

FA Module 13 Capital gains and deferred taxes practice exam questions

(The attached PDF file has better formatting.)

A firm has the following share purchases, with the market prices of the shares:

<i>December</i>	<i>Stock Y</i>		<i>Stock Z</i>	
	<i>Market Price</i>	<i>Shares bought</i>	<i>Market Price</i>	<i>Shares bought</i>
20X0	45	24	59	57
20X1	66	85	20	38
20X2	65		49	

The firm classifies

- Stock Y as available for sale (GAAP) = fair value through other comprehensive income (IFRS)
- Stock Z as held for trading (GAAP) = fair value through profit or loss (IFRS)

All share purchases are on December 31 of the year shown in the table above. The capital gains and losses are taxed at 10% when they are realized. No shares are sold in 20X1 or 20X2.

Question 13.1: Unrealized capital gains and losses

What are the unrealized capital gains (losses) in 20X1?

Answer 13.1:

- Stock Y (available for sale): $24 \times (66 - 45) = 504$
- Stock Z (held for trading): $57 \times (20 - 59) = (2,223)$

(unrealized capital gains = shares held \times Δ (market price))

Question 13.2: Pre-tax income

What is pre-tax income in 20X1?

Answer 13.2: -2,223

(unrealized capital gains and losses on shares held for trading (fair value through profit or loss) affect pre-tax income (income statement or statement of profit or loss))

Question 13.3: Other comprehensive income

What is other comprehensive income in 20X1?

Answer 13.3: 504

(unrealized capital gains and losses on shares available for sale (fair value through other comprehensive income) affect other comprehensive income)

Question 13.4: Taxable income

What is taxable income in 20X1?

Answer 13.4: 0

(No shares are sold, so taxable income is zero)

Question 13.5: Deferred tax asset or liability

What is the deferred tax asset (liability) on December 31, 20X1?

Answer 13.5:

- Stock Y (available for sale): $(0 - 504) \times 10\% = (50.40)$
- Stock Z (held for trading): $(0 - 2,223) \times 10\% = 222.30$

combined deferred tax asset (liability) = $-50.40 + 222.30 = 171.90$

(deferred tax asset = $(\text{tax basis} - \text{carrying value}) \times \text{tax rate}$)

Question 13.6: Taxes paid

What are taxes paid in 20X1?

Answer 13.6: 0

(taxable income is zero)

Question 13.7: Tax expense

What is the tax expense in 20X1?

Answer 13.7:

- Stock Y (available for sale): $0 - (-50.40) = 50.40$
- Stock Z (held for trading): $0 - 222.30 = (222.30)$

combined tax expense = $50.40 - 222.30 = (171.90)$

(tax expense = $\text{taxes paid} + \text{deferred tax liability} - \text{deferred tax asset}$)

Question 13.8: Unrealized capital gains and losses

What are the unrealized capital gains (losses) in 20X2?

Answer 13.8:

- Stock Y (available for sale): $(24 + 85) \times (65 - 66) = (109)$
- Stock Z (held for trading): $(57 + 38) \times (49 - 20) = 2,755$

(Combined unrealized capital gain or loss = $-109 + 2,755 = 2,646$)

(unrealized capital gain = shares held \times Δ (market price))

Question 13.9: Pre-tax income

What is pre-tax income in 20X2?

Answer 13.9: 2,755

(unrealized capital gains and losses on shares held for trading (fair value through profit or loss) affect pre-tax income (income statement or statement of profit or loss))

Question 13.10: Other comprehensive income

What is other comprehensive income in 20X2?

Answer 13.10: -109

(unrealized capital gains and losses on shares available for sale (fair value through other comprehensive income) affect other comprehensive income)

Question 13.11: Taxable income

What is taxable income in 20X2?

Answer 13.11: 0

(No shares are sold, so taxable income is zero)

Question 13.12: Deferred tax asset or liability

What is the deferred tax asset (liability) on December 31, 20X2?

Answer 13.12:

- Stock Y (available for sale): $-50.40 + (0 - -109) \times 10\% = (39.50)$
- Stock Z (held for trading): $222.30 + (0 - 2,755) \times 10\% = (53.20)$

combined deferred tax asset (liability) = $-39.50 + -53.20 = (92.70)$

(change in deferred tax asset = (change in (tax basis – carrying value)) \times tax rate)

Question 13.13: Taxes paid

What are taxes paid in 20X2?

Answer 13.13: 0

(taxable income is zero)

Question 13.14: Tax expense

What is the tax expense in 20X2?

Answer 13.14:

- Stock Y (available for sale): $-109 \times 10\% = (10.90)$
- Stock Z (held for trading): $2,755 \times 10\% = 275.50$

combined tax expense = $-10.90 + 275.50 = 264.60$

(tax expense = taxes paid + deferred tax liability – deferred tax asset)