5.09 Analysis of Income Taxes

Question 1
This fiscal year, a company:
- received in advance from a customer $60,000 for goods to be delivered next year. This amount is recognized as revenue for tax purposes this year but cannot be recognized as accounting revenue until next year.
- prepaid a vendor $12,000 for monthly office cleaning services that will begin next year. This amount cannot be recognized as an accounting expense until next year but is deductible for tax purposes this year.

Based on only this information, if the company is subject to a 25% tax rate, then this year it *most likely* will experience a:
A. $12,000 increase in deferred tax assets.
B. $12,000 increase in deferred tax liabilities.
C. $48,000 increase in deferred tax assets.

Question 2
In 20X8, a security company received payment of £20,000 for services that it will not perform until 20X9. If the statutory tax rate increases from 25% to 30% in 20X9, the effect of this advance payment in 20X9 *most likely* causes an increase in:
A. tax expense of £1,000.
B. taxes payable of £1,000.
C. deferred tax assets of £1,000.

Question 3
An appliance manufacturing company depreciates its noncurrent assets for financial reporting using straight-line depreciation, but the tax code permits the company to use accelerated depreciation for tax purposes. If this company acquired an asset this year that cost €3 million, has a three-year useful life, and has zero salvage value, the *most likely* impact on the company's financial statements at the end of this year will be that the tax base of the asset is:
A. less than the carrying value.
B. equal to the carrying value.
C. greater than the carrying value.

Question 4
A company has a deferred tax asset (DTA) and a deferred tax liability (DTL). If tax rates fall during the next year, holding all else equal, it is *most likely* that the company's deferred tax:
A. asset will increase.
B. liability will decrease.
C. liability will remain constant.

Question 5
A company purchases a service on credit for TRY 10,000 in 20X8. The company recognizes the expense on its income statement that year but will not pay cash until 20X9. Tax laws require that the company recognize the expense when cash is paid. If the company's tax rate is 30%, in 20X8 the company would *most appropriately* record a:
A. deferred tax asset of TRY 3,000.
B. deferred tax asset of TRY 7,000.
C. deferred tax liability of TRY 3,000.

Question 6
A French catering firm prepares and supplies in-flight meals and snacks to airlines at various airports in Europe and reports its financial results under IFRS. Its tax rate is 25%. On January 1, 20X8, the firm incurred €800,000 in research costs to improve the efficiency of its operations. It expensed the entire amount on its income statement but recorded it as an asset for tax purposes. It will amortize this amount equally over four years. Which of the following is the *most likely* impact of the research costs on the firm's 20X8 financial results?
A. The research costs' carrying value equals €600,000.
B. The firm's taxable income is less than its pretax income.
C. The firm reports a deferred tax asset (DTA) of €150,000.

Question 7
An increase in the statutory tax rate will *most likely*:
A. increase both deferred tax assets and deferred tax liabilities.
B. increase deferred tax assets and decrease deferred tax liabilities.
C. decrease deferred tax assets and increase deferred tax liabilities.

Question 8
A deferred tax asset *most likely* results when:
A. taxable income is less than pretax income.
B. income tax expense is less than taxes payable.
C. income tax expense is greater than taxes payable.

Question 9
In 20X5, a company reports different asset amounts for accounting purposes and tax purposes:
- The company reports investment securities at fair value at €200,000 on the balance sheet. For tax purposes, the investments are valued at the original cost of €190,000.
- The company capitalizes €1 million in software development costs. For accounting purposes, 20% of the costs are amortized in 20X5. For tax purposes, 25% of the costs are amortized in 20X5.
- The company reports net accounts receivable (AR) of €480,000 after subtracting €20,000 in allowance for doubtful accounts. For tax purposes, the allowance for doubtful accounts is determined to be 10% of gross AR.

The statutory tax rate is 30%. Based on this information, in 20X5 the carrying amount for assets exceeds the tax base by:

A. €27,000
B. €90,000
C. €108,000

Question 10
Which of the following items is *most likely* to result in the creation of a deferred tax item?
A. Interest received on city and state government bonds
B. Compensation paid in the future with shares of company stock
C. Fines paid to a government agency to settle violations of security laws

Question 11
A company has a tax rate of 25% and reports an income tax expense of CAD 100 million and taxes payable of CAD 75 million for the current year. If this difference is due solely to using different depreciation methods for financial reporting and tax purposes, the company *most likely* has
a:
A. CAD 25 million deferred tax asset.
B. CAD 25 million deferred tax liability.
C. CAD 18.75 million deferred tax liability.

Question 12
A mining company reports financial results under IFRS. It reports the following information for 20X8 and 20X9:

(ZAR thousands)	20X9	20X8
Deferred tax assets	15	18
Deferred tax liabilities	21	14
Taxes payable	35	29

Based on this information, the income tax expense that this company reports in 20X9 is *closest* to:
A. ZAR 25,000
B. ZAR 41,000
C. ZAR 45,000

Question 13
A company recognizes all anticipated payments from an installment sale as revenue in the current period for accounting purposes. The tax code only taxes payments that the company receives. In the current period, for the installment sale revenue, the company *most appropriately* records:
A. a deferred tax asset.
B. a deferred tax liability.
C. neither a deferred tax asset nor a deferred tax liability.

Question 14
In the third quarter of this year, a company that reports under US GAAP prepays a vendor $25,000 for software subscription services that will not begin until next year. The company will not recognize any expense for financial reporting purposes until the software service starts. However, the tax laws allow the company to deduct the full amount this year on their tax return. If the company's tax rate is 20%, the gross impact of this transaction in this year is *most likely* a $5,000 increase to:
A. deferred tax assets.
B. valuation allowances.
C. deferred tax liabilities.

Question 15
Which of the following *most likely* indicates use of a deferred tax liability?
A. An equity's carrying value is less than its tax base.
B. An asset's carrying value is greater than its tax base.
C. A liability's carrying value is greater than its tax base.

Question 16
A company has available-for-sale securities on its balance sheet. If the market value of those securities increases by $100,000, the company will *most appropriately* record:
A. a deferred tax asset.
B. a deferred tax liability.
C. neither a deferred tax liability nor a deferred tax asset.

Question 17
On the last day of this fiscal year, a company receives cash from a customer for a service that it will not provide until the next fiscal year. The company does not recognize any revenue until the service is delivered, but the applicable tax code recognizes revenue when the cash is received. If this transaction creates the only difference between the company's accounting profit and its taxable income, then for this year it will *most likely* increase the company's:
A. tax base.
B. deferred tax assets.
C. deferred tax liabilities.

Question 18
When a deferred tax liability is no longer expected to reverse, which of the following is the most appropriate financial adjustment? The company should:
A. increase total assets.
B. decrease taxable income.
C. increase shareholders' equity.

Question 19
Three companies present the disclosure requirements for income taxes in the notes of their financial statements:

Selected Financial Statement Items			
	Company A	Company B	Company C
Earnings before tax			
Domestic	12,500	18,300	24,600
Foreign	2,500	5,490	6,150
Current income taxes			
Domestic	4,100	5,000	8,100
Foreign	600	1,400	1,500
Deferred taxes			
Domestic	−1,200	2,600	−1,500
Foreign	250	800	−900

Which company most likely has the *lowest* effective tax rate?
A. Company A
B. Company B
C. Company C

Question 20
Tax loss carryforwards are *best described* as losses in the current year that:
A. create a deferred tax liability.
B. reduce future taxable income.
C. lower prior-year tax obligations.

Question 21
An analyst collects the following information (in € millions) on a company:

Income tax expense	500
Deferred tax assets (DTAs)	40
Deferred tax liabilities (DTLs)	80
Prior year DTA	50
Prior year DTL	60

Based on only this data, the company's income taxes payable (in € millions) is *closest* to:
A. 470
B. 490
C. 510

Question 22
An analyst gathers the following information about a company that reports under US GAAP:

(USD thousands)	Year 2	Year 1
Net deferred tax assets	6,400	7,600
Accounting profit	2,300	2,100
Taxable income	3,300	1,900

In Year 2, the decrease in net deferred tax assets *most likely* results from an increase in:
A. statutory tax rates.
B. valuation allowance.
C. deferred tax liabilities.

Question 23
The value of deferred tax liabilities is *most likely* based on tax rates:
A. as of the balance sheet date.
B. averaged over the current fiscal year.
C. expected to apply when the liability is satisfied.

Question 24
In 2X10, a company reports income tax expense of ¥230 million and taxes payable of ¥223 million. If deferred tax assets increases by ¥3 million, then deferred tax liabilities would *most likely*:
A. increase by ¥4 million.
B. increase by ¥10 million.
C. decrease by ¥10 million.

Question 25
This year, a pharmaceutical company:

- capitalizes €20 million in drug development costs at the beginning of the year. For accounting purposes, 25% of the cost is amortized this year. For tax purposes, 30% of the cost is amortized this year.
- spends €5 million on research over the year. The entire amount is expensed for accounting purposes. For tax purposes, the full amount is amortized at 20% annually, starting this year.

The statutory tax rate is 30%. Based on only this information, this year the company will *most likely* report a:
A. deferred tax asset of €3 million.
B. deferred tax asset of €0.9 million.
C. deferred tax liability of €0.9 million.

Question 26
Which of the following *most likely* creates a deferred tax asset?

A. Carryforward of prior years' gains, offset by current losses
B. Greater expenses for financial reporting than for tax reporting
C. Foreign currency received for income earned during the same period

Question 27
A company reports the following information in its first year of operations:

Taxable profit	€155,000
Accounting profit	€140,000
Tax rate	20%

All else equal, if the tax rate had been 25% instead of 20%, then *most likely* the company's:
A. deferred tax assets would have been €750 lower.
B. deferred tax assets would have been €750 higher.
C. deferred tax liabilities would have been €750 higher.

Question 28
Deferred taxes *most likely* result from:
A. only temporary tax differences.
B. only permanent tax differences.
C. both temporary and permanent tax differences.

Question 29
A company that reports under US GAAP has recognized a change in both deferred tax assets and deferred tax liabilities from the previous year. This year its taxes payable decreases and it reports a higher tax expense. The *most likely* reason this occurred is that:
A. valuation allowance has increased.
B. deferred tax assets have increased.
C. the company uses straight-line depreciation for financial and tax reporting.

Question 30
On March 1, 20X7, a company purchased securities of a publicly traded company for €1 million. At the end of 20X7, the securities were worth €800,000. If the company treats the securities as trading securities, then for these securities, at the end of 20X7, the company will *most appropriately* record:
A. a deferred tax asset.
B. a deferred tax liability.
C. neither a deferred tax asset nor a deferred tax liability.

Question 31
A company reports the following information:

(€ *millions*)	20X8	20X7
Deferred tax assets	15	17
Deferred tax liabilities	29	24
Tax expense	19	-

Based on this information, the company's taxes payable for 20X8 are *closest* to:
A. €12 million
B. €22 million
C. €26 million

Question 32
An analyst gathers the following information about a company reporting under US GAAP:

($ millions)	Fiscal Year End 20X1
Total deferred tax assets	1,100
Valuation allowance	(700)
Total deferred tax assets after valuation allowance	400
Total deferred tax liabilities	(1,500)
Net deferred tax liabilities	(1,100)

All else being equal, an increase in the statutory tax rate from 20% to 25% would *most likely* increase:
A. total assets.
B. total liabilities.
C. taxable income.

Question 33
In the fiscal year ending 31 December 20X4, a company:

- received a payment of £50,000 on 30 December 20X4 from a tenant for January 20X5's rent. This amount is taxable in 20X4.
- purchased equipment on 1 January 20X4 for £200,000. The equipment has no salvage value. In 20X4, depreciation expense was calculated as:
    - 20% of the equipment's cost for accounting purposes and
    - 40% of the equipment's cost for tax purposes.
- prepaid £12,000 on 12 December 20X4 for a software subscription to be consumed in 20X5. This amount is tax deductible in 20X4.

Using only the information provided, which of the following *most likely* resulted in a deferred tax asset in 20X4?

A. The prepaid software subscription
B. The rent amount received in advance
C. The different depreciation methods on the equipment

Question 34
In 20X0, a company's deferred tax liabilities increased by €3 million and its deferred tax assets decreased by €2 million. If the company reports €80 million in taxes payable, then its income tax expense (in € millions) is *closest* to:
A. 79
B. 81
C. 85

Question 35
For a company reporting under US GAAP, nontaxable income generated from holding municipal bonds *most likely* causes:
A. a valuation allowance created for certain deferred tax assets.
B. a temporary difference between taxable profit and accounting profit.
C. a permanent difference between taxable profit and accounting profit.

Question 36
A company reporting under US GAAP has deferred tax assets that exceed deferred tax liabilities. All else equal, a reduction in the tax rate will *most likely* increase the company's:
A. operating profit.
B. debt-to-asset ratio.
C. shareholders' equity.

Question 37
In 20X7, a firm:
- receives $10 million of payments in advance from a customer for goods to be delivered in 20X8. Assume the firm pays taxes on this amount in 20X7.
- is fined $5 million by the government. The firm pays the fine at the end of 20X7 and expenses it for accounting purposes. The fine is not deductible for tax purposes under the jurisdiction.

Based on this information, in 20X7, the carrying amount of liabilities is *most likely*:
A. equal to its tax base.
B. $5 million more than its tax base.
C. $10 million more than its tax base.

Question 38
A company that reports under US GAAP presents its 20X3 deferred tax assets valuation allowance at $10,000. In 20X4, it is reported at $0. All else equal, the reduction in the valuation allowance *most likely* signals that the company expects:

A. higher taxes payable.
B. lower taxable income.
C. lower statutory tax rates.