Taxation of Corporations and their Shareholders

Documents for Chapter 6 Lecture

Accounting for Income Tax

UNC Charlotte
Master of Accountancy Program
Turner School of Accountancy

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Instructor Notes from Chapter 6

CAUTION

A company's failure to accurately compute the income tax provision and related balance sheet accounts can lead to the issuance of a material weakness statement by the auditor and, in some cases, a restatement of the financial statements. Not surprisingly, individuals who understand these complex and sometimes counter-intuitive rules are in great demand by public accounting firms and industry.

OBJECTIVE

One objective is to "recognize the amount of taxes payable or refundable in the current year" (referred to as the **current tax liability or asset**). A second objective is to "recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns.

To compute the deferred tax liability or asset, a company must calculate the future tax effects attributable to temporary differences and **tax carryforwards.**

TEMPORARY DIFFERENCES

Temporary differences generally can be thought of as revenue (income) or expenses (deductions) that will appear on both the income statement and the tax return but in different accounting periods. Temporary differences that are cumulatively favorable create deferred tax liabilities, while temporary differences that are cumulatively unfavorable create deferred tax assets.

Total Income Tax Provision	1	Current Income Tax expense (benefit) +
	2	Deferred Income Tax expense (benefit)

Seven steps in the computation of a company's federal income tax provision.

1. Adjust pretax net income or loss for all permanent differences.
2. Identify all temporary differences and tax carryforward amounts.
3. Calculate the current income tax expense or benefit (refund).
4. Determine the ending balances in the balance sheet deferred tax asset and liability accounts.
5. Evaluate the need for a valuation allowance for gross deferred tax assets.
6. Calculate deferred income tax expense or benefit.
7. Calculate additional income tax expense to be recognized for unrecognized tax positions.

Step 1: Adjust Pretax Net Income for all Permanent Differences

GAAP pretax net income includes all revenue including: (1) revenue recognized on current tax return, (2) revenue recognized on a future tax return (temporary item), (3) revenue that will never be recognized on tax return (i.e. Permanent items such as interest on municipal bonds).

GAAP pretax net income includes all items of expense: (1) expense recognized on current tax return,
(2) expense recognized on a future tax return (temporary item),
(3) expense that will never be recognized on the tax return (i.e. permanent items such as non-deductible penalties).

Revenue is often record by debiting an asset or liability, and crediting a revenue account. Expenses are often recorded by debiting an expense account and crediting an asset or a liability account. These involve "double entry" journal entries on the GAAP books.

Revenue is often recognized for a transaction that increases an asset or decreases a liability of the company, etc. An expense is recognized for a transaction in which the company has a decrease in assets or an increase in a liability.

<u>**Some expenses on the tax return involve "free" deductions**</u>. Those expenses do not result from a decrease in an asset or an increase in a liability. Examples: the dividends received deduction and the domestic production activities deduction. There is no journal entry in the GAAP books to record these (free) deductions. They are simply recorded on the tax return and reduce the amount of income tax.

EFFECT OF PERMANENT DIFFERENCES

Permanent differences between the GAAP income and taxable income (including free deductions described above) affect the amount of the effective tax rate, but do not create deferred tax assets and liabilities, because those items involve "permanent" differences- they do not reverse in the future.

When permanent items are removed from GAAP pretax income, the result is the amount of income (loss) that will be taxable (deductible) either this year or in a future year. Your authors refer to this as (book equivalent of taxable income). **Multiplying this amount by the tax rate is a quick way of computing the total tax provision, made up of both current tax expense (benefit) and deferred tax expense (benefit).** <u>**Caution the is accurate only very simple situations.**</u>

Step 2: Identify all Temporary Differences and Tax Carryforward Amounts

Temporary differences in revenue and expense will reverse in the future and create tax savings in the future, or additional tax payments in the future.

Step 2A: Identify Taxable and Deductible Temporary Differences (Prob. 11, 12)

A temporary book–tax difference that will be added to GAAP net income in the future is a taxable temporary difference, which results in a deferred tax liability.

A temporary book–tax difference that will be subtracted from GAAP net income in the future is a deductible temporary difference, which results in a deferred tax asset.

Other book tax differences include carryover of capital losses, net operating losses, and charitable contributions.

Step 3: Compute the Current Income Tax Expense or Benefit (Prob. 19, 20, 26, 29)

When permanent and temporary book – tax differences are removed from GAAP pretax income, the result is the amount of taxable income (or loss) shown in the current year tax return. **Application of the tax rate, generates the amount of current tax expense (benefit).**

Other items may affect the amount of the current tax expense (benefit):
(1) additional tax paid as a result of prior year audits,
(2) tax refunds received from prior years, and
(3) changes in the amount of unrecognized tax benefits.

Step 4: Determine Ending Balances in the Balance Sheet Deferred Tax Asset and Liability Accounts. (Prob. 45)

Computing the Deferred Income Tax Expense or Benefits

- Identify current-year changes in taxable and deductible temporary differences.
- Determine ending balances in each deferred tax asset and liability balance sheet account.
- Identify carryovers (net operating loss, capital loss, charitable contributions) not on the balance sheet.

The current-year deferred income tax expense or benefit is the difference between: (1) the deferred tax asset and liability balances at the beginning of the year and (2) those balances at the end of the year, adjusted for (3) changes in tax carryovers.

Step 5: Evaluate the Need for a Valuation Allowance for Gross Deferred Tax Assets

(or a change in the balance in the existing account).

A valuation allowance is required if it is more likely than not that some or all of the deferred tax asset will not be realized in the future.

A company must determine its sources of future (or past) taxable income.

- Taxable income in carryback years.
- Reversing taxable temporary differences in future years.
- Expected taxable income in future from other than reversing taxable temporary differences.
- Expected taxable income in future taxable years from implementing tax planning strategies.

A company must evaluate (weigh) positive and negative evidence in deciding whether a valuation allowance is needed.

A company must monitor whether increases or decreases should be made to the valuation allowance account every quarter.

Step 6: Deferred Income Tax Expense or Benefit (Prob. 12, 15, 17, 18, 22, 25)

The deferred income tax expense or benefit portion of a company's income tax provision reflects the change during the year in a company's balance sheet deferred tax liabilities or assets. Consider need for deferred tax liability for unremitted foreign subsidiary earnings not considered to be permanently invested in foreign country and changes in future tax rates applicable to deferred tax assets and liabilities.

Step 7: Uncertain Tax Positions

Two-step process in determining if a tax benefit can be recognized in the financial statements.

A company determines if it is more likely than not that its tax position on an account will be sustained on IRS examination based on its merits.

A company then determines the amount of benefit (benefit from deduction, etc.) it expects to be able to recognize. The measurement process requires the company to make a cumulative probability assessment of all likely outcomes of the audit and litigation process. The company recognizes the amount that has a greater than 50 percent probability of being sustained on examination and subsequent litigation.

The amount of benefit not recognized is recorded as a liability on the balance sheet and additional current income tax expense on the income statement.

<u>**Compute Effective Tax Rate (Prob. 24)**</u>

Bank of America

There are two components of income tax expense: current and deferred.
Current income tax expense reflects taxes to be paid or refunded for the current period. **Deferred income tax** expense results from changes in deferred tax assets and liabilities between periods. These gross deferred tax assets and liabilities represent **decreases or increases in taxes expected to be paid in the future** because of future reversals of temporary differences in the bases of assets and liabilities as measured by tax laws and their bases as reported in the financial statements. Deferred tax assets are also recognized for tax attributes such as net operating loss carryforwards and tax credit carryforwards. Valuation allowances are recorded to reduce deferred tax assets to the amounts management concludes are more-likely-than-not to be realized.

Income tax benefits are recognized and measured based upon a **two-step model**: first, a tax position must be more-likely-than-not to be sustained based solely on its technical merits in order to be recognized, and second, the benefit is measured as the largest dollar amount of that position that is more-likely-than-not to be sustained upon settlement. The difference between the benefit recognized and the tax benefit claimed on a tax return is referred to as an unrecognized tax benefit. The Corporation records income tax-related interest and penalties, if applicable, within income tax expense.

General Electric Annual Report-2014

On January 1, 2014, we adopted ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* . Under the new guidance, an unrecognized tax benefit is required to be presented as a reduction to a deferred tax asset if the disallowance of the tax position would reduce the available tax loss or tax credit carryforward instead of resulting in a cash tax liability.

As of September 27, 2014, the total amount of gross unrecognized tax benefits was $4.0 billion, of which $1.4 billion, if recognized, would affect the Company's effective tax rate.

During the fiscal year ended September 27, 2014, the U.S. Internal Revenue Service ("IRS") concluded its review of the years 2004 through 2009, **which resulted in the Company reducing its gross unrecognized tax benefits by $570 million and recognizing a tax benefit of $166 million.**

Deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases, as well as from net operating loss and tax credit carryforwards, and are stated at enacted tax rates expected to be in effect when taxes are actually paid or recovered. **Deferred income tax assets represent amounts available to reduce income taxes payable on taxable income in future years.**

We have not provided U.S. deferred taxes on cumulative earnings of non-U.S. affiliates and associated companies that have been reinvested indefinitely. These earnings relate to ongoing operations and, at December 31, 2014 and 2013, were approximately $119 billion and $110 billion, respectively. Most of these earnings have been reinvested in active non-U.S. business operations and we do not intend to repatriate these earnings to fund U.S. operations. Because of the availability of U.S. foreign tax credits, it is not practicable to determine the U.S. federal income tax liability that would be payable if such earnings were not reinvested indefinitely. Deferred taxes are provided for earnings of non-U.S. affiliates and associated companies when we plan to remit those earnings.

	Corporate Tax Return Problem - first year of operation		December 31, 2016	
	Cash		$180,000	
	Other assets (fixed assets and bond investments)		1,400,000	
	Accounts payable and other liabilities			$250,000
	Capital stock			1,000,000
	Retained earnings			
	Service revenue			700,000
	Interest income - State of North Carolina Bonds	Sec. 103		50,000
	Salary expense, payroll taxes, rent, depreciation, etc.		400,000	
	Loss on sale of capital assets	Sec. 1211, 1212	20,000	
	Trial Balance Total (before recording the income tax provision)		$2,000,000	$2,000,000

Assume federal corporate income tax rate is 40% for all years, and there is no state income tax.

1	What is the amount of the corporation's GAAP net income before taxes?				
	3 Points	Revenue			Note: Only two
		Expenses			accounts have book-
		Net income before income tax			tax differences.
2	Enter net income per books. Present adjustments needed to compute taxable income.				
	3 Points	Net income per books			
				Section 103	
				Sections 1211 & 1212	
3	Compute the deferred tax account balance(s).				
	3 Points				
4	Provide journal entry for income tax provision (current & deferred). Do not record an allowance account for the deferred tax account. Ignore uncertain positions when making this set of journal entries.				
	3 Points	Current income tax expense			
		Current income tax payable			
		Deferred tax asset			
		Deferred tax benefit			
5	Compute GAAP net income after taxes. Start with GAAP net income before taxes.				
	3 Points	GAAP Net Income Before Taxes			
		Provision for income tax			
		Net income after taxes			
6	What is the effective tax rate shown the audited statements? Show computation.				
	3 Points	GAAP Net Income Before Taxes			
		Provision for income tax			
		Effective tax rate			
7	Company estimates it will realize capital gains of $5,000 in next five years. Prepare a journal entry (separate from provision entry above) needed here.				
	2 Points	Deferred income tax benefit			
		Allowance to reduce deferred tax asset…			
8	Uncertain Position. A deduction of $30,000 on tax return is for a conference that was devoted to lobbying matters. You estimate there is a 40% chance that the IRS will allow this deduction completely. There is a 60% chance the IRS will allow a deduction of $18,000. Prepare journal entry needed for this uncertain position. Ignore interest and penalties.				
		Income tax expense			
		Liability for uncertain postions			
9	Three years later, the IRS audits the tax return for current year and allows the $30,000 deduction in full. Prepare the journal entry to record this event.				Statute of limitations has now expired.
		Liability for uncertain postions			
		Income tax expense			

All sales on credit. Income tax rate is 40% for all years. Year 1 is first year of operations.

	Year 1		Year 2	
Sales		$100,000		$100,000
Bad debts (provision)	9,000		5,000	
Other Expenses (paid in cash)	61,000		65,000	
Total Expenses		70,000		70,000
Net Income before Taxes		$30,000		$30,000
Provision for Income Tax				
Net Income				
Balance Sheet Balances		Ending		Ending
Accounts Receivable		$60,000		$85,000
Allowance for Bad Debts		$6,000		$4,000

	Year 1	Year 2
Net Income before Taxes	$30,000	$30,000
Remove provision for bad debts		
Deduct amount written off		
Taxable income for the year		
Tax paid to the IRS for the year (40%)		
GAAP provision for income tax		
GAAP "BASIS" for Accounts Receivable	$54,000	$81,000
TAX "BASIS" for Accounts Receivable	$60,000	$85,000
Excess of tax basis over GAAP basis	$6,000	$4,000
Balance in deferred tax asset account	$2,400	$1,600

Tax Provision Journal Entry				
Current tax expense (benefit)				
Deferred tax expense (benefit)				
Deferred tax asset (Balance Sheet)				
Current tax payable (Balance Sheet)				
Deferred tax liability (Balance Sheet)				

Please record transactions on the accrual basis in the spaces below for year 2.

Balance Sheet ($000)

Transaction		Cash		Accounts Rec.		Allow. for Bad Debts	
	Beg. Bal.	XXX		60			6
1	Sales			100			
2	Collection	68			68		
3	Write-off				7	7	
4	Other Exp.		65				
5	Provision						5
	Balance			85			4

Revenue and Expense ($000)

Transaction		Revenue		Other Expense		Bad Debts Expense	
1	Sales		100				
4	Other Exp.			65			
5	Provision					5	

Chicago Corporation was organized on January 1, Year 1. Income tax rate is 40%

GAAP revenue is $500,000 per year - in each of first 5 years of operation. No state income tax.
GAAP expenses (before depreciation & income taxes) are $445,000 per year - every year.
Machine cost $25,000. GAAP depreciation expense (S/L) is $5,000 per year - for 5 years.
In Year-1, company takes tax deduction for full cost of machine ($25,000), with a 5-year life.

	GAAP-Yr 1	Tax-Year 1	Tax-Year 2	Tax-Year 3
Revenue	$500,000	$500,000	$500,000	$500,000
Operating expenses other than depreciation	($445,000)	($445,000)	($445,000)	($445,000)
GAAP Depreciation expense on machine	($5,000)	($5,000)	($5,000)	($5,000)
GAAP Net Income before Tax	$50,000	$50,000	$50,000	$50,000
Income Tax Rate for all years	40%			
	$20,000			
Deprec. adjustment to GAAP pre-tax income				
Taxable income				
Income tax rate		40%	40%	40%
Income Tax due currently				
GAAP Basis of machine-Ending Balance				
TAX Basis of machine-Ending Balance				
Difference in basis of machine				
Deferred Tax Account-Ending Balance				

Year 1 Entry without extra write-off

	Dr	Cr
Income tax provision		
Income tax payable currently		

Entries with extra write-off

Income Tax Entry - Year 1

	Dr	Cr
Income tax provision-current		
Income tax provision-Deferred		
Deferred tax liability		
Income Tax payable currently		

Income Tax Entry - Year 2

	Dr	Cr
Income tax provision		
Deferred tax liability		
Income Tax payable currently		

Income Tax Entry - Year 4

	Dr	Cr
Income tax provision		
Deferred tax liability		
Income Tax payable currently		

Income Tax Entry - Year 3

	Dr	Cr
Income tax provision		
Deferred tax liability		
Income tax payable currently		

Income Tax Entry - Year 5

	Dr	Cr
Income tax provision		
Deferred tax liability		
Income Tax payable currently		

Corporation began in 2016. It sells equipment with a 2-year warranty.
Company estimates that it will have warranty expense of 10% of sales.
Company will accrue repair expense are $20,000 for 2016 & 2017 sales.
Repairs are made in the year after the year of sale: $20,000 in 2017 (for 2016)

GAAP Financial Reports	2016	2017
Sales	200,000	200,000
Cost of sales and expenses	(100,000)	(100,000)
Estimated Warranty Expense	(20,000)	(20,000)
Net Income Before Tax	80,000	80,000
Income tax rate - 40%	40%	40%
Tax Expense-40% rate	32,000	32,000

Tax Return		
Net Income Before Tax (above)	80,000	80,000
Adjust for warranty expense		
Taxable Income		
Income tax rate		
Current Tax Expense		

GAAP Books	2016	2017
Warranty liability - Beginning	0	20,000
Warranty Expense accrual	20,000	20,000
Subtotal	20,000	40,000
Actually warranty payments	0	20,000
Warranty liability - Ending	20,000	20,000

		Debit	Credit
GAAP Warranty Expense - 2016			
Warranty Expense			
Warranty Liability			
Warranty Payments - 2016	**None**		
GAAP Warranty Expense - 2017			
Warranty Expense			
Warranty Liability			
Warranty Payments - 2017	**20,000**		
Warranty Liability			
Cash			
Entry for Tax Provision - 2016			
Current income tax expense			
Current income tax payable			
Deferred income tax asset			
Deferred income tax expense (benefit)			
Entry for Tax Provision - 2017			
Current income tax expense			
Current income tax payable			
Deferred income tax asset			
Deferred income tax expense (benefit)			

Solution will be different if tax rate is different in 2017.

In 2016, FARGO Corp. sold land for $500,000, which had a cost of $400,000. Gain = $100,000. No down payment. Will collect $500,000 [30% ($150,000) in 2017, 70% ($350,000) in 2018]. Installment Sales method is used on tax return. Tax rate is 40%. Ignore interest.

Basic Information	2016	2017	2018		
Total Operating Revenue	$800,000	$800,000	$800,000		
Total Operating Expense	(600,000)	(600,000)	(600,000)		
Pre-tax Operating income	200,000	200,000	200,000		
Land Selling Price (Notes Rec.)	500,000				
Land Cost	(400,000)				
Gain on sale-GAAP	$100,000				
GAAP Income before Tax	$300,000	$200,000	$200,000		
Gain on Tax Return	$0	$30,000	$70,000	20% of collection	Future Taxable Amount
Taxable Income	$200,000	$230,000	$270,000		

Sale of land	GAAP-2016 Dr.	GAAP-2016 Cr.	Tax-2016 Dr.	Tax-2016 Cr.	Taxable temp. difference	
Notes receivable	500,000		500,000		Note Rec.	500,000
Land		400,000		400,000	GAAP vs.	
Gain on sale of land		100,000		0	tax basis	400,000
Deferred gain on sale of land		0		100,000		100,000

Cash Collection	GAAP-2017 Dr.	GAAP-2017 Cr.	Tax-2017 Dr.	Tax-2017 Cr.	Tax-2018 Dr.	Tax-2018 Cr.
Cash	150,000		150,000		350,000	
Accounts receivable		150,000		150,000		350,000
Deferred gain on sale of land			30,000		70,000	
Recognized gain on sale of land				30,000		70,000

Analysis	2016	2017	2018	Total
GAAP Net Income	$300,000	$200,000	$200,000	$700,000
Tax rate	40%	40%	40%	
Tax on GAAP net income	$120,000	$80,000	$80,000	$280,000
GAAP Net Income	$300,000	$200,000	$200,000	
Deferred gain	($100,000)			
Collections		$150,000	$350,000	$500,000
Recognized gain (tax return)		$30,000	$70,000	$100,000
Taxable income	$200,000	$230,000	$270,000	$700,000
Tax rate	40%	40%	40%	
Tax due currently	$80,000	$92,000	$108,000	$280,000

Journal Entries	2016 Dr.	2016 Cr.	2017 Dr.	2017 Cr.	2018 Dr.	2018 Cr.
Current tax expense (Benefit)	80,000		92,000		108,000	
Deferred tax expense (Benefit)	40,000			12,000		28,000
Income Tax Payable		80,000		92,000		108,000
Deferred Income Tax Liability		40,000	12,000		28,000	

How will entries change if you know in 2016 that income tax rate will change to 50% in 2018?

Charlotte Corporation is in its first year of operations.
The company has pretax income of $400,000.
The company has the following items recorded in its records.
No estimated tax payment was made during year.

Premiums on life insurance of key officer	$20,000
Depreciation on tax return in excess of book depreciation	$10,000
Interest on municipal bonds	$5,300
Warranty expense	$7,000
Actual warranty repairs	$5,000
Bad debt expense	$8,000
Beginning balance in allowance for uncollectible accounts	$0
End balance for allowance for uncollectible accounts	$3,000
Rent received in advance from clients that	
will be recognized evenly over the next four years	$20,000
Tax rate for Year 1 and future years	40%

Prepare the following schedule for the deferred tax amounts for the year.

Items	Book-Tax Difference	Deferred tax liability amount?	Deferred tax asset amount?
Depreciation			
Warranties			
Bad debts			
Rent received			
Total			

Journal Entry for Provision	Debit	Credit
Current tax expense		
Current tax payable		
Deferred tax expense (benefit)		
Net Deferred tax asset or liability		

ATLANTA CORPORATION. Uncertain tax positions

Your client reported Sales of $900,000,000 and net income before tax of $100,000,000.
The income statement shows a major expense in the amount of $40,000,000.
You have some doubt about the deductibility of this expense on the tax return.
You estimate that there is a 70% chance that $30,000,000 will be
accepted in an IRS audit. Assume a 40% tax bracket.
You estimate that there is a 30% chance that all $40,000,000 will be accepted.
Please provide the journal entry to record the provision for income tax.

Sales		**$900,000,000**
Expenses		**$800,000,000**
Net income before taxes		**$100,000,000**
Amount of deduction that is uncertain	**$40,000,000**	
Amount with > 50% chance of acceptance	**$30,000,000**	
Unrecognized benefit		**$10,000,000**
Base for GAAP income tax provision		**$110,000,000**
Income tax rate		**40%**
Income tax provision		**$44,000,000**

Income tax expense		
Income tax payable		
Liability for uncertain position		

Assume that next year, the Tax Court decides in favor of a taxpayer that had
deducted the same expense that you considered uncertain above.
Provide the journal entry you will make next year based on this new information.
Assume you no longer consider it to be an uncertain position.

Liability for uncertain position		
Income tax expense		

Hewlett Packard

We are subject to income taxes in the United States and approximately 80 foreign countries, and we are subject to routine corporate income tax audits in many of these jurisdictions. **We believe that our tax return positions are fully supported, but tax authorities are likely to challenge certain positions, which may not be fully sustained. However, our income tax expense includes amounts intended to to satisfy income tax assessments** that result from these challenges. Determining the income tax expense for these potential assessments and recording the related assets and liabilities requires management judgments and estimates. We evaluate uncertain tax positions in accordance with guidance for accounting for uncertainty in income taxes.

We believe our reserve for uncertain tax positions, including related interest, is adequate. ..
We review our reserves quarterly, and we may adjust such reserves because of proposed assessments by tax authorities, changes in facts and circumstances, issuance of new regulations or new case law, previously unavailable information obtained during the course of an examination, negotiations between tax authorities of different countries concerning our transfer prices, execution of Advanced Pricing Agreements, resolution with respect to individual audit issues, the resolution of entire audits, or the expiration of statutes of limitations.

Exhibit II. Accounts for the Company under Study in this Project Affected by ASC 740 Rules.

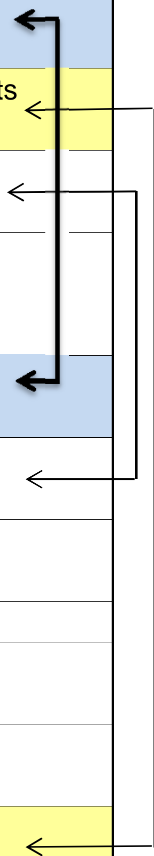
(Amounts rounded, generally to nearest $1,000,000)

#	Item	Amount
1	**Accounts receivable**	**$26,000,000**
	Allowance for uncollectible accounts	**(600,000)**
	GAAP basis of accounts receivable	**$25,400,000**
	Tax basis of accounts receivable	**$26,000,000**
	Deferred tax asset computation is based on the difference between tax basis and the GAAP basis of the asset, caused by use of the allowance method for uncollectible accounts in financial statements and the direct-write-off method on the tax return.	
2	**Property, plant and equipment**	**$72,000,000**
	Accumulated Depreciation	**(41,000,000)**
	Basis of property, plant and equipme	**$31,000,000**
	Deferred tax liability	**$4,000,000**
	A deferred tax liability is the future tax impact of a difference between tax and GAAP basis of the asset, presumably caused here by the use of accelerated depreciation on tax returns.	
3	**Deferred tax asset (liabilities and oth**	**$500,000**
	Presumably this is caused by current accrual of estimated future liabilities that will result in deductible expenses when the company becomes liable for the debt.	
4	**Deferred tax asset (compensation)**	**$2,000,000**
	Presumably this deferred tax asset resulted in at least part from current recognition of stock option expense, to be deducted on the tax return in a future year.	
5	**Alternative minimum tax credit**	**$1,000,000**
	Deferred tax asset for the benefit of the credit carryforward expected to be realized in the future.	
6	**Earnings of foreign subsidiaries**	**$55,000,000**
	"Potential" deferred tax liability	**$20,000,000**
	Company could “potentially” be required to recognize deferred income tax expense and a deferred tax liability for $20,000,000. However, the company has permanently invested those earnings in the foreign countries. Therefore, no accrual of deferred tax liability is required.	
7	**Operating loss carryforward**	**$60,000,000**
	Deferred tax asset	**$23,000,000**
	Deferred tax asset: potential future income tax savings as a result of deducting the loss carryforward.	
8	**Deferred tax asset valuation allowance account established in 2009**	**$27,000,000**
	Reduction of balance in 2010	**(5,000,000)**
	Reduction of balance in 2011	**(6,000,000)**
	Reduction of balance in 2012	**(4,000,000)**
	Current allowance balance for 2012	**$12,000,000**
	In 2009, company established full valuation allowances against U.S. and China deferred tax assets (because of the losses being realized at that time). In 2010, company reduced the allowance balance and recorded an income tax benefit of $5,000,000. In 2011, company recorded an income tax benefit of $6,000,000, partly from realization of loss carryforwards, and partly due to a change in judgment about future profitability of the company. In 2012, company reduced the allowance balance and recorded an income a tax benefit of $4,000,000.	

Note: Company had an allowance for discounts, returns, etc., which is ignored in this summary.

Deferred Income Tax Terms (Kieso, pg. 1018. Intermediate 13th Edition)

1	**Carrybacks.** Deductions or credits that cannot be utilized on the tax return during a year and that may be carried back to reduce taxable income or taxes paid in a prior year. An operating loss carryback is an excess of tax deductions over gross income in a year. A tax credit carry back is the amount by which tax credits available for utilization exceed statutory limitations.
2	**Carryforwards.** Deductions or credits that cannot be utilized on the tax return during a year and that may be carried forward to reduce taxable income or taxes payable in a future year. An operating loss carryforward is an excess of tax deductions over gross income in a year. A tax credit carryforward is the amount by which tax credits available for utilization exceed statutory limitations.
3	**Current Tax Expense (Benefit).** The amount of income taxes paid or payable (or refundable) for a year as determined by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues for that year.
4	**Deductible Temporary Difference.** Temporary differences that result in deductible amounts in future years when recovering or settling the related asset or liability, respectively.
5	**Deferred Tax Asset.** The deferred tax consequences attributable to deductible temporary differences and carryforwards.
6	**Deferred Tax Consequences.** The future effects on income taxes as measured by the enacted tax rate and provisions of the enacted tax law resulting from temporary differences and carryforwards at the end of the current year.
7	**Deferred Tax Expense (Benefit).** The change during the year in a company's deferred tax liabilities and assets.
8	**Deferred Tax Liability.** The deferred tax consequences attributable to taxable temporary differences.
9	**Income Taxes.** Domestic and foreign federal (national), state, and local (including franchise) taxes based on income.
10	**Income Taxes Currently Payable (Refundable).** Refer to current tax expense (benefit).
11	**Income Tax Expense (Benefit).** The sum of current tax expense (benefit) and deferred tax expense (benefit).
12	**Taxable Income.** The excess of taxable revenues over tax deductible expenses and exemptions for the year as defined by the governmental taxing authority.
13	**Taxable Temporary Difference.** Temporary differences that result in taxable amounts in future years when recovering or settling the related asset or liability, respectively.
14	**Tax-Planning Strategy**. An action that meets certain criteria and that a company implements to realize a tax benefit for an operating loss or tax credit carryforward before it expires. Companies consider tax-planning strategies when assessing the need for and amount of a valuation allowance for deferred tax assets.
15	**Temporary Difference**. A difference between the tax basis of an asset or liability and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when recovering or settling the reported amount of the asset or liability, respectively.
16	**Valuation Allowance.** The portion of a deferred tax asset for which it is more likely than not that a company will not realize a tax benefit.



CORPORATE BOOK-TAX DIFFERENCES.

Book income may differ from taxable income from many types of transactions.

Permanent differences

A.	**Some book income is never taxed for regular tax (AMT not relevant here).**	
1	Tax-exempt interest received on state and municipal obligations	**103**
2	Life insurance proceeds received by corporation on employee, at death	**101**
B.	**Some book expenses are never deductible on the tax return.**	
3	Expenses incurred in earning tax-exempt interest	**265**
4	Corporate payment of prem. for life insurance on officers or key employees	**264**
5	Fines and expenses resulting from a violation of law	
6	Disallowed travel and entertainment costs	**274(k)**
7	Political contributions	**162(e)**
8	Federal income taxes per books, which is based on GAAP (SFAS No. 109)	**1.164-2(a)**
C.	**Some tax deductions are never reported as expenses in GAAP statements.**	
9	The dividends-received deduction	**243**
10	The U.S. production activities deduction	**199**
11	Percentage depletion of natural resources in excess of their cost	

Temporary differences

D.	**Some revenues or gains are included in GAAP income in the current year but not reported on the tax return until later years.**	
12	Installment sales reported in full for book purposes in the year of sale but reported over a period of years using the installment method for tax purposes	**453**
13	Gains-involuntary conversions recognized for GAAP but Tax deferred	**1033**
E.	**Some revenues or gains are taxable before they are included in GAAP income. These items are included in taxable income when received but are included in GAAP income as they accrue.**	
14	Prepaid rent or interest income (Revenue received this year, earned in future)	**1.451-1(a)**
15	Advance subscription revenue	
F.	**Some expenses or losses are deductible on the tax return later than they are included in GAAP income.**	
16	Excess of capital losses over capital gains are expensed in GAAP income statement in loss year (carried back or over to other years for tax purposes)	**1211, 12**
17	Book depreciation in excess of tax depreciation	**168**
18	Charitable contributions exceeding the 10% of taxable income limitation, (currently expensed for book purpose but carried over for tax purposes)	**170(b)(2)**
19	Bad debt accruals using the allowance method for book purposes and the direct write-off method for tax purposes	**166**
20	Organizational and start-up expenditures, expensed currently for book purposes but partially deducted and amortized for tax purposes	**248** **195**
21	Product warranty liabilities expensed for GAAP in year of sale but deducted on tax return when the liability is fixed (generally when repair is required)	**1.461-1(a)(2)**
22	Net operating losses (NOLs) (for tax) carry back 2 years & carry over 20 years	**172**
G.	**Some expenses or losses are deductible on the tax return before they are deducted on the GAAP income statements**	
23	Tax depreciation in excess of book depreciation	**168**
24	Prepaid expenses deducted on the tax return in the period paid, but accrued over a period of years for book purposes	

Group D and F items create deferred tax liabilities.
Group E and G items create deferred tax assets.

Taxable Income. The excess of taxable revenues over tax deductible expenses and exemptions for the year as defined by the governmental taxing authority.

Current Tax Expense (or Benefit). The amount of income **taxes paid or payable (or refundable)** for a year as determined by.. provisions of enacted tax law to the taxable income or excess of deductions over revenues for that year.

Deferred Tax Expense (or Benefit). The change during the year in an entity's deferred tax liabilities and assets. For deferred tax liabilities and assets acquired in a purchase business combination during the year, it is the change since the combination date. Income tax expense (or benefit) for the year is allocated among continuing operations, discontinued operations, extraordinary items, and items charged or credited directly to shareholders' equity.

Tax (or Benefit) [Also called the provision]. Tax (or benefit) is the total income tax expense (or benefit), including the provision (or benefit) for income taxes both currently payable and deferred.

Deferred Tax Consequences. The future effects on income taxes as measured by the applicable enacted tax rate and provisions of the enacted tax law resulting from temporary differences and carryforwards at the end of the current year.

Deferred Tax Asset. The deferred tax consequences attributable to **deductible temporary differences** and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. A deferred tax asset is reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Deferred Tax Liability. The deferred tax consequences attributable to **taxable temporary differences.** A deferred tax liability is measured using the applicable enacted tax rate and provisions of the enacted tax law.

Temporary Difference. A difference between the **tax basis** of an asset or liability computed pursuant to the requirements in Subtopic 740-10 for tax positions, and its **reported amount** in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively.
Paragraph 740-10-25-20 cites eight examples of temporary differences. Some temporary differences cannot be identified with a particular asset or liability for financial reporting…, but those temporary differences do meet both of the following conditions:

a. Result from events that have been recognized in the financial statements
b. Will result in taxable or deductible amounts in future years based on provisions of the tax law.

Some events recognized in financial statements do not have tax consequences. Certain revenues are exempt from taxation and certain expenses are not deductible.

Events that do not have tax consequences **do not give rise to temporary differences. [permanent]**

Taxable Temporary Difference. Temporary differences that **result in taxable amounts in future years** when the related asset is recovered or the related liability is settled.

Deductible Temporary Difference. Temporary differences that result in **deductible amounts in future years** when the related asset or liability is recovered or settled, respectively.

Tax Position. A position in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets. The term tax position also encompasses, but is not limited to:

a. A decision not to file a tax return
b. An allocation or a shift of income between jurisdictions
c. The characterization of income or a decision to exclude reporting taxable income in a tax return
d. A decision to classify a transaction, entity, or other position in a tax return as tax exempt
e. An entity's status, including its status as a pass-through entity or a tax-exempt not-for-profit entity.

Unrecognized Tax Benefit. Difference between a tax position taken or expected to be **taken in a tax return** and the **benefit recognized** and measured pursuant to Subtopic 740-10.

Valuation Allowance. The portion of a deferred tax asset for which it is more likely than not that a tax benefit will not be realized.

Requirement. A tax liability or asset shall be recognized based on the provisions of this Subtopic applicable to tax positions for the estimated taxes payable or refundable on tax returns for the current and prior years.

A **deferred tax liability or asset** shall be recognized for the estimated future tax effects attributable to temporary differences and **carryforwards**.

It shall be presumed that all **undistributed earnings of a subsidiary** will be transferred to the parent entity. Accordingly, the undistributed earnings of a subsidiary included in consolidated income shall be accounted for as a temporary difference ….

The presumption that all undistributed earnings will be transferred to the parent entity **may be overcome**, and no income taxes shall be accrued by the parent entity,..if sufficient evidence shows that the subsidiary has invested or will **invest the undistributed earnings indefinitely** or that the earnings will be remitted in a tax-free liquidation.

Carryforwards. Deductions or credits that cannot be utilized on the tax return during a year that may be carried forward to reduce taxable income or taxes payable in a future year. An operating loss carryforward is an excess of tax deductions over gross income in a year; a tax credit carryforward is the amount by which tax credits available for utilization exceed statutory limitations.

Selected notes from annual reports and SEC filings. Companies: Apple, Duke Energy, IBM, Walmart Park Sterling Bank, Toll Brothers, Wells Fargo, 3M.

[Wells] Current income tax expense represents our estimated taxes to be paid or refunded for the current period and includes income tax expense related to our **uncertain tax positions**.

[Toll] Provisions (benefits) for federal and state income taxes are calculated on reported pretax earnings (losses) based on current tax law and also include, in the applicable period, the cumulative effect of any changes in tax rates from those used previously in determining deferred tax assets and liabilities. Such provisions (benefits) differ from the amounts currently receivable or payable because certain items of income and expense are recognized for financial reporting purposes in different periods than for income tax purposes.

The Company establishes reserves for income taxes when, despite the belief that its tax positions are fully supportable, it believes that its positions may be challenged and disallowed by various tax authorities. The consolidated tax provision (benefits) and related accruals include the impact of such reasonably estimable disallowances as deemed appropriate. To the extent that the probable tax outcome of these matters changes, such changes in estimates will impact the income tax provision (benefit) in the period in which such determination is made.

[3M] Our effective tax rate is calculated by dividing income tax expense **by** income before income tax expense less the net income from noncontrolling interests.

The effective tax rate for 2013 was 28.1 percent, compared to 29.0 percent in 2012, a decrease of 0.9 percentage points, impacted by many factors. Factors that decreased the Company's effective tax rate included international taxes as a result of changes to the geographic mix of income before taxes, the reinstatement of the U.S. research and development credit in 2013, an increase in the domestic manufacturer's deduction benefit, the restoration of tax basis on certain assets for which depreciation deductions were previously limited, and other items. Combined, these factors decreased the Company's effective tax rate by 4.0 percentage points. This benefit was partially offset by factors that increased the effective tax rate by 3.1 percentage points, which largely related to adjustments to 3M's income tax reserves for 2013 when compared to 2012.

Included in these interest and penalty amounts are interest and penalties related to tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

[Duke] Deferred income taxes and foreign withholding taxes have not been provided on undistributed earnings of Duke Energy's foreign subsidiaries when such amounts are deemed to be indefinitely reinvested. The cumulative undistributed earnings as of December 31, 2013 on which Duke Energy has not provided deferred income taxes and foreign withholding taxes is approximately $2.4 billion. The amount of unrecognized deferred tax liability related to these undistributed earnings is estimated at between $300 million and $375 million.

[Apple] The Company's effective tax rates for all periods differ from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings, a substantial portion of which was generated by subsidiaries organized in Ireland [which has a statutory tax rate of 12.5%], for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S.

[Walmart] In addition to the amounts shown in the table above, $1.0 billion of unrecognized tax benefits are considered uncertain tax positions and have been recorded as liabilities.

[Park Sterling Bank] The Company adjusted its net deferred tax asset as a result of reductions in the North Carolina corporate income tax rate that were enacted July 23, 2013, and will become effective January 1, 2014, and January 1, 2015. The lower corporate income tax rate resulted in a reduction in the deferred tax asset in 2013 and an increase in current period income tax expense for the year ended December 31, 2013.

[Apple] Management believes that an adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

IBM- New Standards to be Implemented

In July 2013, the Financial Accounting Standards Board (FASB) issued guidance regarding the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. Under certain circumstances, unrecognized tax benefits should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward.

[IBM] The company records deferred tax assets for [stock] awards that result in deductions on the company's income tax returns, based on the amount of compensation cost recognized and the statutory tax rate in the jurisdiction in which it will receive a deduction. Differences between the deferred tax assets recognized for financial reporting purposes and the actual tax deduction reported on the income tax return are recorded in additional paid-in capital (if the tax deduction exceeds the deferred tax asset) or in the Consolidated Statement of Earnings (if the deferred tax asset exceeds the tax deduction and no additional paid-in capital exists from previous awards).

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. 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?

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?

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

"obsolete based on FASB"

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

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.

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.

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.

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.

"obsolete based on FASB"

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.

"obsolete based on FASB"

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.

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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 ☐

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. ☐
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.

34. The deferred tax asset to be recognized is

a. $0. **b.** $120,000 current.

c. $600,000 current. **d.** $600,000 noncurrent.

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

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

"obsolete based on FASB"

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

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

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. $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.
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

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

"obsolete based on FASB"

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.

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

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.
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.

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-.
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.

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

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.