FA Module 13: Deferred taxes assets and liabilities (overview 3rd edition)

(The attached PDF file has better formatting.)

(Readings from the third 3rd edition of the Robinson text.)

Readings: chapter 13

- § 5 unused tax losses and tax credits
- § 6 recognition and measurement of current and deferred tax

[§7 (presentation and disclosure, and §8 (comparison of IFRS and U.S. GAAP) are not on the syllabus.]

Know the major influences on deferred tax assets and liabilities:

- Taxable temporary differences
- Deductible temporary differences
- Changes in income tax rates
- Operating loss carry-forwards
- Valuation allowances

Review the readings for the previous module; few students fully grasp deferred tax assets and liabilities on a first reading. Make sure the logic is clear to you, though it may take time to understand all the details.

Review the exercises for accounts receivable, research and development costs, deferred revenue; prepaid expenses; unrealized capital gains and losses; depreciation methods; and inventory accounting methods on the discussion forum; the final exam problems are similar.

The proper way to compute deferred tax assets and liabilities is the balance sheet method described in the textbook (and in the IFRS and SFAS statements): compare the carrying value of the asset or liability with its tax basis. Two other methods are simpler (intuitive):

- The income statement method compares taxable income with pre-tax income on the statement of total comprehensive income.
- The reversal method considers the tax liability or refund if the asset or liability were liquidated now.

The exercises explain when each method is simplest.

The readings are short for this module; spend your study time working the practice problems on the discussion forum relating to deferred tax assets and liabilities, depreciation schedules, and unrealized capital gains and losses. Many exhibits are not tested on the final exam because they contain concept not on the syllabus for this course, but they show clearly the accounting entries. For example, make sure you understand why accrued liabilities create deferred tax assets and accrued assets create deferred tax liabilities. (Answer: the firm recognizes the liability in its financial statements but it has not yet incurred the offsetting tax credit.) The final exam does not test whether a deferred tax liability is charged directly to equity, so Example 5 Taxes Charged Directly to Equity is not on the syllabus. But make sure you understand how all the accounting entries are computed. The accumulated depreciation for both financial and tax statements are computed in detail in the exhibit, and the difference in bases gives the deferred tax assets and liabilities.

Look at the table above end of chapter question 17. Why do accrued expenses create a deferred tax asset? (These expenses are on the financial statements but not on the tax return; when they appear on next year's tax return, they will reduce the tax liability.) Depreciation in this example causes a deferred tax liability. Does that mean the tax depreciation schedule is faster or slower than the depreciation schedule used for financial statements?