferred tax liability	$41,600

X

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42. South Co. has pre-tax accounting income for the year ended December 31, 2017 of $345,000.

Temporary difference	**Future taxable (deductible) amount**
Gross profit on installment sales	$288,000
Depreciation	$90,000
Unearned rent revenue	($300,000)

Compute taxable income for 2017.
a. $423,000 **b.** $267,000 **c.** $723,000 **d.** $333,000. **B**

43. Larsen Corporation reported $100,000 in revenues in its 2016 financial statements, of which $33,000 will not be included in the tax return until 2017.
The enacted tax rate is 40% for 2016 and 35% for 2017. What amount should Larsen report for deferred income tax liability in its balance sheet at December 31, 2016?
a. $11,550 **b.** $13,200 **c.** $14,700 **d.** $16,800 **A**

44. At December 31, 2016 Raymond Corporation reported a deferred tax liability of $180,000 which was attributable to a taxable type temporary difference of $600,000. The temporary difference is scheduled to reverse in 2020. A new tax law enacted in 2016 will increase the corporate tax rate from 30% to 40% for 2017. Raymond should record this change by debiting
a. Retained Earnings for $60,000. **c.** Income Tax Expense for $18,000. **D**
b. Retained Earnings for $18,000. **d.** Income Tax Expense for $60,000.

45. A reconciliation of Gentry Company's pretax accounting income with its taxable income for 2016, its first year of operations, is as follows:

Pretax accounting income	$3,000,000
Excess tax depreciation	(150,000)
Taxable income	$2,850,000

The excess tax depreciation will result in equal net taxable amounts in each of the next three years.
Enacted tax rates are 40% in 2016, 35% in 2017 and 2018, and 30% in 2019.
The total deferred tax liability to be reported on Gentry's balance sheet at December 31, 2016, is

a. $60,000. **b.** $50,000. **c.** $52,500. **d.** $45,000. **B**

46. Khan, Inc. reports a taxable and financial loss of $1,950,000 for 2017.
Its pretax financial income for the last two years was as follows:

2015	$900,000
2016	1,200,000

The tax rate is 30% for all periods affected. Kahn uses the carryback provisions.
The amount that Khan, Inc. reports as a net loss for financial reporting purposes in 2017 is:

a. $1,950,000 loss. **b.** $ -0-. **D**
c. $585,000 loss. **d.** $1,365,000 loss.

47. Rodd Co. reports a taxable and pretax financial loss of $800,000 for 2017.
Rodd's taxable and pretax financial income and tax rates for the last two years were:

2015	$800,000	30%
2016	800,000	35%

The amount that Rodd should report as an income tax refund receivable in 2017, assuming that it uses the carryback provisions and that the tax rate is 40% in 2017, is

a. $240,000. **b.** $280,000. **c.** $320,000. **d.** $360,000. **A**

48. Haag Corp.'s 2017 income statement showed pretax accounting income of $1,500,000.
To compute the federal income tax liability, the following 2017 data are provided:

Income from exempt municipal bonds	$60,000
Depreciation deducted for tax purposes in excess of	
depreciation deducted for financial statement purposes	$120,000
Estimated federal income tax payments made	300,000
Enacted corporate income tax rate	30%

What amount of current federal income tax liability should be included in Hagg's December 31, 2017 balance sheet?

a. $ 96,000 **b.** $132,000 **c.** $150,000 **d.** $396,000 **A**

49. On January 1, 2017, Piper Corp. purchased 40% of the voting common stock of Betz, Inc. and appropriately accounts for its investment by the equity method.
During 2017, Betz reported earnings of $720,000 and paid dividends of $240,000.
Piper assumes that all of Betz's undistributed earnings will be distributed as dividends in future periods when the enacted tax rate will be 30%.
Ignore the dividend-received deduction. Piper's current enacted income tax rate is 25%.
The increase in Piper's deferred income tax liability for this temporary difference is

a. $144,000. **b.** $120,000. **c.** $86,400. **d.** $57,600. **D**